Corrected Transcript

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Aon Plc (AON)

Q1 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and thank you for holding. Welcome to Aon Plc's First Quarter 2018 Earnings Conference Call. At this time, all parties will be in a listen-only mode until the question-and-answer portion of today's call. If anyone has an objection, you may disconnect your line at this time.

I would also like to remind all parties that this call is being recorded and that it is important to note that some of the comments in today's call may constitute certain statements that are forward-looking in nature as defined by the Private Securities Reform Act of 1995. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical results or those anticipated. Information concerning risk factors that could cause such differences are described in the press release covering our first quarter 2018 results as well as having been posted on our website.

Now, it is my pleasure to turn the call over to Greg Case, President and CEO of Aon Plc.

Gregory C. Case
President, Chief Executive Officer & Executive Director, Aon Plc

Thanks very much, operator, and good morning, everyone. Welcome to our first quarter 2018 conference call. Joining me today is our CFO, Christa Davies. For your reference, I'd note that there are slides available on our website to follow along with our commentary today.

Before we discuss the financial results of the quarter, I'd like to reflect on Aon overall on our decade-long mission to be the leading global professional services firm, delivering a broad range of risk, Retirement and Health Solutions, enabled by proprietary data and analytics. We have taken significant steps to evolve into the firm you see today. As you know, nearly a year ago, we completed the divestiture of our outsourcing platform, a meaningful acceleration of our proven strategy. The divestiture was just one step in our journey, but it was a step that provided a further catalyst for our actions to unlock the next wave of shareholder value, as it reinforces our focus as a professional services firm; further aligns Aon's portfolio around our clients' highest priorities; generates significant capital to accelerate investment in innovation and emerging client needs; provides a catalyst to unite our firm under one operating model, creating greater efficiency and operating leverage; and reinforces our return on invested capital, decision-making priority and emphasis on delivering double-digit free cash flow growth over the long term.

Our optimism is built through our conviction that these actions will substantially strengthen our firm on the heels of a decade of industry-leading improvement and innovation for our clients and shareholders. With this momentum, we're already seeing improvement in our growth profile to provide new investment in high growth, high margin areas across our portfolio. Organic revenue has increased from 3% in both 2014 and 2015 to 4% in 2016 and 2017.

Our journey continues, as we focus on driving greater innovation and more insightful content to deliver improved outcomes on behalf of our clients. Stronger growth, combined with increased operating leverage and free cash flow margin, reinforces our long-term outlook and the significant upside we anticipate in the value of our firm over the coming years.

Now turning to the quarter on page 5 of the presentation. Consistent with previous quarters, I'd like to cover two areas before turning the call over to Christa for further financial review. First, our performance against key metrics we communicate to shareholders. Second, overall organic growth performance, including continued areas of strategic investment. I would also note that the financial results discussed on today's conference call and shown in the presentation slides, are all on a comparable basis year-over-year, adjusting 2017 results retrospectively to pro forma amounts which include the impact of the revenue recognition accounting change that was formally adopted as of the first quarter 2018.

On the first topic, our performance versus key metrics. Each quarter, we measure our performance against the key metrics we focus on achieving over the course of the year: grow organically, expand margins, increase earnings per share, and deliver double-digit free cash flow growth. In the first quarter, organic revenue growth was 3% overall, driven by strong growth in Reinsurance and Commercial Risk Solutions. Also noting double-digit growth overall in total revenue.

Operating margin increased 230 basis points and operating income increased 22%, primarily reflecting savings from investments in our Aon United operating model and core operational improvement. EPS increased 26% to $2.97, reflecting both strong operating performance and effective capital management, partially offset by a higher effective tax rate.

And finally, adjusted free cash flow increased $28 million or 16% when excluding the near-term impacts resulting from the divestiture, primarily reflecting strong operational improvement. Overall, a strong start to the year with positive performance across each of our key metrics in what is now our seasonally largest quarter.

Turning to slide 7, on the second topic of organic growth and strategic investments. Reported revenue growth in the first quarter increased 13% year-over-year or 8% excluding favorable FX translation, which is an acceleration above historical levels of 6%. Organic revenue growth was 3% overall in the first quarter, driven by strong growth in both Reinsurance and Commercial Risk Solutions.

Reflecting on each of our core growth platforms. In Commercial Risk Solutions, organic revenue growth was 4%, an acceleration from 2% in the prior-year quarter. On average globally, exposures were modestly positive and the impact from pricing was modestly negative, resulting in a relatively stable market impact overall.

