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ADP.OQ - Q2 2024 Automatic Data Processing Inc Earnings Call

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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Good morning. My name is Michelle, and I'll be your conference operator. At this time, I would like to welcome everyone to ADP's Second Quarter Fiscal 2024 Earnings Call. I would like to inform you that this conference is being recorded. After prepared remarks, we will conduct a question-and-answer session. Instructions will be given at that time.

I will now turn the conference over to Mr. Danyal Hussain, Vice President, Investor Relations. Please go ahead.

Danyal Hussain - *Automatic Data Processing, Inc. - VP of IR*

Thank you, Michelle, and welcome everyone to ADP's Second Quarter Fiscal 2024 Earnings Call. Participating today are Maria Black, our President and CEO; and Don McGuire, our CFO. Earlier this morning, we released our results for the quarter. Our earnings materials are available on the SEC's website and our Investor Relations website at investors.adp.com, where you will also find the investor presentation that accompanies today's call.

During our call, we will reference non-GAAP financial measures, which we believe to be useful to investors and that exclude the impact of certain items. A description of these items along with the reconciliation of non-GAAP measures to their most comparable GAAP measures can be found in our earnings release. Today's call will also contain forward-looking statements that refer to future events and involve some risk. We encourage you to review our filings with the SEC for additional information on factors that could cause actual results to differ materially from our current expectations. I'll now turn it over to Maria.

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Maria Black - *Automatic Data Processing, Inc. - President, CEO & DIrector*

Thank you, Danny, and thank you, everyone, for joining us. This morning, we reported strong second quarter results, including 6% revenue growth and 9% adjusted EPS growth. I'll begin with a review of the quarter's financial highlights before providing an update on the progress we are making across our strategic priorities. We delivered solid Employer Services new business bookings in the second quarter reaching a new record bookings volume for Q2 and keeping us on track for our full year outlook.

Growth was especially robust across our small business portfolio, and we also experienced healthy growth in our mid-market and international business. With steady demand in HCM and a healthy new business pipeline at the end of the quarter, we look forward to the important selling season ahead. Employer Services retention was strong in the second quarter. Although it declined slightly compared to the prior year, we once again exceeded our expectations as we continue to benefit from a healthy overall business environment and from our very high client satisfaction levels. Our employer services paid for control growth remained at 2% for the second quarter. The overall labor market remains resilient, and our clients continue to add employees at a moderate pace which is resulting in a very gradual deceleration in pays per control growth. And last, our PEO revenue growth of 3% for the second quarter was in line with our expectations, and we are very pleased to have delivered strong PEO new business bookings that were ahead of our expectations. Based on continued healthy activity levels, we feel good about our PEO bookings momentum, and we look forward to seeing a gradual reacceleration of our PEO business in the second half of this fiscal year.

Moving on to a broader update. During the second quarter, we launched a new brand advertising campaign being the next anything. The campaign highlights how the world of work is always changing, sometimes gradually, sometimes suddenly and trusted business solutions must evolve with it. The theme aligns with our strategic priorities to give our clients the advantage of our leading technology, expertise and scale.

In Q2, we continued to push forward on our first strategic priority to lead with best-in-class HCM technology. A key part of that is the rollout of ADP Assist, our cross-platform solution powered by Gen AI that proactively delivers actionable insights in plain language to enhance HR productivity, aid decision-making and streamline day-to-day tasks for our clients and their employees. ADP Assist seamlessly integrates with ADP products across multiple platforms. Using an intuitive conversational interface, it provides valuable and contextual insights which touch every aspect of HR. For example, in addition to the features we shared with you last quarter, including our natural language reporting capability, in Q2, we integrated natural language search capabilities into our Run platform, which allows us to understand intent behind the search term and use Gen AI to mine ADP's deep knowledge base to deliver easy-to-use and effective content.

ADP Assist also helps clients validate payrolls and solve common employee challenges across HR, payroll, time and benefits. It's a comprehensive experience that is trained on the industry's largest and deepest HCM data set and our deep knowledge base to service highly credible and actionable insights so that clients can make smarter decisions. We are excited about the road map ahead for all of our major solutions, and we expect it to help us build on the recognition we continue to earn in the market. In Q2 alone, we were pleased to be recognized for product leadership by 3 major industry analyst rankings. Everest Group named ADP the highest leader out of 27 providers in its multi-country payroll solutions Peak Matrix report. Nelson Hall identified ADP as a leader in its payroll services vendor evaluation and assessment tool in all markets. And Ventana Research named us an exemplary leader across its North American global and payroll management buyers guide for performing the best and meeting overall product and customer experience requirements.

Our second strategic priority is to provide unmatched expertise and outsourcing solutions. We shared last quarter that we were beginning to equip our associates with Gen AI capabilities through our agent assist technology. In Q2, we expanded our call summarization deployment to a greater portion of our service associates and started to see productivity gains with shorter handle time and improved service quality. With our global service associates fielding millions of calls annually, we are incredibly excited to test ways to optimize those client interactions.

Our third strategic priority is to benefit our clients through our global scale, and we continue to lean into this advantage. In Q2, we announced a strategic collaboration with Convera, a global business-to-business payments company to help our multi-country clients manage the complexity of global payroll and cross-border payments through an integrated platform by combining Convera's payment solutions with our global payroll expertise we're enhancing the client experience by minimizing the need to access various banking platforms and improving payment accuracy, compliance and security. We also announced the launch of ADP Retirement Trust services to support our growing retirement services business. Standing up our own trust services entity demonstrates our scale and commitment to our retirement clients positioning us on par with financial industry leaders and ahead of HCM competitors that rely on third parties.

