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ADP.OQ - Q3 2026 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 third-quarter fiscal 2026 earnings call. I would like to inform you that this conference is being recorded.

(Operator Instructions).

I will now turn the conference over to Matthew Keating, Vice President, Investor Relations. Please go ahead.

Mattew Keating - *Automatic Data Processing Inc - Vice President, Investor Relations*

Thank you, Michelle, and welcome everyone to ADP's third-quarter fiscal 2026 earnings call. Participating today are Maria Black, our President and CEO; and Peter Hadley, 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 a 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.

Maria Black - *Automatic Data Processing Inc - President, Chief Executive Officer, Director*

Thank you, Matt. This morning, we reported another strong quarter of results with revenue growth, margin expansion and EPS growth all coming in ahead of our expectations and reflecting the significant progress we are making across our strategic priorities at a pivotal time for our industry.

Before we get into the details of our performance, I want to share a few thoughts on why this is a defining moment for human capital management and why I am so excited to be leading ADP in the AI era. HCM is about helping companies manage the workforce infrastructure that makes business possible, whether you're a Fortune 500 company or a small local business, that has always been our driving mission and it has never been more critical than it is today.

As AI adoption continues, businesses will only face greater workforce complexity. AI is redefining the very nature of work and how we collaborate while increasing regulatory interest around privacy and data protection. And fortunately, that's exactly where ADP thrives.

We execute with precision when it matters most. In terms of rapid change and disruption, businesses need the compliance, accuracy and trust that ADP delivers at scale. Through economic cycles, shifting labor trends and waves of technological transformation, we have consistently met every moment by investing in R&D, evolving how we serve our clients and raising the bar for what HCM can deliver.

ADP was the first in HCM to deliver automation, move to the cloud, provide a mobile app and create an online marketplace, we believe it's our job to lead the industry in innovation. And now we're doing it again with AI. For us, success means leading the way in a trusted service-driven and AI-powered HCM and setting the industry standard for accuracy, compliance and partnership around the world. Our performance this quarter shows how we're executing on that.

Before I discuss our strategic progress, I'd like to review some key highlights from our results. We delivered solid Employer Services new business bookings growth in the third-quarter. Results were particularly strong in international and compliance solutions. Our insurance and retirement services offerings also continue to contribute to growth in our small business portfolio.

Both our Employer Services retention rate and our overall client satisfaction levels reached new record highs for a third-quarter. This strong performance is the result of continued progress across our three strategic business priorities. I'll start with what we are doing to lead with best-in-class HCM technology.

AI makes HCM more important, and we believe it unlocks tremendous value and opportunity for our industry that plays out in two ways. First, while AI excels at prediction and efficiency, it can't execute critical high-stakes HCM functions with a level of accuracy and consistency required. Because at the end of the day, payroll isn't a software function, it's a commitment to the people who showed up and did the work and there is no room for error.

Second, AI has added new layers of complexity for our clients as they manage their payroll, workforce management and regulatory compliance. These functions are rapidly evolving. And now more than ever, businesses will need a trusted HCM partner who can decode the puzzle and reliably deliver these critical services. I also want to be direct about something analysts and investors are rightly focused on. AI is changing both work and the workforce. And with our business grounded in all aspects of payroll and beyond, we are working on answers every single day.

Our research with the Stanford Digital Economy Lab shows that AI is reshaping work at the task level. While this could lead to job displacement in certain task areas, we expect other new job categories to be created in this tech transformation. What we know for navigating through economic cycles and labor market shifts and the data we've gained along the way is that even as workforces change, the work of managing them, paying them accurately and keeping them compliant doesn't go away.

AI is shifting how work gets done, but that doesn't eliminate the need to manage it and managing a workforce through disruption makes HCM more complex. We are not immune to shifting employment trends, but we are built for the world they represent. What differentiates

ADP's approach is that our AI is built in the very core of how we orchestrate, govern and execute HR and pay processes, grounded in regulatory logic, operational data and decades of expertise.

This goes far beyond chatbots or surface layer automation that can enhance the user experience. It's about delivering real-world outcomes where accuracy and auditability are nonnegotiable. For example, in January, we launched ADP Assist agents that apply advanced intelligence to real workforce challenges across payroll and HR. These persona-based agents think, plan and act with human oversight, they are designed to handle routine tasks so people can focus on high-value strategic work that requires judgment, expertise, creativity and connection.

And since that launch, we've already seen meaningful results. Our ADP Assist payroll agents have saved an average of 30 minutes per payroll. Our ADP Assist tax registration agents have helped businesses maintain compliance and avoid penalties and interest on late tax filings.

Our Smart Actions search has reduced clicks and time spent by around 80% for common HR actions. And those are just a few examples. We are continuing to accelerate this work, roll out new ADP Assist agents and look for more opportunities to make work easier. ADP Lyric HCM is also saving time and effort for our clients.

One senior HR leader at a supply chain firm shared that the AI tools within Lyric have significantly reduced the number of steps in the recruiting process from 23 down to just 8 by providing advanced candidate insights. Another client, a global holding company used Lyric to replace more than a dozen disparate systems, which enabled a 71% leaner payroll operations model and that's just the beginning.

In March, we further expanded our Agentic AI ecosystem through the ADP Marketplace, our industry-leading open platform where clients connect to ADP solutions with third-party applications across the HR and workforce technology landscape.

We launched a dedicated space within marketplace for carefully selected AI agents from our partner companies that give HR teams intelligent support across the employee life cycle and all agents are aligned with ADP's principles on safe and responsible AI. Our approach is also earning external recognition.

ADP was ranked number one in HR on Fast Company's Most Innovative Companies list, and RUN Powered by ADP held its position as a top-ranked small business product by G2 for the second consecutive year. I want to congratulate our entire team on these well-deserved achievements.