We saw solid growth globally across most geographies, driven by more than $200 million of total new business generation and strong management of our renewal book portfolio. Results reflect strong growth across the Americas including double digit growth in both Canada and Latin America, as well as particular strength in U.S. retail, driven by a 17% increase in new business generation.

Internationally, growth was driven by strength in the EMEA region, again, highlighted by substantial new business generation, up 26% versus the prior year. Finally, total revenue growth excluding favorable FX increased 14%, driven by the inclusion of our UMG and Henderson acquisitions in EMEA.

In Reinsurance Solutions, organic revenue growth was 6%, an acceleration from 4% in the prior year quarter, a really strong performance on what is now our seasonally largest quarter for Reinsurance. Market impact was modestly positive on results in the quarter reflecting both a continuation of moderating pricing and modest upward pressure in [ph] loss-exposed (00:07:07) geographies, partially offset by clients adjusting their buying behavior as industry pricing fluctuates.

Results reflect strong growth across every major category, again, this quarter including treaty, facultative, and capital markets transactions. We saw particular strength in treaty placements, driven by another quarter of net new business generation. Looking ahead for Reinsurance, we would remind you of the strong second half comparable for 2018, as 2017 benefited from a higher than normal catastrophe season and capital markets activity albeit what are now our seasonally smallest quarters.

In Retirement Solutions, organic revenue growth was flat compared to 2% in the prior year quarter. Results reflect solid growth in investment consulting, including continued double-digit growth in delegated investment management solutions, reflecting an increasing client demand for Aon's tailored solutions and objective advice.

We also saw a growth in our talent rewards and performance practice for assessment services, an area of recent M&A investment. Results were offset by a modest decline in project-related work and an unfavorable impact from timing of certain revenue into future quarters in the talent practice.

In Health Solutions, organic revenue growth was flat against a strong comparable of [ph] 50% (00:08:25) in the prior year quarter. We saw solid growth in health and benefits brokerage, highlighted by particular strength internationally across Asia and EMEA regions to provide strong management of the renewal book portfolio.

We also saw solid growth in the U.S., with double-digit growth in voluntary benefits, an area we have seen increasing client demand as employers look to tailor their benefit strategies to offer their employees cost-effective options outside of traditional coverage. Results in the quarter were unfavorably impacted by certain project-related work that benefited the prior year quarter in our healthcare exchange business.

In Data & Analytic services, organic revenue growth was 1% compared to 6% in the prior year quarter. We saw continued growth in our core Affinity business with particular strength in the U.S. and EMEA. Results in the quarter were offset by an anticipated unfavorable impact from changes in certain client contracts, most notably the transition of a certain government contract in our flood business.

Overall, a strong start to the year despite some quarterly noise due to timing and tough prior year comparables. Driven by an improved portfolio of mix and significant investment in high growth areas, we continue to position the firm for improved long-term growth.

Turning to slide 8 to discuss areas of strategic investment. Clients continue to navigate an increasingly volatile world with natural disasters combined with economic, demographic, geopolitical forces and the exponential pace of technology change, all converging to create a challenging new reality for businesses. Aon has a strong track record of allocating capital to developing innovative first-to-market solutions to help solve problems and create differentiated value in response to specific client needs. These strategic investments in high growth areas, driven by our ROIC decision-making process are improving the firm's long-term growth profile and increasing operating leverage across the portfolio.

We're investing organically and through M&A across the portfolio in areas such as Data & Analytics, deliver better client outcomes through content-driven insight; cyber risk advisory, expanding on the acquisition of Stroz Friedberg; health and elective benefits brokerage, as global employers are increasingly focused on improving their overall benefits packages; healthcare exchanges where we offer the broadest set of solutions and help, geographically with the recent acquisitions of UMG and Henderson, reinforcing our industry-leading position in EMEA; and, finally, in delegated investment management solutions, a business with rapidly growing client demand with the recent acquisition of the Townsend Group, bringing a greater depth of expertise in real estate assets to our distribution scale, and increasing our ability to provide alternative private market assets.

In summary, results in the first quarter represent a strong start to the year, with significant double-digit growth across revenue, operating income, earnings per share, and adjusted free cash flow. We believe our unmatched level of investment in content, in client-serving capabilities, combined with improved operational performance through our Aon United operating model and effective capital management place us on track to exceed $7.97 of earnings per share in 2018, and more important, unlock significant shareholder value through double-digit free cash flow growth over the long term.

I'm now pleased to turn the call over to Christa for further financial review. Christa?