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This commitment can really matter to financial advisers, keep data within ADP's trusted ecosystem and provides a cost and price benefit to ADP and our clients over the long term. Our scale also affords us the opportunity to partner with other leading technology providers in innovative ways, and we continue to expand on many of those partnerships to provide our sales implementation and service teams with client-specific insights to quickly address market shifts, drive more personalized interactions and deepen our overall client engagement. Overall, our second quarter represented strong outcomes on the financial front. And with respect to our key strategic priorities, I'd like to thank our associates who continue to deliver exceptional products and outstanding service to our clients, particularly now as many of them are in the middle of our most hectic time of year completing year-end work.

I'm proud to share that their efforts helped drive our overall Net Promoter Score to its highest level ever in the second quarter. Thank you again for all that you do for ADP and for our clients. And now I'll turn it over to Don.

Don Edward McGuire - *Automatic Data Processing, Inc. - CFO*

Thank you, Maria, and good morning, everyone. I'll provide more color on our results for the quarter as well as our updated fiscal 2024 outlook. Overall, we reported a strong second quarter with our consolidated revenue growth moderating in line with our expectations, and our adjusted EBIT margin coming in slightly better than expected. However, the interest rate backdrop has changed since we last provided our full year outlook, and we are lightly tweaking our outlook, which I will detail.

I'll start with Employer Services. ES segment revenue increased 8% on a reported basis and 7% on an organic constant currency basis coming in slightly ahead of our expectations. As Maria shared, we continue to grow our ES new business bookings resulting in a record second quarter bookings volume. Our small business portfolio and international business provided outsized growth contributions this quarter. And with a steady HCM demand environment and healthy pipelines, we feel on track for our 4% to 7% new business bookings growth outlook for the year. As mentioned earlier, our ES retention declined slightly in Q2 versus the prior year, but again, exceeded our expectations. Given our first half retention outperformance, we are increasing our full year retention outlook slightly. We now anticipate a 40 to 60 basis point decline in our full year retention, which is 10 basis points better than our prior forecast. ES pays per control growth of 2% in Q2 and was in line with our expectations, and we are maintaining our 1% to 2% growth outlook for the full year. And client funds interest revenue increased in line with our expectations in Q2 as a slight decline in our average client funds balance, which we discussed last quarter, was more than offset by an increase in our average yield. However, we are revising our full year client funds interest outlook lower to reflect the change in prevailing interest rates since our last update.

We now expect fiscal '24 client funds interest revenue of $985 million to $995 million, and we expect a net impact from our client funds extended investment strategy of $835 million to $845 million, representing a reduction of about $20 million at the midpoint. In total, there was no change to our fiscal '24 ES revenue growth forecast of 7% to 8%. Our ES margin increased 170 basis points in Q2. driven by both operating leverage and contribution from client funds interest revenue growth, but reflecting the impact of a reduced client funds interest revenue forecast as well as a slight increase in expected Gen AI-related spend, we are tweaking our fiscal '24 ES margin outlook and now anticipate the lower end of our prior margin range.

Moving on to the PEO, we had 3% revenue growth, driven by 2% growth in average worksite employees in the second quarter. These metrics were in line with our expectation, and we are encouraged to see signs of stabilization in our PEO pays per control growth. As Maria mentioned, our PEO new business bookings were very strong in Q2. With continued healthy activity levels, we continue to anticipate a gradual ramp in our worksite employee growth in the back half of fiscal '24. And we are maintaining our full year growth outlook of 2% to 3%. PEO margins decreased 50 basis points in Q2. As we shared last quarter, we assume this year's workers' compensation reserve release benefit will be lower than last year's benefit, and we are further narrowing our PEO margin expectation to be down 80 to 100 basis points in fiscal '24 and versus our prior expectation of a decline of 50 to 100 basis points.

Putting it all together, there was no change to our fiscal '24 consolidated revenue growth outlook of 6% to 7%. With the 2 changes to segment margin, we now expect our adjusted EBIT margin to increase by 60 to 70 basis points versus our prior outlook for an increase of 60 to 80 basis points. We continue to expect an effective tax rate of around 23%, and we still anticipate fiscal '24 adjusted EPS growth of 10% to 12% with the middle of that range, the most likely outcome, given current assumptions. Thank you. And I'll now turn it back to the operator for Q&A.

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We will take our first question from Mark Marcon with Robert W. Baird.

Mark Steven Marcon - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Congratulations on all the accolades that you've gotten from the third-party reviewers. I'm wondering if you can talk a little bit about some of the initiatives. And specifically, one that stood out was setting up your own trust. Can you talk a little bit about the investment there and how we should think about how that would end up unfolding and what do you think some of the reactions would be with some of your third-party partners like you've got bank partnerships and CPA partnerships and obviously, benefit administration partnerships. How do you think they'll end up reacting?

Maria Black - *Automatic Data Processing, Inc. - President, CEO & DIrector*

Thank you, Mark. I appreciate the question, and I appreciate your well wishes on all of our recognition, certainly excited to see across the board -- the recognition we mentioned during the prepared remarks, but also the continued momentum across all of our initiatives. Happy to comment on Retirement Trust Services. It is really a demonstration of our scale.

And so when I think about what it means to our clients, what it means to the ecosystem that you mentioned, banks, CPAs. I think it's all incredibly positive. And trust services are a core component of any 401(k) plan. Given the size and the scale of our retirement services business, what we found is that the pool of what's known as third-party trustees, if you will, that are capable of handling a business just of our size is actually becoming shrinkingly more difficult, if you will, in terms of the number of providers that are able to offer stand-alone trust services to a retirement offering of our size.