Our second strategic priority is to provide clients with unmatched expertise and outsourcing solutions. I'll speak to three structural advantages that together position ADP to deliver on this priority and lead the HCM industry through its AI transformation. The first advantage is our data. AI is only as good as the data it's built on, and ADP has the industry's strongest workforce data foundation built over nearly 77 years.

We pay one in six workers in the US and moved $3.3 trillion in the US in fiscal 25. We capture payroll, HR and compliance events for more than 1.1 million clients and 42 million workers globally across roles, industries and geographies, giving us incredible insights into the workforce and its emerging trends. This advantage will continue to compound for our data and AI capabilities over time and will further widen the gap between ADP and our competitors. The second advantage is our domain expertise.

Every ADP Assist agent is grounded in our unmatched institutional knowledge from decades of hands-on experience with companies of all sizes. Our deep understanding of HR processes, workflows, exceptions and regulatory nuances is built into the very architecture of our products, services and systems. Our service model delivers human expertise and guidance alongside high-impact technology, pairing AI-driven efficiency with expert judgment and automation with accountability. And as AI drives regulatory change and fragmentation, we have a true structural advantage. Let's consider the current landscape.

So far this year, more than 200 HR-related compliance laws have been enacted in the US, including several governing the use of AI. This June, the EU transparency directive will take effect and employers continue to face increasingly complex and sometimes conflicting requirements across local, state and federal jurisdictions on issues ranging from pay transparency to leave policies.

But as I mentioned before, this is exactly where we thrive. Since AI entered the mainstream, ADP has operationalized an accelerating wave of changes. And when the regulatory environment accelerates as it is now, our clients will coalesce around the partners they trust to get it right, a fact that has shown up in our consistently strong retention.

This has earned expertise the kind that comes from pioneering an industry and leading the way through disruption. We are also focused on using AI to sharpen our expertise. We have continued to scale the deployment of additional generative AI capabilities across service operations through The Zone, our proprietary end-to-end solution that transforms our client-facing teams engage, serve and support clients across the full life cycle.

As of March, 20% of the total service population was on The Zone platform, and we expect to reach over 40% by the end of fiscal 26. Several high-volume service teams, including SBS and Wisely are operating at full utilization, which means GenAI-enabled workflows are becoming embedded in our standard service operations and helping our teams create value through a more seamless experience for our clients.

The third advantage is the trust in our brand. Clients have relied on ADP for the most essential HCM processes for decades because we consistently deliver through change and complexity. In the age of AI, trust is more important than ever, and we are deepening trust every day through our commitment to ethical and responsible AI development.

Finally, we remain focused on our third strategic priority, benefiting our clients with our global scale. ADP supports clients across 140 countries and 67,000 ADP associates deliver compliant HCM solutions, local expertise and trusted relationships to more than 1.1 million clients every day. We connect directly to tens of thousands of government entities, tax authorities, regulatory bodies and banking institutions globally.

Our final mile ecosystem is extremely difficult to replicate and becomes even more important as the regulatory landscape becomes more complicated and fragmented by country, state, city, town and municipality. Large businesses already recognize how hard it is to get this right.

We just recently secured several new enterprise clients, including one of which has tasked us to deliver a 30-country payroll transformation. These clients trust ADP for these complex processes because we understand what's required in each country, we have the infrastructure, and we can flex to support their exact needs. AI is changing work and the workforce.

We know there will be new regulations, new workforce models and new risks. ADP is purpose built for this challenge. We bring together the regulatory discipline, data integrity, process intelligence and human guidance required to productively incorporate AI into mission-critical HCM. That's why the world's leading organizations choose ADP as their partner for a rapidly changing world of work. I would like to take a moment to thank all our associates worldwide for their exceptional service and performance as we continue to advance our strategic priorities in the age of AI.

Every result we report every client we serve and every innovation we launch starts with them. We said at the top of the call that this is a defining moment for HCM. I believe that deeply, and I know just as deeply that ADP is strongly positioned to capture the opportunity ahead. And now I'll turn the call over to Peter.

Peter Hadley - *Automatic Data Processing Inc - Chief Financial Officer*

Thank you, Maria, and good morning, everyone. I will start by providing some more color on our third-quarter results, and we'll then update our fiscal 2026 outlook. This morning, we reported strong third-quarter results that included 7% revenue growth, 80 basis points of adjusted EBIT margin expansion and 10% adjusted EPS growth. These results were all ahead of our expectations, and we are adjusting our full year guidance to reflect this performance as well as making a few other changes, which I'll detail.

One thing worth noting before I get into the numbers. The margin expansion we achieved reflects disciplined investment. We are funding our AI transformation across our products, internal tools and service delivery while continuing to deliver on our financial commitments. This discipline is intentional, and it shows up in the results.

I will focus on our Employer Services segment first, where I'll cover both our results and our updated outlook. ES segment revenue in Q3 increased 7% on a reported basis and 5% on an organic constant currency basis with favorable FX contributing close to 2 points of revenue growth. As Maria shared, ES new business bookings were solid in the third-quarter, and our pipelines were healthy at quarter end with ongoing macro uncertainty and given the typical importance of our fourth-quarter, a range of new business bookings outcomes remains possible.

Accordingly, we are maintaining our 4% to 7% full year growth guidance. Driven by our strong ES retention performance in Q3, we are improving our guidance range by 10 basis points and now forecast ES retention to be flat to down 20 basis points for the year. ES pays per control growth remained at 1% for the third-quarter and our updated outlook calls for about 1% growth in fiscal 2026.