Christa Davies

Chief Financial Officer & Executive Vice President, Aon Plc

Thank you so much, Greg, and good morning, everyone. As Greg noted, our first quarter results reflect positive performance across each of our key metrics, highlighted by strong organic revenue growth in Commercial Risk and Reinsurance Solutions, substantial operational improvement and double-digit growth in adjusted free cash flow. We are continuing to drive efficiencies in our operating model and allocate capital to the highest return opportunities.

As Greg previously highlighted, the financials discussed on today's conference call and shown in the presentation slides are all on a comparable basis year-over-year, adjusting 2017 results retrospectively to pro forma amounts that include the impact of the revenue recognition accounting change that was formally adopted as of the first quarter 2018. Please refer to pages 11 to 15 of the press release schedules for financials that provide a comparable year-over-year view. And similar to last year, we've provided nine quarters of comparable financials in Excel format on our Investor Relations website.

Turning to slide 10 of the presentation. Our core EPS from continuing operations excluding certain items increased 26% to $2.97 per share for the first quarter compared to $2.35 in the prior year quarter. Certain items that were adjusted for in the core EPS performance, and highlighted in the schedules on page 11 of the press release, include non-cash intangible asset amortization, non-cash restructuring charges and non-cash expenses related to pension settlement. Results included a net $0.12 cent per share favorable impact from changes in foreign currency exchange rates and certain hedging programs, including a $0.19 per share favorable impact from FX translation, primarily driven by a weaker US dollar versus the euro, partially offset by a $0.03 per share loss on the re-measurement of assets and liabilities in nonfunctional currencies, recognizing other expense and last through from the prior quarter benefited from a $12 million or $0.04 per share reduction in expenses related to certain hedging programs

If [ph] currency (00:13:50) remains stable at today's rates, we'd expect foreign currency translation to have an immaterial impact in the second quarter and the remainder of 2018. Lastly, included in the results was a $7 million or minus $0.02 unfavorable impact from losses on certain long-term investments recognized through other expense.

Turning to the next slide to discuss our strong operational performance. Operating income increased 22% and operating margin improved 230 basis points to 31.8% compared to the prior-year quarter. Operating margin improvement primarily reflects 160 basis points of savings from restructuring initiatives and other operational improvements before any reinvestment and 90 basis points of core improvement. This was partially offset by a minus 20 basis point net unfavorable impact from FX translation and certain hedging programs.

From a dollar standpoint, operating income increased $174 million, with $52 million driven by incremental savings before reinvestment and $45 million of net favorable impact from FX translation and certain hedging programs. The remaining $77 million or 10% growth year-over-year was driven by solid organic revenue growth and core operational improvement, a strong start to the year operationally as we continue to execute against our multiyear investment in the firm and improve on invested capital across the portfolio.

I'd like to spend a few minutes discussing the investments we're making to create our next-generation global business services model that allows a better scalability, flexibility, and enhanced colleague and client experience. These investments are intended to create one operating model with increased operating leverage.

Our primary investment areas are across IT, real estate, and people. In IT, we expect to create greater insight from data center optimization, application management, and strategic vendor consolidation. In real estate, we expect to drive greater collaboration and engagement through real estate portfolio optimization. And in people, we expect to create scalable and efficient operations using centers of excellence and third-party providers.

As part of these operating model investments, we expect to invest an estimated $1.17 billion in total cash over the three-year program from 2017 through 2019. These investments include an estimated $975 million of cash charges. We incurred $497 million of expense and spent $280 million of cash in 2017. Future cash outlay is expected to increase modestly in 2018 then expected to decline each year thereafter. And an estimated $200 million of incremental capital expenditure investment with $27 million incurred in 2017, approximately $100 million expected in 2018, and $70 million expected in 2019. There is an additional estimated $50 million of noncash charges included as part of asset impairments.

Overall, we expect these investments and other expense discipline initiatives to deliver $450 million of estimated annual savings in 2019 before any potential reinvestment. Further, we have been deploying the balance of the proceeds from the sale of our outsourcing business to the highest return on capital opportunities, including investments in high-growth, high-margin areas across our portfolio and direct return to shareholders through share repurchase.

Turning to the next page. In the first quarter, we incurred $74 million of restructuring related charges compared to $144 million in the prior year quarter, primarily relating to workforce reduction and other general initiatives. Since inception, we've incurred $571 million of restructuring-related charges representing 56% of the updated total program estimates.

The cash impact in the first quarter was an outflow of $98 million, compared to $31 million in the prior-year quarter. We also incurred $15 million of additional capital expenditure compared to $1 million in the prior-year quarter. We recognized $63 million of savings in the first quarter compared to $11 million in the prior-year quarter, and $228 million of savings since inception of the program, representing 51% of the expected $450 million total program savings.