So in terms of that, we made the decision to launch our in-house trust services. We believe that this is a great value to our clients, to the ecosystem. It puts us on par with other industry leaders in the financial services and really a competitive advantage against some of our HCM competitors that continue to leverage the third-party trustees. So for us, I think it's a big commitment to the business that we have, the retirement business that is, which really can matter to financial advisers. And as we said, CPAs and banks really by taking the trust services and how the implication is that we have better control over our costs. Ultimately, that yields a better price for our clients, a better service. We also have the ability to maintain all of the data inside of ADP's ecosystem which, as you know, is a big component of who ADP is in terms of data integrity and all those things. So that's kind of the retirement trust services in a nutshell Mark.

Mark Steven Marcon - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

And then just it was noticeable that you basically are anticipating a lower level of decline in terms of the ES retention, which is coming off of record levels. To what extent is that due to an anticipation of lower levels of bankruptcies as opposed to just the improvement that you've been seeing in terms of your client service scores?

Maria Black - *Automatic Data Processing, Inc. - President, CEO & DIrector*

So retention is going incredibly well, right? And we mentioned that in the remarks, year-to-date retention has definitely been better than we expected. And so I think things are fundamentally really healthy right now.

One thing to keep in mind as I kind of think about the outlook, is that we are, as you mentioned, we are coming off of some of the record highs that we've seen over the last several years. And while we believe that from a specifically a down market perspective, we're close to being normalized

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back to fiscal '19 trends, we do also anticipate some pressure in the back half from perhaps out of business in bankruptcies having more of a material impact. We haven't seen it to date but we certainly want to ensure that we're cognizant of the fact that we believe it's prudent given that we have retention running at such record levels, we believe it's prudent to plan for it in the back half to have some pressure.

And obviously, just like any year, Mark, retention is always noisy, and so we have some normal variability in some services in the back half. Just like you, I'd like to think that there's opportunity there. I think only time will give us the answer to that, but that's kind of how we're thinking about the back half.

Operator

Our next question comes from James Faucette with Morgan Stanley.

James Eugene Faucette - *Morgan Stanley, Research Division - MD*

Great. Appreciate all the detail this morning. I wanted to quickly just touch on PEO. You called out a strong acceleration in the business, but it looks like outlook for revenues was changed. You may have mentioned that, but I'm just trying to capture how much of that is timing issue versus the concentration you have in professional services and technology, which still seem a little bit soft, at least in the employment reports.

Don Edward McGuire - *Automatic Data Processing, Inc. - CFO*

Yes, James. Thanks for that question. We've been happy to see the stabilization in the the pays per control in those sectors, the financial services and technology sectors. So although where there's still a little bit of noise there, it certainly stabilized from what we saw in the prior quarter. So that's positive.

I do think that as we looked at our sales results, our bookings for PEO, we were very happy with the bookings. Maria mentioned that already very good. I think as we kind of put that together, the improvement in the pays per control and the improvement in our bookings. I think we're going to be heading towards that reacceleration that we've been pointing to over the last couple of quarters in the PEO but really just trying to get the impact of those 2 components, those variables is really what's going to help us get that reacceleration going.

Danyal Hussain - *Automatic Data Processing, Inc. - VP of IR*

James -- just to clarify James, the pays per control, although it's stabilizing, it's not providing any sort of upside versus our prior forecast. So bookings are going well. It takes quite a bit in terms of bookings to really drive a material change to the current year revenue, which you all understand. With pays per control is still providing sequential gradual drag. Those 2 are sort of netting out to an in-line outlook.

James Eugene Faucette - *Morgan Stanley, Research Division - MD*

Got it. Danny. And then quickly on AI. It seems like there's a little bit of incremental investment there and certainly a big focus on this call. But wondering about how we should think about the -- how you're anticipating a return on that investment and over what kind of time frame? And maybe more qualitatively what kinds of paybacks, where there's increased customer satisfaction or internal operations, et cetera?

Maria Black - *Automatic Data Processing, Inc. - President, CEO & DIrector*

Yes. So I'll start on the AI side and tell you all the reasons again that I'm so excited about it. Maybe Don can give you a little bit about how we're thinking about the return on investments that we're making. So just to remind everyone how we're thinking about AI in its most simplistic way, I

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think about it really in 3 buckets, the first of which is product and innovation. So putting generative AI into all of our innovation cycle. So that's everything from product development to the features and functionality that I mentioned in the prepared remarks.

And by the way, later this morning, we're actually issuing a press release that goes through some of our product and innovation, call it philosophy and launches of products, right? So some of what this press release speaks to is how we're thinking about and our design principles around making things easy, smart and human within our product and innovation cycles to really drive things like payroll assist, things like ADP assist into the market in a meaningful way.

So product is really kind of the first bucket. And as you'll see, we're making significant investments there. We do have ADP assist now more broadly deployed across the product set, and we're seeing meaningful impact as it relates to our client experience on that. The second bucket is what I call efficiency and service efficiency, and this is really about giving all the same things that we're looking to give our clients to make their jobs easier and more effective and efficient and giving those same tools to our associates. And so we have agent assist. I'm pleased to say that from an agent assist perspective, we've more than doubled the number of associates today that are engaging in AI tools overall.

Specifically, a big piece of that is anchored in agent assist and the things we're doing around call summarization. Again, I'll let Don comment on investments and return. But just to kind of give you a flavor of what we're talking about here the feedback we're getting from our associates is there are times we're saving up a minute or 2 minutes by aiding things like call summarization. And while that probably seen minuscule, what I would offer to you is we have thousands of service associates, and we also have millions and millions of calls that we take every single year. And so we're pretty optimistic and excited about a minute here in a minute there and what that means from an incremental opportunity for us over time, right? So we continue to lean into service efficiency and really getting all of our associates more effective as it relates to their ability to engage with our clients.