Client funds interest revenue increased by more than we anticipated in Q3, driven by 9% growth in our average client funds balances. We are increasing our full year average client funds balances growth forecast to about 6% and are continuing to expect an average yield of approximately 3.4% for the year.

As a result of our revised expectation for balances growth, we are increasing the midpoint of our fiscal 2026 client funds interest revenue forecast by $25 million to a range of $1.34 billion to $1.35 billion. We are also raising the midpoint of the expected net impact from our extended investment strategy forecast by $25 million to a range of $1.3 billion to $1.31 billion. We also now expect overall ES revenue growth of 6% to 7% for the fiscal year.

Our ES margins increased by 130 basis points in Q3, driven by operational productivity improvements that we are realizing across our business as well as the contribution from client funds interest revenue growth. The investments that we are making in AI, in service tools and in product innovation are yielding meaningful productivity improvements in our business, allowing us to reduce our cost to serve, while at the same time, enhancing our clients' experience.

As an example, our continued investment in our RUN platform, along with the AI-powered tools that were deployed to support our more than 900,000 small business clients have enabled an 8% year-over-year reduction in client contacts in fiscal Q3, our busiest quarter of the year. These outcomes help us drive faster margin expansion and a better client experience, as shown by our continued record client satisfaction and retention results. The good news is that while these outcomes are becoming more meaningful and are now starting to manifest more noticeably in our financial results, we believe that the opportunity in front of us is substantial.

We are only in the very early innings in terms of what this can yield in terms of a superior client experience as well as business growth and financial benefits for ADP. Turning now to the PEO. Total PEO Revenue increased 7% in the third-quarter, with PEO revenue excluding zero-margin pass-throughs, growing 5%.

Stronger PEO new business bookings growth helped offset some continued softening in PEO pays per control growth in the quarter keeping growth in average worksite employees at 2% for Q3. We continue to forecast fiscal 2026 average worksite employee growth of about 2%.

We also saw continued strong growth in gross payrolls as well as higher SUI revenues, both of which contributed to the uptick in peer revenue growth in the quarter. Following the strong revenue performance in Q3, we are increasing our full year PEO revenue growth guidance to 6% to 7% and raising our PEO revenue, excluding zero-margin pass-throughs, growth outlook to 4% to 5%.

PEO margins decreased 120 basis points in Q3, driven mainly by zero-margin pass-through growth, higher SUI costs and higher selling expenses. Putting it all together, we are increasing our fiscal 2026 consolidated revenue growth outlook to 6% to 7%, and raising our adjusted EBIT margin expansion forecast to 70, 80 basis points. Our full year effective tax rate guidance of around 23% is unchanged.

And finally, we are increasing our fiscal 2026 adjusted EPS growth forecast to 10% to 11%, which continues to be supported by share repurchases. As we look ahead to fiscal 2027, I also wanted to share a few early thoughts. First, we were pleased to increase our adjusted EBIT margin expansion guidance in fiscal 2026. While it is still early in our planning process for fiscal 27, we remain very focused on continuing this acceleration when it comes to margin expansion as we realize further productivity benefits from our AI transformation.

Second, as a result of our laddering strategy, we remain positioned for continued tailwinds from our client funds portfolio as anticipated reinvestment rates remain above the average yield of our maturing securities driving overall yields expected on the portfolio above fiscal 2026 levels.

And finally, you will have noticed a meaningful increase in our share repurchase activity during this fiscal year to date. We expect to continue share repurchases at or above these elevated levels across the balance of this year and throughout fiscal 2027, absent major changes in the market backdrop. I would like to emphasize that this elevated buying is in addition to our long-standing commitment to growing our dividend and to the levels of investments that we are making and will continue to make in our business to best position us for success in the future.

We remain laser-focused on driving growth in our new business bookings and maintaining strong client satisfaction and retention levels while at the same time investing in our products, our people and our AI capabilities to deliver sustainable revenue growth, margin expansion and shareholder returns over time. Thank you.

And I'll now turn it back to the operator for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Bryan Bergin, TD Cowen.

Jared Levine - *Cowen and Company LLC - Analyst*

This is actually Jared Levine on for Bryan today. I wanted to start in terms of the implied 4Q guidance. I know you're not guiding FY27 at this time, but anything to call out in terms of using that implied 4Q revenue growth rate as we think about FY27 growth year?

Peter Hadley - *Automatic Data Processing Inc - Chief Financial Officer*

Thank you for the question. Yes. Look, I mean, we guide to a range of outcomes. So the guidance that -- we've increased our revenue guidance. We're very happy with that increased our margin guidance and our EPS guidance.

I think there's still a lot to do in the fourth-quarter with respect to bookings, with respect to retention in the PEO. So we're not really going to be more precise than the ranges we shared, but we feel confident with respect to our trajectory going into the fourth-quarter and exiting the fiscal year. Probably the one thing I would note would be we benefited by a little over 1.5 points of FX in the third-quarter in ES segment I'm talking about.

We're expecting that to moderate a little in the fourth-quarter, so a little bit less benefit from FX on the revenue side, should help the margin profile a little bit because whilst it's a revenue tailwind, it's a little bit of a headwind from a margin perspective. So that's really, I guess, the only specific point I would call out with respect to Q4 being different to Q3, but we feel confident with our guide and our exit point.

Jared Levine - *Cowen and Company LLC - Analyst*

Understood. And then good to hear about the record 3Q Employer Services retention rate. Can you dig into if that was broad-based or specific any areas and kind of where you still see areas for opportunity to improve that retention rate?