Now, let me discuss a few of the line items outside of operations on slide 14. Interest income increased $2 million to $4 million, reflecting additional income earned on modestly higher cash balances compared to the prior year quarter. Interest expense was similar at $70 million. Pension income increased $1 million to $9 million. As noted at yearend, beginning in Q1 of 2018, we adopted a new accounting standard that shifted the financial components of [ph] net period of pension costs and net period (00:18:49) post-Retirement benefit costs from above the line in compensation and benefit expense to below the line as part of other income expense.

Other expense of $17 million primarily includes $10 million or minus $0.03 of losses due to the unfavorable impact of exchange rates on the remeasurement of assets and liabilities in nonfunctional currencies, as well as $7 million or minus $0.02 of losses on certain long-term investments. Based on current assumptions, we believe that approximately $10 million per quarter is the right run rate to model for other income expense in 2018, primarily related to pension income, excluding all other items we do not forecast that could be favorable or unfavorable in any given period.

Turning to taxes, the adjusted effective tax rate on net income from continuing operations, excluding the applicable tax impact associated with certain non-GAAP adjustments, increased to 16.5% compared to 13.3% in the prior year quarter, primarily driven by changes in geographic distribution of income as well as various impacts relating from U.S. tax reform.

The adjusted effective tax rate in both periods included a net favorable impact from certain discrete items, primarily relating to share-based compensation. We continue to believe the best estimate of our full-year non-GAAP effective tax rate is approximately 19% based on current interpretation of changes in U.S. legislation, assumptions of geographic mix of income, and impact of discrete items.

Lastly, weighted average diluted shares outstanding decreased 6% to 250.2 million in the first quarter compared to 267 million in the prior quarter, as we continue to effectively allocate capital including the repurchase of 3.9 million Class A ordinary shares for approximately $550 million in the first quarter. The company has approximately $4.9 billion of remaining authorization under its share purchase program.

Actual shares outstanding on March 31 were 245.2 million and there are approximately 4 million additional dilutive equivalents. Estimated Q2 2018 beginning dilutive share count is approximately 249 million, subject to share price movement, share issuance and share repurchase.

Now, let me turn to the next slide to discuss our solid balance sheet and financial flexibility. At March 31, 2018, cash and short-term investments decreased to $715 million. Total debt outstanding increased modestly to $6.1 billion, and total debt to EBITDA on a GAAP basis for continuing operations decreased to 2.6 times. As discussed previously, while debt to EBITDA will be initially elevated as a result of the sale of our outsourcing business, we expect to return back to the 2 to 2.5 times range by the end of 2018, driven by operational improvement.

Reported cash from operations for the first three months of 2018 decreased $42 million to $140 million, primarily driven by $67 million of incremental cash restructuring charges partially offset by operational improvement. Excluding certain near-term impacts resulting from the divestiture, including restructuring initiatives, adjusted free cash flow increased $28 million or 16%. Adjusted free cash flow growth was primarily driven by strong operational performance in the quarter.

A reconciliation of adjusted free cash flow to reported cash flow from operations is provided in Appendix E of this presentation. As cash outlays from near-term restructuring initiatives wind down in 2019 and beyond, we would expect adjusted free cash flow to converge with reported free cash flow.

The new revenue recognition accounting change did not have an impact on total cash flow or free cash flow. Appendix F of the presentation provides a pro forma comparable view of cash flow from operations for the prior year showing that cash flow is completely unaffected by the revenue recognition accounting change.

Turning to the next slide to discuss our free cash flow growth over the long term. We value the firm based on free cash flow and allocate capital to maximize free cash flow returns. This disciplined capital management approach is focused on a decision-making process that maximizes return on invested capital which we have consistently improved each year since 2010, increasing 610 basis points to 17.8% in 2017.

We've also taken significant steps to maximize the translation of each dollar revenue into the highest amount of free cash flow, including working capital initiatives and actions to manage our cash pension contributions. Since 2010, we've increased our free cash flow margin by nearly 1,000 basis points. In 2017, our free cash flow margin on underlying basis, excluding the impact of the divestiture was 17.8%.

Looking forward, we expect two main drivers to continue to contribute to incremental free cash flow generation. The first is continued operational improvement, driven by accelerating organic revenue growth and further margin expansion. The second is working capital improvement, as we focus on closing the gap between receivables and payables. We expect working capital to contribute to free cash flow by over $500 million over the long term.