And then last but not least, by the way, I could go on and on and on all day on this topic. But last but not least, very, very important is how we're thinking about generative AI in our go-to-market motions. And so we have, for years, been at the tip of the spear of sales modernization. We have partnerships that are 2 decades old where we've always been leading the way with what it looks like to have a best-in-class modern distribution and sales force, and this is no different for us. We already have a broad set of our sellers leveraging tools along the lines of generative AI, many of which are through our best-in-class vendors and partners that we have and we're seeing great impact there. Things that I used to do myself at a personal level, manually such as pre-call planning, by the way, things like call summarization for prospecting -- these are big items for us as it relates to our go-to-market motions, and we've just started scratching the surface.

So all in, really excited, again, just kind of wraps t all up. I think it's about product, service efficiency and our go-to-market motion. We are making active investments. Some of those investments are things that we've shifted that we were already working on in digital transformation. Some of it is incremental investments. And so I think with that, I'll turn it over to Don, if you can kind of talk about how we're thinking about our incremental investments and moreover the return on that.

Don Edward McGuire - *Automatic Data Processing, Inc. - CFO*

Yes. So I think Maria has just outlined some of the exciting areas that Gen AI will have for us. And some of the things that will change how they will make the client experience better, how they help our associates how they help us sell more, et cetera. But I would say at this point in time, what we're really talking about is some modest investments in Gen AI. I think it's going to be a little while before we start to see returns from those things, but we certainly do anticipate returns. But in the near term right now, it's really a time for investing in these tools, et cetera, and we'll see those outcomes, those financial outcomes somewhere down the road.

Operator

Our next question comes from Ramsey El-Assal with Barclays.

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Ramsey Clark El-Assal - *Barclays Bank PLC, Research Division - Research Analyst*

You guys called out higher seller expenses as just one component of the margin headwinds in PEO. I guess the question, is this just the cost to compete in PEO at this point? In other words, is it becoming more expensive to compete in PEO? Or do you expect expense levels related to selling to sort of abate in a more normalized time period?

Don Edward McGuire - *Automatic Data Processing, Inc. - CFO*

Yes. I don't think there's -- just to answer the question. There's nothing really unusual or fundamentally different about our selling expenses and how we go to market in the PEO, I think, certainly, as we see higher sales, as you know, we get a lot of our sales -- half of our sales give or take from internal. So some of that's a little bit of our internal housekeeping, if you will, how we allocate expenses between business units, et cetera, but higher sales generally translate into higher selling expenses.

So really nothing fundamentally different in how we go to market, certainly not seeing any fundamental differences in the competitive landscape that's driving those expenses.

Ramsey Clark El-Assal - *Barclays Bank PLC, Research Division - Research Analyst*

Got it. Okay. And then one follow-up for me. In the context of the international product launches like Rural in Ireland and also, I guess, the partnership you guys just announced with Convera. Can you comment on the international value proposition itself, whether it's sort of largely the same as it is in the U.S.? Or are there distinctive products, needs, partnerships required in these markets that you guys sort of still need to build out to more fully execute on the international opportunity?

Don Edward McGuire - *Automatic Data Processing, Inc. - CFO*

Yes, I'll start, and [you Mari] can add here in a second. So as you know, if you look at our revenue as international revenue as a percentage of the total, and it's not where we'd like it to be, even though roughly 40% of the people we pay around the world are in international. So -- and the reason for that is that we have fundamentally different offers in the U.S. We have things like PEO. We also have money movement services, tax services, pretty much broadly distributed.

Some of those offers don't have the same value proposition outside of the U.S. market. So our opportunity there is not quite the same. Perhaps it will be as time goes on, some of those services may be available in other markets. But as we speak today, they're not there, the value prop isn't the same. And with respect to Convera as a partner, just to speak to that a little bit, we have thousands of clients and those thousands of clients have thousands of entities spread across multiple countries around the world. And if you think about the complexity and the difficulty of paying their people in some of these small countries and then getting the payments to the various social security providers in those countries.

Having somebody like Convera who can help a large European or a large U.S. multinational managed the treasury function in those small countries around the world without having to set up all the banking, et cetera. Someone like Convera actually is a great partner for us to facilitate those cross-border payments in a very -- in a compliant way, et cetera. So I think that's very positive for us. So we do have some partners in international, like Convera, as I just mentioned, but we still see it as a great opportunity for us to continue to grow.

Maria Black - *Automatic Data Processing, Inc. - President, CEO & DIrector*

That's right. If I may, one of the things I think what Don is suggesting is really, the opportunity we have with international. And so when you put it in the context of what the business that we have in the U.S., there is a tremendous opportunity for us to think more broadly in international partnerships as the one Don just outlined with Convera is a big piece of that.

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What I would also add is that -- from an international perspective, we did call out the performance specifically in Q2 on international. That's, by the way, in bookings. That's on the heels of a solid Q1. What I would offer as well as we have record retention. We have record customer experience and client experience in international. So I think we have a tremendous value proposition in international. By the way, some of the recognition I cited during the prepared remarks is really about how best-in-class our offer is with respect to the international offering we have. So that said, as Don mentioned, we're not satisfied. I think there's more opportunity to get scaled and grow are beyond payroll offerings partnerships are a big piece of that. But undoubtedly, we're performing and competing very, very well internationally.

Ramsey Clark El-Assal - *Barclays Bank PLC, Research Division - Research Analyst*

Fantastic sounds like good things ahead. Appreciate it.

Maria Black - *Automatic Data Processing, Inc. - President, CEO & DIrector*

Oh, you know what, let me just comment because you mentioned role in international. So I just thought I'd mention that really quickly, which is we are very excited about the down market and international role is one way that we're getting after that. And the pilot programs that we're running are teaching us a lot as we think about the down market and international.

Operator

Our next question comes from Bryan Keane with Deutsche Bank.