Maria Black - *Automatic Data Processing Inc - President, Chief Executive Officer, Director*

Yes. Jared, it's Maria. And equally as pleased with the result in retention. It exceeded our expectations and we raised the full year guide as a result of that, and we feel that overall, it was broad-based strength. The notable improvements that we saw were across international compliance, enterprise, small business, really saw strength in retirement services. It actually hit a new quarterly record for us.

So it was broad-based strength. We're really pleased with what we're seeing. I think it's a direct reflection of the investments we've made into product, the investments we've made into service and how we engage with our clients, some of the things that we discussed during the prepared remarks. So really pleased with overall results in retention.

Operator

Mark Marcon, Baird.

Mark Marcon - *Robert W. Baird & Co Inc - Analyst*

Congratulations on the strong results. I'm wondering if you can talk a little bit about the bookings. You didn't change the forecast range for the year, and it's still relatively wide with one quarter to go. Can you just discuss a little bit about what you're seeing with regards to the bookings in the third-quarter and year-to-date? And specifically, any areas that you're seeing really good results in, in terms of the various segments?

And also, to what extent can you give some commentary in terms of whether or not you're still seeing kind of a 50-50 mix in terms of bookings as it relates to upsells versus brand new logos? And then I've got a follow-up.

Maria Black - *Automatic Data Processing Inc - President, Chief Executive Officer, Director*

Okay. Thanks, Mark, and good to hear from you. Happy to comment on the overall demand environment and bookings. So first and foremost, we were very pleased with what we saw with respect to bookings in the third-quarter. We built on the momentum that we had the first couple of quarters, the first half of the year.

So pleased with where we sit heading into the fourth-quarter. But as always, we have a lot to get done in the fourth-quarter. I'll get back to that. I think the strength that we saw specifically in the third-quarter was anchored in some of the areas that I mentioned, international. That's a highlight for us.

Obviously, there's a lot happening in the world. So pleased to see the strength in international. Excited to see the strength in compliance. I think that speaks directly to some of the commentary I made around the infrastructure and final mile and the connectivity that we have.

That business is the business that connects a lot of these things to the infrastructure of how payroll actually gets done in the world. Also saw strength across our small business portfolio in the additional, call it, beyond payroll offerings of insurance and retirement services, which again speaks to kind of the strength that we're seeing in the down market. So overall, really pleased with the third-quarter with respect to the overall performance. I would say, as we head into the fourth-quarter, there's always a lot to get done.

We left the range relatively wide, as you mentioned. I think all of those options are outcomes for us. The sensitivity of it, if you will, is around $20 million, $21 million per percent. So if you imagine, 8,500 sellers, which is about what we have that are at the ready with all the right products, a stable backdrop from a demand perspective, all the right incentives, everybody is excited to execute about throughout the fourth-quarter with good solid pipelines, but we have a lot to get done as we always do at this time.

To answer your question around the 50-50, it's exactly the same. So it's about 50% that comes from new logos and 50% that comes from anything, call it, beyond payroll or additional business. So that's the -- that's what we have as a backdrop, and we're pretty excited with what we need to get done in the fourth-quarter.

Mark Marcon - *Robert W. Baird & Co Inc - Analyst*

That's excellent color, thank you Maria. And then with regards to the financials, one, you mentioned how AI is making you more efficient. And I couldn't help but notice that the R&D or the program costs were relatively flattish despite the nice increase in terms of revenue. And I'm wondering if you can talk a little bit about some of the efficiencies that you're gaining across the board from AI and particularly in terms of new product development and the tools that you might be employing there, both in terms of reduced expenses, but also speeding up the development process.

Peter Hadley - *Automatic Data Processing Inc - Chief Financial Officer*

Thank you, Mark. Yes, look, I think the R&D cost line, just to be clear, has obviously the usual accounting treatment. So again, there's capitalization, there's amortization and so on and so. You know, quarter to quarter, I'm not sure what you're looking at, but at least quarter-to-quarter or sequentially, the line may not move that much. We have a continued investment.

We also allocate within priorities. So we've certainly pivoted more of our spending in R&D towards AI initiatives, be it on the product side to benefit our clients as well as on the efficiency side. So there's a range of different things. Some of the expense also is carried in operations where we're spending and investing to deploy The Zone, our proprietary service, but built on Salesforce technology that's rolling out AI infused and certainly helping. And then we have other examples floating around out there, I'll give you one example that in addition to what we mentioned in our prior remarks. So in India, it's also year-end in India at March 31.

We actually had a reduction. We do a lot of work for our clients, validating tax advantage sort of allowances and the receipts. We actually deployed AI this year for the first time, reduced the call volumes by 35% in the year-end process, also reduced the labor by 35%. That was deployed against that sort of manual, but very necessary compliance efforts. So it's really a broad-based thing.

We certainly have pointed our investment dollars in the direction of AI as well as the usual spend that we like to do to bring best-in-class products to market. And I wouldn't necessarily be too much into the sequential nature of the R&D program cost line in the P&L. Some of that can be accounting and some of that can be reallocation of dollars either within R&D or between R&D and operating costs.

Operator

Jacob Smith, Guggenheim Securities.

Jacob Smith - *Guggenheim Partners - Analyst*

Can you provide an update on your traction in the quarter? And just in general, with Lyric's unique architecture compared to with standard across legacy HCM platforms. Are we seeing Lyric open up new use cases or customer segments that weren't really serviceable before?

And also on a related note, we've heard from enterprise customers that Lyric is being deployed in some cases as the best-of-breed payroll and compliance layer alongside, these existing HCM platforms. Can you just talk about how prevalent that buying motion might be whether that's expanding the addressable market beyond pure displacements?