In summary, performance in the first quarter reflects a strong start to the year and continued progress against the actions we're taking to strengthen the firm. We believe that accelerating revenue growth and continued operational improvement, combined with significant financial flexibility and strong adjusted free cash flow generation, position the firm to deliver on our near-term goal of exceeding $7.97 adjusted earnings per share in 2018.

As Greg noted, we're excited about the long-term outlook and our ability to deliver double-digit free cash flow growth, combined with an expected reduction in total shares outstanding, representing substantial upside and what we believe is the next significant value creation opportunities for shareholders.

With that, I'd like to turn the call back over to the operator for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question will come from Dave Styblo of Jefferies. You have an open line.

David Styblo
Analyst, Jefferies LLC

Q

Hi, there. Good Morning, and happy Friday, guys.

Gregory C. Case
President, Chief Executive Officer & Executive Director, Aon Plc

A

Same to you. Thanks.

David Styblo
Analyst, Jefferies LLC

Q

Wanted to just come back to slide 11. I don't think I'm quite triangulating the math quite right on the margin expansion year-over-year. So, it's apples-to-apples, you're up 230 basis points on operating margin, 160 basis points of that is from the restructuring savings. And then I think the FX will have a drag of 20 basis points. So that would made it – that accounts for another 20 basis points. So, is the difference there of your operating margin – you know what I think I've actually just solve my own questions. Sorry about that. [indiscernible] (00:26:16)

Christa Davies
Chief Financial Officer & Executive Vice President, Aon Plc

A

So, you got 90 basis points of margin expansion from the [ph] core base (00:26:20)...

David Styblo
Analyst, Jefferies LLC

Q

Yeah, yeah.

Christa Davies
Chief Financial Officer & Executive Vice President, Aon Plc

A

Does that make sense?

David Styblo
Analyst, Jefferies LLC

Q

Yeah. I missed that last point there. Okay. So that's self-explanatory. As far as, as you go forward to the rest of the year and your outlook on organic growth, I know, you guys don't typically give guidance. You started the year at 3% here and you do have some tough comps in Reinsurance for the back half of the year. Management's goal has been to continue to accelerate organic growth over the next couple of years here. Is that going to be hard to do this year, just given the dynamics from 2017, or do you guys already have visibility on some areas of new business wins that give you confidence that you can at least match last year's 4% or possibly even move it higher?

Gregory C. Case
President, Chief Executive Officer & Executive Director, Aon Plc

A

Yes. David, our message is consistent. But while there's a little bit of noise back and forth on the different revenue lines in the quarter, when we think about the year in 2018 and beyond 2018, we think this quarter – we view this quarter as just another quarter of on-track progression. So, if you go back and think about sort of our investments in the higher margin, higher growth areas, historically go back a few years ago we're, kind of, 3%, 3%. The last two years, we're at 4%, 4%, again, on track, sort of to continue that progress. And if you think about sort of what happened in the quarter, 13% reported, take out the FX we're 8% – by the way that 8% is higher than our 10-year average reported, which is at 6%. So from our standpoint, this quarter is just another step on a progression for organic growth, margin improvement, and as Christa importantly pointed out, free cash flow growth improvement.

David Styblo
Analyst, Jefferies LLC

Q

Okay. And then, more broadly, as you look across your portfolio in terms of maybe a matrix of both geographies and product lines or solutions, can you talk a little bit more about market share upside potential and margin expansion headroom? I'm just trying to get a sense if you're maxed out on some countries or solutions and similarly, what areas of your business are perhaps underperforming not quite at targets where you see opportunity, other than the things that you're doing with the BPO cost savings?

Gregory C. Case
President, Chief Executive Officer & Executive Director, Aon Plc

A

Well, let's come back again, I'll sort of point you back to – I'll talk about sort of top line, and Christa maybe can comment on the margin piece a little bit as well. Listen, one of the things that we're excited about, we talked a year ago about the divestiture of our outsourcing business, which was yet another catalyst for the next step in the progression of Aon, both to reinforce our work as a professional services firm, it also reinforce strongly our ability to continue to bring together Aon United, how we deliver our global firm to our clients in a local way. And that means we can invest more and more in a single operating platform, a single P&L. All these things are driving greater operating leverage and are fueling the performance improvement, the operating margin improvement you're seeing.

And then what we also did is broke out the five revenue lines. You could really see we're making investments and we like the opportunities across all five of the lines. In particular, areas to create net new demand. So if you think about in Commercial Risk, what we're doing in cyber to change the game in cyber, to create net new demand, real set of opportunities.