Bryan Connell Keane - *Deutsche Bank AG, Research Division - Research Analyst*

Congrats on the solid results. Don, I just want to ask about average balances. I know we were expecting a little bit of a headwind from the payroll tax deferral. Maybe you can quantify that as part of the reason for the drop of balances down 2%? And then what's the go forward there we should expect? Is there a more of a headwind from the payroll tax deferral for balances and maybe expect a similar decline in the back half of this year?

Don Edward McGuire - *Automatic Data Processing, Inc. - CFO*

No, I think you are right to call out the payroll deferral -- payroll tax deferral. That definitely was behind the decline quarter-to-quarter. We don't -- that's now behind us, so that's not going to be there. So we are expecting 2% to 3% balanced growth throughout the balance of the year. So we think that's very positive.

I think a big call out though on the whole CFI program is just the fact that since we spoke last 5-year and 10-year interest rates are down about 80 bps on both of those. And so I think that's a little bit of a headwind, and that's roughly the $20 million or so that we're calling down the flow number for the balance of the year. But still very optimistic about growth. Certainly, the reason that it's not growing as quickly perhaps as it did last year, we've certainly seen some moderation in wage growth. And we've talked about even though pays per control behaving as we expected, they are certainly lower -- pays per control growth is lower than it was in the back half and will be lower in the back half of this year than it was in the back half of last year. So -- and those would be the major influencers, if you will, to the full balance as we go forward to the back half.

Bryan Connell Keane - *Deutsche Bank AG, Research Division - Research Analyst*

Got it. And is that part of moving of the ES margins to the lower end of kind of the range you talked about. I think you talked about rates there. Just what was the surprise from 3 months ago on rates that maybe caused you to push the margins towards the lower end or where you think the lower end of the new margin range.

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Don Edward McGuire - *Automatic Data Processing, Inc. - CFO*

Yes, so you're right. I think the float certainly is a component of us guiding to the middle of our range for sure. So that's a component. We don't try to second guess the markets.

We use yield curves that are out turning the market to estimate what we think our returns are going to be. So no real surprises other than seeing what's happening in the overall market, and then we're taking the forward yield curves and applying those to our balances, and that's where we land.

Operator

Our next question comes from Scott Wurtzel with Wolfe Research.

Scott Darren Wurtzel - *Wolfe Research, LLC - Research Analyst*

Maybe just wanted to start off on some trends that we've seen so far in the selling season. It seems like through 2Q, it was pretty positive on the bookings side. But maybe wondering how we've sort of tracked into 3Q? And then also what you've seen maybe from competitors, any changes in pricing go-to-market strategy and all that would be helpful.

Maria Black - *Automatic Data Processing, Inc. - President, CEO & DIrector*

Scott, we feel good about the demand environment overall at this point. I think companies are still hiring. We saw that this morning actually as well. And companies are still investing in their people, their talent, they're investing in HR I think there are a couple of things I'd highlight to you. The down market, definitely companies are continuing to hire, and they're continuing to buy. We have tremendous second quarter results. By the way, that business has been executing incredibly well really for many, many quarters.

And that's our Run offering, but it's also all the things that are attached to Run, so I think insurance services, retirement services all of the down market is doing incredibly well to give you a little bit of a line of sight as it is the 31st of January. So we do actually have a tiny bit of visibility specifically to the down market. And you asked about trends into the third quarter. What I would offer to you is January looks good. I think we're actually on track to onboard something close to like 30,000 units in that business alone in the month of January. And so that's the size of some companies, if you will. So it's pretty incredible to see the execution in the down market.

We have solid pipelines really across the mid-market, well drop market, the mid-market did incredibly well. In the second quarter, from a competitive standpoint, I think we get a lot of questions around the competitive landscape. Has it shifted in the mid-market? What I would offer to you is it hasn't really shifted. It's been a competitive space for us for a long time. It's an area for us that we're executing very, very well. We have best-in-class products. We continue to take friction away from our clients, make it easy for our clients to engage with us. We know this based on our results and retention. We know this based on our results and record NPS.

We had good bookings in the mid-market. So I think the mid-market is solid and certainly not getting any easier for our clients to be employers in the mid-market. As it relates to the international space, I think I covered that already, so I won't touch much more on international, but a good Q2 on the heels of a good Q1. And then in our enterprise and upmarket space, this is an area that has normally, I think it's kind of the norm -- new normal on longer deal cycles that have more individuals involved in those cycles. So we're paying close attention to it. And certainly, all the things that are happening kind of across that space, but I would suggest to you that we feel relatively solid about our pipelines and our ability to bring that business in the back half.

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Scott Darren Wurtzel - *Wolfe Research, LLC - Research Analyst*

Great. That's helpful. And just a follow-up for Don. Just on the float income guidance, sort of noticed a pretty notable increase on your outlook for the client short portfolio. So just wondering if you could maybe give a little bit of color on sort of the change in geography on those investments for the balance of the year.

Don Edward McGuire - *Automatic Data Processing, Inc. - CFO*

Yes. So maybe let me clarify that for you a little bit. So really, we haven't changed our investment strategy at all. What we have done is we've tweaked a little bit the way we were going to -- we were borrowing funds in the market day in and day out. So what you're seeing is we're actually entering the market a little bit early. So instead of borrowing everything we need to on a peak borrowing day. We've simply spread the borrowing out over 2, 3 days so that we can tap the market in a more -- in a smoother way, if you will.

And I think if you're looking at the average balances on that -- on the appendix sheet that's in the release, you'll notice that, that number has gone up in the short a fair bit, but that's the driver. So it's not a change in our investment strategy at all. It's just a change in a bit of a tweak in the way we're actually borrowing funds in the market when we need larger amounts of -- when we have larger amounts of borrowing.

Operator

Our next question comes from Bryan Bergin with TD Cowen.