Maria Black - *Automatic Data Processing Inc - President, Chief Executive Officer, Director*

Yes. Thanks, Jacob. I appreciate the questions around Lyric. As always, we are incredibly excited about the momentum of Lyric. We didn't call it out in the bookings commentary, but certainly pleased with what we've seen in terms of the pipeline build and the execution on Lyric, call it, year-to-date, had a couple of examples, obviously, in the prepared remarks on the impact of AI within Lyric and some of the things that we're solving for clients.

So to address the traction, I would tell you, our clients are equally as excited. We're excited. We see this front and center just this quarter. We had our annual ReThink event, which is our enterprise customers on a global scale, getting together to really talk about how they're solving for things like global payroll, global time. We also had our Meeting of the Minds meeting just a couple of weeks ago in Orlando, which is about 2,000 of our enterprise clients in the US getting together.

And I will tell you that Lyric is, for sure, gaining the momentum and attention of analysts, clients. It is the architecture. You mentioned the architecture. It does create new use cases. The way that we have it deployed with the ability to be position management base as well as traditional base does create an architecture that's incredibly flexible, it's dynamic.

That's why it's resonating both with the analysts and the clients, not just because it's modern and new and has AI inside, but very core of the engine and how it's architected that allows for the flexibility and dynamic way to manage work and how work happens today, and that's certainly what I am busy talking about with our clients, which is how do we solve for this new future work, how do we lean into how they're actually running and operating these businesses and Lyric does that it fits squarely into that.

So it is opening up new dialogue, new conversations with our clients, I suppose, new addressable use cases to use your language. I think in addition to that, as you marry it to our global time story, which really came about through the Workforce software acquisitions.

So you think about global time, global payroll as well as global HR. There is this ability to plug these things, call it all together as we go to market in addition to, by the way, having global service, and that's unique for ADP. So again, it's changing the conversation with those clients who are looking to us to solve for this new world of work that we find ourselves in.

So we're really excited about where Lyric is taking us both from a narrative perspective, from a pipeline perspective, but also from an addressable market perspective. And there are use cases where we can deploy Lyric in new and unique ways, that are gaining traction and more to come on that probably as we head into '27, but really excited to the places that it's taking us and it's definitely changing the conversation in the market.

Jacob Smith - *Guggenheim Partners - Analyst*

And just a quick follow-up, too. As Lyric bookings ramp in the large enterprise, how are you thinking about scaling implementation capacity over time, whether that's investing internally or potentially working with system integrated partners in the future?

Maria Black - *Automatic Data Processing Inc - President, Chief Executive Officer, Director*

Yes. Jacob, I'm so glad you asked because I left out that part, which is an important piece. The answer to the question is both. So we are scaling internally. But we also have this ability to go to market with system integrators in a more meaningful way than we have in the past.

So we've had relationships, both with mid-tier system integrators as well as, call it, the more global system integrators. Certainly, we've learned a lot from the acquisition of Workforce Software as they've been partnered deeply with many system integrators, think the likes of Accenture, and we also have relationships with others, be it EY, KPMG, et cetera.

But we're really excited to continue to build out, especially as it relates to this marriage between global payroll and global time and our ability to put that together with the systems integrator that's also working with that client to solve in real time for the future of work. So a big piece of our strategy, really excited to see where it leads us.

Operator

Dan Dolev, Mizuho.

Dan Dolev - *Mizuho Securities USA LLC - Analyst*

Maria. I think Peter, great results. Congrats, well deserved. I wanted to ask about, I know there was a question about AI and R&D, but more about -- I think your competitor mentioned that there was some difficulty selling software modules. I just want to see from your perspective how this looks? I think last time we talked about it, there was no problem whatsoever. Just wanted to sort of check the box on this one.

Maria Black - *Automatic Data Processing Inc - President, Chief Executive Officer, Director*

Yes, it's a great question. I'm not sure who entirely you're referring to. But certainly from our end, based on our pipelines and our results and again, spending times with our clients, both at the ReThink event as well as our Meeting of the Minds event, I would tell you that software is alive and well, especially for core function type of companies, and that's exactly where HCM fits in. So again, not knowing the nature or the type of company that you're referencing, that's not the case of our vantage point as it relates to HCM.

Again, the way we see it is we see the future of work as one that is AI infused and AI really powering workforce, but that doesn't take away the need to actually manage this year orchestration of paying people and keeping them compliant.

And so while it's reshaping the work really at the task level, and that's the research we were doing with Stanford that we see the need to ultimately manage work is actually becoming more complex, not less complex. I would say HCM is very different than that. And obviously, the value of getting all of those things right is actually increasing. So the more complex it's becoming the more valuable it is for us to do exactly what we're doing.

I think the other part is in line with that, it's really about having the highest levels of standards, ethics, the need for accuracy, security, and also this idea of auditability because in the world of HCM, be it payroll and the ecosystem that defines payroll or the rest of the HR benefits and all the ecosystems and connectivity that we have to -- whether it's government entities or carriers, the room for error, ambiguity, or just good enough like it doesn't exist. Payroll needs to be 100% accurate, 100% of the time.

And so that's a big differentiator, I think, specifically for HCM, which kind of leads me to I guess, the last point, which is that we were kind of built for this, right? So if you think about us in the 77 years, we've been doing this for our clients navigating through economic cycles, transformation cycles, the world of work and all of the stuff is making things more complex.

And we have the background, the trust, the data, the deep domain expertise in our products and services, but also the expert people to help our clients through this. I have to tell you, when I was at the Meeting of the Minds, and I know it's the case for one of our events this week as well in the mid-market, we're celebrating clients that have 50 years of tenure with ADP.

And I think that's a direct reflection of, as I said on the prepared remarks, like earned expertise, clients are turning to us at this pivotal time to help them navigate this. I'd say HCM is alive and well, definitely a core function and not something that can be replicated easily by any of these new entrants, if you will.