In Reinsurance, we see tremendous opportunities to create net new demand with what is a truly industry-leading leadership teams. So think about what we just did or have done historically in the U.S. mortgage world in which we created net new demand in the U.S. mortgage world to the tune of $10 billion in premium. You saw us displace what is a very, very unique [indiscernible] (00:29:27) in the marketplace. First of its kind, for the World Bank for four countries who face quake risk they couldn't recover from in prior periods. So, these are real innovations, sort of, in Reinsurance. You're seeing the same on the Retirement side, in what we're doing with delegated, on the Health side, in what we're doing with the exchanges. And then very excited about what we're doing with Data & Analytics to, again, create areas of net new demand.

So, for us, Dave, we really did see the [indiscernible] (00:29:51) outsourcing business as a real catalyst. And what you see in the first quarter is just the continued progress against that. But in terms of margin, Christa, anything you'd add to that?

Christa Davies
Chief Financial Officer & Executive Vice President, Aon Plc

A

Yeah. The thing I'd say, Dave, is we do see margins continuing to accelerate, and there are a number of things driving that. One, obviously, is bringing together the Aon operating model under one operating model. And you can see the progress there in terms of the savings, $165 million of restructuring savings in 2017. We're on track to deliver the $300 million of savings in 2018 and, again, on track to deliver the $450 million of savings next year in 2019. So, that's obviously contributing to margin expansion.

The second thing I'd say is we are continuing to improve on the core margins of our business through great work across the whole of Aon, which is just terrific. And the third I'd say, which is really the area Greg highlighted, which is we continue to invest in higher revenue growth, higher margin, higher return on capital areas, which is building leverage into the business. And I think Data & Analytics is the best example of that. It's a very high margin business, and that is translating through the higher free cash flow growth. So, we're very excited about the future growth in revenue, margins, and free cash flow.

David Styblo
Analyst, Jefferies LLC

Q

Okay. Thank you.

Operator: Our next question will come from Sarah DeWitt of JPMorgan. You have an open line.

Sarah E. DeWitt
Analyst, JPMorgan Securities LLC

Q

Hi. Good morning. The near-term goal of at least $7.97 of adjusted EPS this year, I imagine when you said it, you didn't assume that there would be $0.16 of FX benefit this quarter. So, should we be thinking about that as you can hit $7.97 this year ex-FX?

Christa Davies
Chief Financial Officer & Executive Vice President, Aon Plc

A

So, Sarah at the time of the transaction in May 2017 we gave guidance of exceeding $7.97 EPS in 2018 as you said. We're not updating guidance on a quarterly basis based on tax headwinds, FX tailwinds or frankly much stronger operating performance. We do believe we're on track to exceed $7.97 and the results in Q1 demonstrate this.

Sarah E. DeWitt
Analyst, JPMorgan Securities LLC

Q

Okay. All right. Thank you. And then just on the share buybacks. How should we think about the pace of that going forward, is a good proxy to think about adjusted income less dividends is being available for buybacks given that I think your preferred [ph] way to deploy it, giving (00:32:23) the returns in the business?

Christa Davies
Chief Financial Officer & Executive Vice President, Aon Plc

A

Yes. I think that's absolutely right, Sarah. What I would say is if you look at free cash flow, we've got a use of cash on restructuring, we've got a use of cash on dividends and then that is essentially cash available for share repurchase, investment in organic opportunities and investment in M&A. And as you've seen we continue to invest to ensure [indiscernible] (00:32:47) remains the highest return on capital opportunity across Aon.

And then the other thing I would note, Sarah, is as we grow operating income and free cash flow over the long term, you should expect that we'll grow debt to keep that debt to EBITDA in line with the ratio I outlined.

Sarah E. DeWitt
Analyst, JPMorgan Securities LLC
Q

Okay, great. Thank you.

Operator: Our next question comes from Arash Soleimani of KBW. You have an open line.

Arash Soleimani
Analyst, Keefe, Bruyette & Woods, Inc.
Q

Thanks. Just quick question in terms of the tax rate, I know before you'd put a 19% expected rate for this year. Just curious if that changes, has changed at all based on increased clarity that you may have received in terms of the tax code?

Christa Davies
Chief Financial Officer & Executive Vice President, Aon Plc
A

Arash, we do believe that 19% is the correct rate for the full year 2018. And so what you're really seeing is a lower tax rate in Q1 and then a higher tax rate in Q2, Q3 and Q4 to average to 19% for the year.

Arash Soleimani
Analyst, Keefe, Bruyette & Woods, Inc.
Q

Okay, thanks. And I guess my next question is, are you seeing any changes in the demand for cyber especially with some of the European regulation?