Bryan C. Bergin - *TD Cowen, Research Division - MD & Analyst*

First question I had is on EBIT margin. Can you comment on what drove the outperformance versus your view for that to be down, I think, in 2Q? I'm curious if that was an aspect of timing within the year versus better-than-expected efficiency. And I think, Don, I heard you mentioned some Gen AI investments to come. Is that incremental spend versus the prior plan?

Don Edward McGuire - *Automatic Data Processing, Inc. - CFO*

So yes, let me start, Bryan, let me start with the first part of your question. So -- there was a little bit of modest revenue outperformance in the quarter. So I think that was a contributor to the margin. And then we had some expenses we always have focused on expenses. There's a few things, a little bit of bad debt, a little bit of head count, et cetera, and perhaps a little bit of timing, but nothing significant to really call out as a contributor.

In terms of the Gen AI spend, yes, we are spending a little bit more than we said we were going to last quarter. So we do have a bit of incremental spend. It's not a huge amount, but I know that lots of folks like to measure things in 10 bps. So we are calling it out. Not an incredible amount, but a little bit more than we had said in the prior quarter.

Bryan C. Bergin - *TD Cowen, Research Division - MD & Analyst*

Okay. And then just, I guess, a follow-up then on Gen AI and ADP assist here. Is that a feature you're able to monetize directly or more so kind of an enhancement you're offering for free to drive the CSAT scores higher? And I guess understanding you're leaning into these developments, do you kind of view -- you think about the monetization of Gen AI products. Is this a near-term dynamic or more so kind of feature and product differentiation that's a longer-term modernization dynamic?

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Maria Black - *Automatic Data Processing, Inc. - President, CEO & DIrector*

So Brian, ADP Assist is really the overarching, call it, brand, if you will, that we're leveraging to talk through all the things that we're putting into our products to make things easier. The way that I think about it is it's really just the next phase of digital transformation for ADP using new tools and technology.

So said differently, our intention is not to charge to make things easier for our clients to do business. That is our commitment to our clients, always has been is to make it as easy as possible to process payroll to have accurate payrolls. And so it's not a monetization effort as it stands. It's really about just leveraging the new technology to step change the digital transformation that we've had underway candidly, for many, many decades since the dawn of the computing era. So -- that's kind of how we're thinking about ADP Assist in terms of monetization in general.

Do I believe there's monetization as it relates to Gen AI? Of course, I think it's more about the dollar long term, right? So I think about it, the dollars that we're putting in today will yield multiple dollars for us in years to come. So there will be distinct monetization opportunities as we create new products into the market as we think about various things of that nature, perhaps features and functionality. There will also be gains in sales and retention that will lead, in my mind to investments that are proven today in Gen AI to drive incremental bookings and retention over the long term. So I think it's about putting a dollar in today with the belief that it will yield many dollars of margin to come, if you will, as well as bookings, et cetera.

Operator

Our next question comes from Samad Samana with Jefferies.

Samad Saleem Samana - *Jefferies LLC, Research Division - Equity Analyst*

Maybe on the PEO business, I was curious, I know you guys called out some of the bigger verticals inside of the PEO business and that there's maybe some more softness there than you had expected in technology and professional services. Any change in the exposure other than side of the PEO business or within like the big verticals? Are you guys seeing any change in the trends that you saw maybe over the last couple of quarters?

Maria Black - *Automatic Data Processing, Inc. - President, CEO & DIrector*

The trend in specifically, professional services have stabilized. And so I think Danny made the comment earlier, it's no longer contributing to the deceleration. So it used to the professional services cohort used to contribute to the acceleration of pays per control than we found ourselves where it was contributing to a deceleration and it's largely stabilized at this time.

Samad Saleem Samana - *Jefferies LLC, Research Division - Equity Analyst*

Got you. And just as you think about the pricing environment, I know that we're still not at when the company does the annual price increases. But as you think about maybe for new deals or for new customers that are onboarding any change in the kind of price pressure or competitive nature of what your competitors are offering in terms of discounts or what ADP is having to offer? And just as we look ahead of price increases, how are you thinking about this year's price increase?

Don Edward McGuire - *Automatic Data Processing, Inc. - CFO*

Yes. We're not really seeing any changes, Samad, in the price environment, the competitive environment. We think we're priced appropriately. And we've always acknowledged that we're a little bit more premium to others, but we're happy with that because we think we offer a better service and stability, et cetera. So no real changes. You're right. It is a little bit of really the budget cycle kicks off here in the next 6, 8 weeks or so, and we'll certainly be looking at the pricing increases for next year and weighing all the regular factors, what's inflation being.

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We thought our price increases were very well received last year. We thought they were in line -- so we'll keep that in mind. But as always, we're always interested in the long-term value prop with our clients and being competitive in the market. So we're always measured, I believe, when we think about the price increases that we do hand out to our clients.

Operator

Our next question comes from Kevin McVeigh with UBS.

Kevin Damien McVeigh - *UBS Investment Bank, Research Division - Analyst*

Great. Maria, I think you talked to kind of implementations a little bit. Can you remind us maybe what percentage of the revenue is done internally on implementations today? And if that's a shift philosophically what that can be over the course it's on. If I heard the remark, right? Maybe I picked it up wrong, but just any incremental thoughts on that?

Don Edward McGuire - *Automatic Data Processing, Inc. - CFO*

Yes, maybe, Kevin, you're a bit soft, by the way, but you're a little bit hard to hear, but I think the question was what kind of revenue we derive from implementation and...

Kevin Damien McVeigh - *UBS Investment Bank, Research Division - Analyst*

Yes.

Don Edward McGuire - *Automatic Data Processing, Inc. - CFO*

Yes. So it's not a substantial sub-10% of our overall revenue comes from setup we internally call setup fees. So it's not a substantial amount.