Dan Dolev - *Mizuho Securities USA LLC - Analyst*

Great, well, we agree. Congrats.

Operator

Tien-Tsin Huang, JPMorgan.

Tien-Tsin Huang - *JPMorgan Chase & Co - Analyst*

Just thinking about the outlook revision up and the good results here. Can we go through quickly the attribution of what's driving the change in the outlook? It seems like it's higher balances, some improvement in retention is the majority of it? Did I catch that? I just wanted to make sure I covered the -- we covered that.

Peter Hadley - *Automatic Data Processing Inc - Chief Financial Officer*

Yes. Thanks, Tien-Tsin, for the question. Yes, we're very pleased to increase the outlook. I think part of that is obviously the strong performance that we've delivered in Q3. The balance growth, we've increased our balance growth there. We see solid sort of underlying revenue growth opportunity in both PEO and in Employer Services exiting Q3 going into Q4.

Some of that is retention. As you mentioned, some of that is the pays per control lift in terms of our guide that we made for Employer Services. And another piece I just wanted to mention is price. So the last couple of quarters, we've been talking about looking our goal to achieve around 100 basis points of contribution from price, I'm pleased that our outlook actually is reflected a little increase in that. So expecting more like 130 basis points from price.

And I think that is positive, not only obviously for our financials, but when I compare that with our client satisfaction scores and our retention scores, both at record levels. Our offering is resonating the tools, the products that we're deploying are resonating, and there -- and, you know, we are able to achieve value for that through our pricing.

So there's a number of levers, all more or less working in the same direction, as I mentioned in one of the earlier questions. The only thing that we see softening a little bit going into Q4 is the contribution from FX, which was a little larger than we contemplated for Q3. We're not conflating the same level of contribution from FX to our revenues in the fourth-quarter.

Tien-Tsin Huang - *JPMorgan Chase & Co - Analyst*

Okay. Perfect. We're going through that, and then the pricing is definitely emerging that you're able to seek out more value. Maybe just my somewhat related to that, just thinking about competition and bookings. I think Mark asked about it well.

But any change in competitive intensity? I know there's a lot of focus here on some of the upstarts and maybe some of the more AI native or digital native companies. Any change there, Maria, that you're seeing? I know your bookings is reaffirmed, which is great. We'd love to get a little more on what's going on in the ground.

Maria Black - *Automatic Data Processing Inc - President, Chief Executive Officer, Director*

Yes. So it's a great question. I certainly understand the nature of it. I think with respect to any new type of entrants and pressures and in term of anything that would have entered the market in the last, I don't know, a quarter or two, I wouldn't say we're seeing anything new and exciting there that's increasing levels of pressure or competition. I would say it's always competitive, especially, by the way, in the back half of the year.

So certainly, Q3 represents a big bookings quarter for us. Q4 represents a big bookings quarter for us. And since we kind of set the tone in the market for HCM, it's always competitive this time of year. And there are lots of very formidable competitors out there. But I wouldn't say that there's anything to call out that's changed.

Certainly, there's some noise with certain companies that are potentially, I don't know, going public, some were going private, some were emerging. There's always some of that. There's always incentives being put in the market. By the way, we're putting incentives in the market. But I would say the -- to me, as somebody who's had a front row seat to the competitive landscape for decades, I would tell you, it feels pretty normal, if you will.

It's highly competitive. We show up well. We show up well with good products, good service, incredible distribution, an incredible ecosystem around us and that distribution accountants, brokers, SIs and certainly, the investments we're making. So I would say -- and I could go through each one of the markets, but I would say it's relatively competitive, which is exactly the type of sport we like to play.

Operator

Scott Wurtzel, Wolfe Research.

Scott Wurtzel - *Wolfe Research LLC - Analyst*

Just one for me. The commentary, I think, on ADP Assist. It was great to hear, but I think more broadly now that you've had some of these products and AI features in the market for some time now. What is sort of the overall feedback that you've been hearing from clients regarding these products? And is there anything potentially more on the AI front from a product perspective that clients are looking for?

Maria Black - *Automatic Data Processing Inc - President, Chief Executive Officer, Director*

So I'll start, and certainly, Peter, if you have anything to add. I would tell you, Scott, that the feedback is incredible. I cited a couple of examples. I probably could have gone on for 30 more off the top of my head. In terms of use cases, the impact that it's making. I think it speaks volumes. You see it in the client satisfaction. You see it in the retention, and you also see it now in our efficiency and our results.

And so I think there's a lot to be said for the work that we've done over the last three years. I think we were quick to organize. We've been able to infuse AI throughout the entire organization, whether it's on the go-to-market motion, it's in the product, it's really across the entire enterprise, how we build the products. So I think feedback from the clients is meaningful when they start seeing the impact of workflows being changed and then becoming either more efficient or saving time. And so I think it's also, though, exactly what they would expect of us.

And the good news is, I think we're only just scratching the surface. So as we continue down the road map of the ADP Assist overarching umbrella across each one of the HCM phylums, and we continue to change workflows, we continue to build more efficiency into how we service our clients or how the domain experts at our clients are able to engage in the work that they're doing. We're pretty excited about the feedback thus far, but there's a lot more where it's coming from and a lot more that we can bring to the clients, and we look forward to doing that throughout the coming years.

Operator

Jason Kupferberg, Wells Fargo.

Jason Kupferberg - *Wells Fargo Securities LLC - Equity Analyst*

So obviously, still a lot of debate in the market about how AI could impact seat-based revenue models. I think ADP has said in the past, a 1% change in pays per control impacts ES revenue by about 25 bps. So can we infer from that, that only about 25% of the ES business, excluding float is priced on a per employee per month basis? Or is there more nuance to it. And then just on the PEO side, I think the revenues are more tied to client head count there. But maybe if you can clarify all that with some numbers, that would be really helpful.