Gregory C. Case
President, Chief Executive Officer & Executive Director, Aon Plc
A

Arash, as we've talked before we actually see tremendous client need sort of in this category. Virtually every client we talk to is addressing this question and it's a question of sort of at the board level, at the CEO level but also down on the operations of all of our clients businesses. So this is an area of increasing concern for them.

And as you've highlight, the $450 billion of reported loss last year there was against that kind of $3 billion in premium give or take. We are privileged to place a good portion of that. But if you think about $3 billion versus $450 billion, that's an area of substantial need and a great opportunity for us at Aon and as an industry to help our client support that. And that $450 billion, to your point, was largely U.S. based. When you think about the adoption of GDPR and the data requirements in Europe which literally kicked in this month, the reported requirements go up, which means the $450 billion is going to go into something that's closer to $1 trillion.

So you're absolutely correct. This is an area of high, high need for our clients and an area of substantial opportunity for Aon which is one of the reasons we've invested so heavily behind it both in traditional ways, core brokerage and all of the things we do around that. The arrangements we've set up on behalf of clients but also with the investments we made in just content and insight, and Stroz Friedberg as an example, who have an extraordinary insight into sort of specific incidents and how they occurred, and why they occurred. And we're applying that to underwriting characteristics and criteria to create more opportunity for our clients.

Q – [09QYVY-E Arash Soleimani]>: Thank you very much.

Operator: Our next question comes from Yaron Kinar of Goldman Sachs. You have an open line.

Yaron Kinar
Analyst, Goldman Sachs & Co. LLC

Q

Good morning, Greg and Christa. Just wanted to circle back to organic growth for a second. So, if I understand your comments correctly, ultimately, we shouldn't read too much into a bit of a slowdown in the first quarter here. And for the full year, you still expect steady, if not accelerating, growth. Is that a fair summation?

Gregory C. Case
President, Chief Executive Officer & Executive Director, Aon Plc

A

Yeah. And I think you summarized it very well. There might be some noise, sort of back and forth on the different revenue lines. But, again, take a step back. Literally, we feel the trajectory continues very positively on the growth side for us, again, going back over multiple years now. Going back four years, 3% and 3% going then to 4% and 4%, we think we're on a very good progression for the year.

And if you look at reported overall, as a firm, even though there was noise back and forth between the revenue lines, overall the firm were at 3% organic, 8% excluding FX reported, and 13% reported. So, these are very, very strong levels that continue to reinforce the growth trajectory of Aon. And, again, we look at this as kind of a single P&L. This is Aon overall delivering a growth top line, delivering operating improvement free cash flow growth, and that set of characteristics continues to look very positive.

Yaron Kinar
Analyst, Goldman Sachs & Co. LLC

Q

Okay. And then maybe if I dig a little deeper into organic growth, you called out a couple things there, specifically weaker project-related revenue in both Retirement and Health and also very strong growth in EMEA in Commercial Risk Solutions. So, I was just hoping that maybe you could give a little more color around the project-related revenue. And then on EMEA, can you maybe talk about how the UK is shaping up within EMEA? Is it also a contributor, or is it just so – are you seeing some weakening there that's offset by other growth in the region?

Gregory C. Case
President, Chief Executive Officer & Executive Director, Aon Plc

A

Well, let me make sure I get [indiscernible] (00:37:29) I think you're asking about specifically and then about EMEA and the UK. On the Health side again, this represents a category with just tremendous monumental opportunity to assist clients that's currently strong and it's increasing. It's a category you've seen us invest in substantially both organically and by M&A. Think about what we've done in the exchanges as well as M&A things like Admix.

We grew at 7% in 2017. And just to your point, we see 2018 as yet another year of similar growth in progress. So, all good things. There was a very strong comparable. 15% in 2017 and that was just some specific onetime initiatives to support clients which were terrific but as we think about the year very, very strong in terms of, sort of, how that's progressing.

And then on EMEA, we just have an exceptionally strong team in EMEA and the UK. And they've done fantastically well, double-digit new business growth which has been absolutely spectacular, sort of, across the region and in the U.K. We've also added capability. As I talked before about our two acquisitions, that also come online and done exceptionally well. So, for us, this is just an area of opportunity, and it continues to build, and we expect that progression to continue.

Yaron Kinar
Analyst, Goldman Sachs & Co. LLC

Q

And can you talk specifically about the project-related revenues both in Retirement and Health?

Gregory C. Case
President, Chief Executive Officer & Executive Director, Aon Plc

A

On the Health side, it was really more around, again as we implement major programs for clients, occasionally, there are programs that – particularly around some of the exchange work we do that are onetime, and the conversions and we had a number of those in the first quarter 2017 which was terrific. But again, it drove a 15% organic number in Q1. Again, if you think about we ended up 7% for the year and that's what we see progressing over time.