Kevin Damien McVeigh - *UBS Investment Bank, Research Division - Analyst*

And then do you see that down over time? Does that become less if you outsource that? And is there any way to think about the margin impact from that initiative?

Don Edward McGuire - *Automatic Data Processing, Inc. - CFO*

Well, I mean you also -- so no, I don't think there's a big opportunity there. We certainly have had conversations. We certainly have lots of folks who would like us to outsource our implementation because they think it's a revenue stream for them. We like to have that control over the client from sale through to go live in service, not to say that we won't work with third parties to help us from time to time, which we do.

But it's really not that large a factor. Certainly, there's some money there to be had, but it's not that large a factor in the overall scheme of things. There's also some interesting accounting, of course, around implementation and set-up fees and the deferral over the terms of the contract. So once again, it would take a lot of changes to do anything, make any changes of the bottom-line financials in the near term.

Operator

Our next question comes from Tien-Tsin Huang with JPMorgan.

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Tien-Tsin Huang - *JPMorgan Chase & Co, Research Division - Senior Analyst*

Good results here. Just wanted to dig in on your prior comments. I know a lot of people asked on PEO and the healthy activity there and the confidence of the acceleration. Is ADP doing anything differently? Or is industry demand changing? I understand it's not -- doesn't sound like if there's a cost or pricing change there. So I just want to make sure I understood that.

Maria Black - *Automatic Data Processing, Inc. - President, CEO & DIrector*

Thank you. I'm happy to talk about PEO bookings. I think -- as mentioned in the prepared remarks, we're very pleased with our PEO bookings. This really is the fourth quarter that we've seen positive PEO bookings momentum. And the Q2 specifically exceeded our expectations -- most of the pressure that we felt in the PEO has been a byproduct of kind of the pressure on that pays per control and having to overcome that, which is why the focus on bookings has been so paramount for us. And certainly, we delivered that in the second quarter.

In terms of from a demand perspective, I speak about the PEO all the time, as you know. I think the demand continues to be incredibly strong. I wouldn't suggest that there's anything unnatural that we are doing outside of a tremendous amount of focus across the enterprise to ensure that we're executing on the PEO bookings side, but in terms of anything unnatural or demand changing. I think the value proposition, as I always say, it's stronger than it's ever been. I think clients in that space are looking toward ADP to help them from a PEO value proposition, so everything from payroll to benefits to navigating the complexity of being a business and having the ability to execute on our employment relationships.

So I would say the value proposition is as strong as it's ever been. I think it remains strong. The demand is there. The organization is focused on PEO bookings as an execution lever for us, and I'm pleased to see that we did just that in Q2, and we really had -- this marks the fourth quarter of positive bookings momentum from the PEO.

Operator

Thank you. Our next question comes from Jason Kupferberg with Bank of America.

Unidentified Analyst

This is Caroline, I'm on for Jason. Thanks for taking our question. So pays per control growth has been 2% quarterly through the first half. But the guide for full year '24 is still 1% to 2%. So what are the drivers of the second half deceleration? Or do you think that the high end has become more likely?

Don Edward McGuire - *Automatic Data Processing, Inc. - CFO*

Caroline, thanks for the question. We said we would go to -- we'd be 1% to 2% for the year, and we certainly have that 1% to 2% range still in the back half. we're not really anticipating any slowdown in pays per control, but we certainly have it built in. So perhaps we're a little bit conservative there.

But as we sit here today, demand -- the employment demand continues to be robust, although still declining somewhat. But I think we're confident that in the back half, we're going to be declining a little bit, but still coming in on that 1% to 2% range for the year. Not much -- not really much more to say there, other than employment demand, labor markets continue to be maybe a bit softer than they were. But as we saw this morning at our NER report, hirings still out there, still good growth. So not a lot of extra color. I don't think that around pays per control.

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Operator

Our next question comes from Dan Dolev with Mizuho.

Dan Dolev - *Mizuho Securities USA LLC, Research Division - MD & Senior Equity Research Analyst*

Great results here. Just a strategic question. Obviously, if you look over the next 12 to 18 months, interest rates are coming down, there is a big debate out there on the ability to offset some of those headwinds in terms of revenue. Can you talk about maybe some idiosyncratic initiatives that you could do to offset the headwind from declining interest rates.

Don Edward McGuire - *Automatic Data Processing, Inc. - CFO*

I think that's really a macro question, I guess. I guess the macro answer to that would be that if interest rates start to decline, we'll see an offsetting increase just in economic activity. And if we see that increase in economic activity, we should see revenue go up, we should see bookings opportunities go up, et cetera. So I think that if interest rates come down and I know there's lots of debates whether it's 2 cuts or 4 cuts, et cetera, who knows?

But if they do come down, we should certainly avoid the recession, nobody's asked about a recession on the call today, so thank you. I think the consensus is that there's not going to be a recession. So just certainly, any of the polls suggest that economy is healthy with 3.3% GDP growth in the last report. So if rates come down, the economy should remain healthy and a healthy economy should help continue to contribute to our growth.

Danyal Hussain - *Automatic Data Processing, Inc. - VP of IR*

Dan, I'll just add also, our model involves reinvesting further out on the yield curve. And as you know, we're still reinvesting at higher rates than what's embedded in the securities that are rolling off. So even if we do start to see short-term interest rates fall next year, which is obviously consensus at this point, a lot of that will be offset by the reinvestments that we have further out on the yield curve. And so it's too early to be talking specifically about the interest rate outlook for next year, but we would just recommend you keep that in mind.

Don Edward McGuire - *Automatic Data Processing, Inc. - CFO*

Yes, that's fair. I think if you look at our reinvestments, our current reinvestments are still up 4%, which is higher than our average yield today. So there still are opportunities. Our float is expected to continue to grow over the next 12 to 24 months. Certainly, it's going to grow more slowly than we would have expected at the end of last quarter. But there's still upside from flow, which is perhaps not as much upside.