Peter Hadley - *Automatic Data Processing Inc - Chief Financial Officer*

Thanks for the question, Jason. No, on the Employer Services side, we have a higher propensity or proportion, if you like, of our revenue that is seat based than 25%. So in the down market, it's actually lower than that or about 80% of our revenues are base fee. We have other revenue models in the downmarket in Retirement Services, for example, Insurance Services is more of a commission model on our -- on the insurance premiums that we sell. We have asset-based revenues as well as participant-based revenue in the down market.

In the mid-market and the upmarket, though, we were much more, if you like -- we're much more seat-based models. We do have other revenue streams, implementation and project services and so on, but we are much more attributed to the seat-based model. In saying that, we feel like there's -- it's a value-based pricing approach that we've always taken. So again, the value we confer is not necessarily linear with the number of employees the client has. We're providing compliance.

We're providing people getting paid, a good experience, money being moved. So again, I think we have opportunities should the need to arise, we're not seeing need arising in the data at the moment with respect to pivoting the model in whatever way would make sense for us and our clients, should that be the case.

In the PEO, I would say it's more indirectly an employee-based model or a seat-based model. The predominant billing model we have in the PEO is the percentage of payroll. So obviously, the number of employees can influence the percentage of payroll, but so can wage levels, wage inflation, obviously, some of the pass-through revenues, like taxes and workers' comp and things like that. So really, I would say the PEO model probably is less directly exposed to the seat-based pricing mechanism than maybe the mid-market and upmarket of the ES space.

Jason Kupferberg - *Wells Fargo Securities LLC - Equity Analyst*

Okay. So that's good color. And I wanted to just come back on bookings. I know we're reiterating the guide here. It feels like the tone qualitatively all year has been pretty consistently bullish. So just wanted to get your take on relative confidence level in kind of the lower end versus the higher end of the 4% to 7%. I know it can kind of come down to the wire during the last quarter of the fiscal year, but just how you're feeling about that with two months to go?

Maria Black - *Automatic Data Processing Inc - President, Chief Executive Officer, Director*

Sure, Jason. It is the question and I think you have it right, which is sometimes it does come down to the wire and we have a lot to get done. And that said, given the broad based strength that we saw really in the first three quarters, we are -- you know, we feel confident in the 4% to 7% bookings guide. I don't know that. If we knew the outcome, I think we would have guided differently, but I think all of those options are on the table, if you will.

But we feel good about pipelines. We feel good about the incentives. We feel good about the sellers, the ecosystem, the products, the backdrop, HCM backdrop seems stable. So I think we're excited to see how this fiscal year ends, but we're certainly at the ready and are executing against it.

Operator

Ramsey El-Assal, Cantor Fitzgerald.

Ramsey El-Assal - *Cantor Fitzgerald LP - Analyst*

Congratulations on some solid results today. The PEO segment margins came in a little bit below our model. And you mentioned a few drivers. I think one of them was higher selling expenses. What does that mean exactly in this context? Is it like concessions to new clients or higher incentive for your sales staff? Just trying to figure out sort of what that is and what it implies?

Peter Hadley - *Automatic Data Processing Inc - Chief Financial Officer*

Thanks for the question, Ramsey. Yes, there was probably three things that went on in the PEO with respect to margins this quarter. One of them is higher selling expenses. I'll get to that. The other is the SUI revenues came in stronger than we were expecting, and we were pleased to see that given what it represents in terms of wage base and so on, but it comes at a lower margin.

The third piece, which is maybe less noticeable as we had positive -- some positive reserve releases in the workers' comp reserves for indemnity, less positive than the same time last year, which produced a little bit of margin drag in the PEO.

But back to the selling expenses, the real reason why the selling expenses were higher was, we had a really strong quarter in terms of sales. So again, that creates -- there's a variable cost model with respect to selling, and we had a strong quarter, as Maria alluded to earlier with respect to PEO sales, so that brought additional selling expenses. The pays per control, as I mentioned in my prepared remarks, continued to soften a little bit in PEO. It was solid in ES, softened a little bit in the PEO.

That is a margin that -- high margin revenue that sort of goes away. So when you put the combination of the higher sales, which generate higher selling expense with the pays per control situation, you see a little bit of erosion in the margin net -- on a net base in addition to the SUI and in addition to the workers' comp reserve releases being slightly lower this year than what they were last year.

Ramsey El-Assal - *Cantor Fitzgerald LP - Analyst*

Got it. A quick follow-up. I mean international has been a bright spot in the business for quite some time. Is there a way to accelerate that strategy? This is probably something you've commented on in the past, but maybe via M&A. Could you kind of press the gas pedal a little bit on international to bolster further?

Peter Hadley - *Automatic Data Processing Inc - Chief Financial Officer*

Yes, great question. It's certainly something we look at. We do quite a bit of small, I guess, small deals, but quite a bit of M&A. We've acquired a number of our partners in our Celergo network over the years, including some more recent ones in Mexico, in the Nordic countries. So we have that piece.

We also have workforce software, which was, as Maria was talking about earlier, is a global time offering, not just the domestic offering, albeit it was a US company, but it had presence in places like Canada, the UK, Australia and so on and the product hunts in many locations across the world beyond where that company had presence. Is there more opportunity to do M&A? Yes, I believe so. I think it's a question of finding the right fit, and we have people that are studying the market, and we obviously have contacts with many companies out there.

And as and when we find one that would be additive to our model and accretive to our opportunity at ADP, we will certainly look to pursue that, but nothing to disclose or announce on this call.