And on the Retirement side, it was really more around as we describe there's really more timing in a specific project and the timing was around again different initiatives we take on behalf of clients and how [ph] we word them (00:39:16) on behalf of clients that are going to roll into the second half of the year, not the second quarter but the second half of the year that we'll fully balance out. Again, no change to overall projection and views on the year in that category.

Yaron Kinar
Analyst, Goldman Sachs & Co. LLC

Q

Thanks. I appreciate the color.

Operator: Our next question comes from Elyse Greenspan of Wells Fargo. You have an open line.

Elyse B. Greenspan
Analyst, Wells Fargo Securities LLC

Q

Hi. Good morning. My first question, just going back to the conversation on margins. You guys saw a 230 basis points of margin improvement this quarter on 3% organic. Do you view this as sustainable level? And, I guess, what I'm also thinking about is, you guys told us there would be about – to get to the $300 million, we have about $135 million of saves for the full year. And you guys saw just under 40% of that level in the first quarter. So how do we think about the margin progression for the back three quarters in relation to just a different number of savings coming through, as well as, the 230 basis points of margin improvement you saw in the first quarter?

Christa Davies
Chief Financial Officer & Executive Vice President, Aon Plc

A

Yes. One other thing we would say, Elyse is, as we look at our revenue growth for the quarter, I know you'll focus on organic, we really focus on total because M&A is absolutely contributing to top line and bottom line performance, and we're incredibly excited about the $1 billion of M&A we did in 2016 and the $1 billion that we did in 2017.

And so, as we look at the 13% revenue growth for the quarter, that is absolutely contributing to margin expansion and we do expect margins to continue to expand in the second half of the year – well, in the balance of the year for a full-year margin expansion. And if you think about the progress on margins for the full year, that will continue to occur as the savings ramp in the balance of the year.

Elyse B. Greenspan
Analyst, Wells Fargo Securities LLC

Q

Okay. And that was actually, to your point on the acquisitions, that was another question I had. So really two parts, as we think about modeling is – you guys saw about 5% revenue growth from acquisitions this quarter. Can you help us just think through the amount that could come through in the balance three quarters, kind of what rolls off and when or maybe just high level? And then, in terms of margins, were the acquisitions that came through in revenue this quarter, were they accretive to your margins, meaning are they running at stronger margins than the rest of your business?

Christa Davies
Chief Financial Officer & Executive Vice President, Aon Plc

A

Yes. So, Elyse, we haven't given revenue or margin guidance from the acquisitions. What I would say on reported revenue is, if you look at the last 10 years, reported revenue has been 6% CAGR. And so that's a pretty good way to model revenue and certainly the way we think about it. Obviously, we're looking at the components of that, that are driven from organic versus M&A versus FX, but 6% reported is not a bad way to think about it because it's happened over a 10-year period of time.

As we think about margins, they're typically lower on a full year basis in the first year because we've got a bunch of integration costs associated with them. And so that's definitely a way to think about acquisitions as they come in. They'll contribute to revenue. They will be a little lower margin in the first year, and then obviously, for us to do M&A, it has to have a return on capital higher than buyback. And so it's certainly going to contribute in the long term.

Elyse B. Greenspan
Analyst, Wells Fargo Securities LLC

Q

Okay. Thank you. And then one last question, just going back to free cash flow quickly. Obviously, just some moving parts on each quarter, but the goal for the year, meaning 2018 is it still about double-digit off of the adjusted 2017, about that $1.8 billion number?

Christa Davies
Chief Financial Officer & Executive Vice President, Aon Plc

A

That is exactly right, Elyse. So, what we would say is our long-term growth of free cash flow is double digits. If you take the $1.8 billion in 2017, we will grow double digits this year. And as you think about uses of free cash flow, 2018 is the peak year for restructuring the use of cash. And so as restructuring tails off in 2019 and every year off that, you'll see free cash flow accelerate.

Elyse B. Greenspan
Analyst, Wells Fargo Securities LLC

Q

Okay. Thank you very much.

Operator: Thank you. I would now like to turn the call over to Greg Case for the closing remarks.

Gregory C. Case

President, Chief Executive Officer & Executive Director, Aon Plc

Thanks very much, everyone. I really appreciate you being part of the call and look forward to our discussion next quarter. Thanks very much.

Operator: Thank you, speakers. And that concludes today's conference call. Thank you, all, for participating. You may now disconnect.