Operator

Our next question comes from Pete Christiansen with Citi.

Peter Corwin Christiansen - *Citigroup Inc., Research Division - VP and Analyst*

Two questions. Now that we fully lap ERTC, I'm just curious if you've noticed any changes in client demand or competitive tactics, particularly in the down market.

Maria Black - *Automatic Data Processing, Inc. - President, CEO & DIrector*

Yes. Pete, the ERTC, as you know, and I think what you're referencing is the new deadline that was pulled forward 5 quarters actually. So the deadline actually, as it stands is potentially today. I think we're still waiting for the final kind of execution, if you will, of that new deadline. But arguably, we're

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having to execute on behalf of our clients with today in mind. And so there's a tremendous amount of volume that we are pushing through on behalf of our clients.

And it has put pressure into the system, which is hard to watch and witness by the way, as it relates to the very clients that are supposed to be helped by this and the challenges that they're facing, trying to navigate it. So we're doing everything we can in our power to help and process these claims. In terms of financial impact for us, as it relates to ERTC, it isn't a financial impact to us. I think it's very de minimis as it relates to our overall revenue as it relates to our overall incremental. We really -- from a standpoint of what we're looking towards is about supporting our clients is I think some of our competitors have used it more as a business and a revenue than us as it relates to how we're thinking about it. But undoubtedly, the advancement of this deadline til today has not been ideal for really anyone engaged in it.

Peter Corwin Christiansen - *Citigroup Inc., Research Division - VP and Analyst*

That's helpful. And then I'm curious, the combination of HCM and payments functionality. It's certainly been a theme, EWA is obviously a big, big portion of that and that cross-border. Do you see opportunities to increase penetration there to add more capabilities either through partnership, M&A further into payments and I'm thinking perhaps even like disbursements, all those sorts of things.

Maria Black - *Automatic Data Processing, Inc. - President, CEO & DIrector*

From a strategic standpoint, Pete, what I would offer is continuing to solve for our clients and employees and how they engage with us. If you imagine across ADP, we paid 41 million wage earners in the U.S. that's [$25 million.] I think last time we talked about our widely offering what we disclosed was that we had 1.5 cardholders or something like that. So you just kind of give you the opportunity, scale of it.

We believe there's tremendous opportunity to increase how we're engaging with our clients, whether that's through the likes of Wisely, it's through the likes of EWA as you're suggesting or it's any other type of payments and things that we can do to make it easier for our clients and employees to move through the world of work, right? And so the way I think about it and the partnerships that we're actively out there in the market talking to and thinking about are anywhere we can add value in our clients' and employee life and flow. So as they move through their day and they clock in through ADP's mobile app, which by the way, we have 10 million users that are actively using our ADP mobile apps. So as they're engaging with ADP, are there opportunities for us to insert value there, whether that's things like EWA, it's things like payments, it's things like financial and wellness apps like the companion app we have through Wisely. These are all top of mind for us as we go through our strategic discussions and as we think about partnerships in the future for ADP.

Operator

We have time for one last question, and that question comes from Ashish Sabadra with RBC Capital Markets.

Ashish Sabadra - *RBC Capital Markets, Research Division - Analyst*

So just a multipart question on PE and following up on some of the commentary earlier on solid bookings and moderating PPC -- sorry, paper control headwinds -- as we look at the WSE growth, we have continued to see a sequential improvement there better than what we saw last year. And just given the commentary, is it fair for us to assume that we should continue to see that improve as we go through the year.

And then on revenue per WSE, I was wondering if you could comment on looks like pricing trends are positive, but if you could comment on any other puts and takes, participation, anything else that could help drive better revenue per worksite employee.

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Maria Black - *Automatic Data Processing, Inc. - President, CEO & DIrector*

So the answer to your question is yes. We do expect that the bookings contribution, coupled with a bit of stability on the pays per control side, coupled with retention getting more favorable in the back half. All of those things should lead to the reacceleration that Don mentioned earlier that we've been pointing to in the back half I think in terms of other componentry within the PEO, you mentioned a few of them.

There's payroll per works unemployed, there's workers' compensation, there's state unemployment -- some of these things are things that we're still waiting to really see the outcomes. I'll give you an example. One of those is state unemployment in terms of, obviously, we sit here today forecasting what that looks like. Most of those rates are issued throughout this quarter. And so while we have some line of sight, in the end, we don't know entirely what the state unemployment outcome. We do expect that it creates a little bit of a rates are going down year-on-year again this year. But again, only time will tell. Sometimes the states, as an example, make very strange decisions that aren't always in line with what's happening from a broader labor and unemployment perspective. So all that to say, I think -- I don't know that I could sit here today and give you any componentry that seems strange or out of the norm. I think they are all things we're watching as we look toward the reacceleration of the PEO in the back half.

Operator

Thank you. I'd like to turn the call back over to Maria Black for any closing remarks.

Maria Black - *Automatic Data Processing, Inc. - President, CEO & DIrector*

Yes. So really quickly, I think I'll end with how I ended my prepared remarks, which is a huge shout out to all of the associates and the entire ecosystem across ADP. So that's ADP associates, partners, channels all of the stakeholders that really contributed to what was a good, good solid Q2 but also a good solid first half. I'm really excited about the back half and what we'll accomplish not just in fiscal '24, but moreover in calendar 2024.

It's a time and it's an exciting year for ADP. This year is the year that we actually round our 75th anniversary. And when I think about who this company is over the last 7 decades and 75 years? I can't see -- I can't wait to see what we're going to do in the next 75. So look forward to sharing in that celebration with all of you as we head into 2024 together. Thank you.

Operator

Thank you for your participation. This does conclude the program, and you may now disconnect. Everyone, have a great day.

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