Operator

Dan Jester, BMO Capital Markets.

Dan Jester - *BMO Capital Markets - Analyst*

Maybe a two-parter on ADP Assist. So your first one is, I don't know if you shared this in the prepared remarks. If you have you made any comments about sort of uptake repeat usage, engagement levels with the customers that have access to it.

And then the second part of the question is you commented about the payroll agent saving a lot of time, Smart Actions saving a lot of time. As you roll more of these out, how do you view out sharing some of the value from the time savings that these agents are providing? Maybe this ties to Peter's comments about price but sort of any comments on that would be very helpful.

Maria Black - *Automatic Data Processing Inc - President, Chief Executive Officer, Director*

Sure. Thanks, Dan. Really excited about the progress we're making across the ADP Assist portfolio and innovations, if you will. And I think we are seeing that uptake in terms of clients, and we're definitely seeing - I think you asked about repeat clients. I would tell you, as often is the case in many of these AI tools that we will engage in.

Once they get started, they get, call it, hooked on continuing to process improve and engage with these tools. And so you definitely see those that, engage in things like the Smart Actions and the Smart Search, come back time and time again and kind of pick up where they leave off and continue to work and that's exactly what would be expected of these tools, and I think they're bringing the intended value.

And certainly, our clients are looking to us to continue to innovate across each one of these phylums of the HCM domain to make the workflows easier and to make things better for them and better for us. And that's really how we think about it. I think it's showing up well in things like retention and bookings and efficiency.

Peter cited some stuff around the places that we have these tools deployed internally at ADP and what it's yielding in terms of efficiency in our small business and Wisely, and we will continue to see that. And certainly, we see that at the client side as well. In terms of how we think about it from a price perspective, I think Peter made the comments earlier in terms of our value-based pricing, I think that's what we're always solving for.

So we're not really looking at this as a discrete usage type of fee at a piece by piece level. We really look at it as core in the fabric of how we operate and how we deploy our products to our clients. And I think it shows up in things like margin and efficiency. I think it shows up in bookings. I think it shows up in retention, and that's kind of the way we think about sharing this opportunity with our clients. I don't know if you have anything to add there, Peter.

Peter Hadley - *Automatic Data Processing Inc - Chief Financial Officer*

No, I think it's important to recognize, like the -- in everything we do in this area, we're looking at where is the value and how should that be attributed. So again, whether this is through specific pricing, whether that's through general price increase, whether it's through revenue share models, we have -- Maria was talking about in the prepared remarks the Marketplace Agent program that we've just launched as well as our own internal efficiency and cost savings.

For us, it's less about, I guess, how do we specifically price, that's certainly important. But ultimately, what is the value created, what is the appropriate allocation of that between ourselves and our clients and monetizing that -- taking advantage and monetizing that for mutual benefit. That's really how we think about it. And there's probably a laundry list, I guess, of different scenarios, which we don't have time to go through today in terms of how we do that.

But I think you can rest assured that we feel strongly about capturing the value that we're conferring through pricing and other mechanics as well as, obviously, what I was talking about on the efficiency side, that is certainly a bottom line savings that go to our EBIT numbers as well as likely will be fueling our further and future investments in this area. That's really helpful.

Dan Jester - *BMO Capital Markets - Analyst*

And then just as a follow-up, actually, is on the Marketplace. And maybe just philosophically, maybe give us an update on sort of partner versus build it yourself for these third-party agents and ultimately, are you ambivalent whether a customer uses your build agents or a third-party agents? Or how should we think about that evolving over time?

Maria Black - *Automatic Data Processing Inc - President, Chief Executive Officer, Director*

It's a great question, Dan. And I would start by saying we are not ambivalent. The way we think about it is always putting the client first. So it's really about the client and how do we solve for them and make their world easier and that's what led us to be the first launch an ADP Marketplace. It is the largest HCM marketplace.

We have over 800 integrated solutions across the globe actually as well. So we've expanded the footprint in the last year or so internationally, and it's really about providing those clients the choice and the ability oftentimes to connect their systems and their views on their workforce, their views on things like compliance, their views on whether it's time.

So it's not an ambivalent, it's really quite the opposite. It's really about putting the client first and extending our capabilities to meet the clients' needs and demands. And that's exactly what the marketplace does.

What I was excited to share during today's call was also our approach with respect to doing that in a secure and ethical data way in this new world of AI. And so we have AI agents kind of partitioned off inside of our ADP marketplace to make sure that they're operating the right way for our clients in conjunction with us, and that's really exciting as we think about, again, clients that are navigating all of these things across the HCM landscape to do the right thing for their employees and their workforces and how we can show up there and make that work for them as an imperative piece to our strategy.

Operator

Thank you. This concludes our question-and-answer portion for today. I'm pleased to hand the program over to Maria Black for closing remarks.

Maria Black - *Automatic Data Processing Inc - President, Chief Executive Officer, Director*

Thanks, Michelle, and thank you, everyone, again, for your interest and for joining us. As you probably heard throughout the call today, I believe deeply in the world of work. I believe everything that it represents all the beauty and human connection and what work means to people. And I also believe that this is a defining moment for our industry for human capital management. The leaders need to lead at this time and need to lead in this world of work, and that's exactly what the leader is doing.

That is what we are doing. That is how we show up today for our insight, is how we show up today for our stakeholders with our results. So I'll end with where I ended the prepared remarks, which is that every single result, every single award, every single client, that's an extension of us and our culture that we serve and every innovation that we're bringing to the market it starts with our ADPers and our ADP associates. And I couldn't be more proud and grateful to represent us all today. So thanks for the time.

Operator

Thank you for your participation. You may now disconnect. Everyone, have a great day.