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Aon Plc (AON)

Q2 2018 Earnings Call

CORPORATE PARTICIPANTS

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

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

OTHER PARTICIPANTS

Sarah E. DeWitt
Analyst, JPMorgan Securities LLC

Kai Pan
Analyst, Morgan Stanley & Co. LLC

Yaron Kinar
Analyst, Goldman Sachs & Co. LLC

Adam Klauber
Analyst, William Blair & Co. LLC

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.

Elyse B. Greenspan
Analyst, Wells Fargo Securities LLC

Jon Paul Newsome
Analyst, Sandler O'Neill & Partners LP

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and thank you for holding. Welcome to Aon Plc's Second Quarter 2018 Earnings Conference Call. At this time, all parties will be on 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 and 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 second quarter 2018 results as well as having been posted on our website.

Now, it's my pleasure to turn the call over to Greg Case, CEO of Aon Plc.

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

Thanks, John, and good morning, everyone. Welcome to our second quarter 2018 conference call. Joining me here today is our CFO, Christa Davies.

After many, many conference calls, we're excited to introduce a new approach today, all intended to be hopefully more helpful for all of you. Christa and I would like to start by highlighting our colleagues around the world delivered a strong result in Q2 and the first half of the year, reinforcing our continued momentum we talked about in the first quarter call as well.

Beginning on today's call, what we plan to do is post for you a comprehensive stand-alone document that provides both financial backup and a commentary on our strategic priorities, and really how our plans are producing results. And we're confident, you'll let us know how we can improve the new approach, but we really want to make sure you know what our intent is here, a broader-based conversation.

Fundamentally, the document we posted is meant to provide all that we would have covered in our initial commentary and more. And as a result, we plan to use our time on the call to provide a little bit more insight into the longer-term view for the firm. This approach will also allow us to describe two or three investment or growth areas that we think are strengthening our capability to serve clients pretty fundamentally. And, hopefully, you get the idea. We hope to give you a better insight on Aon and important areas around our firm, like our journey to deliver Aon United. And that's really a perfect place to start our discussion today.

The idea of Aon United at scale and the benefits that accrue when our global firm works together effectively are substantial. And it's not historically an area we would have covered on this call, but nonetheless it's a very important piece of our long-term success and a real growing strength of Aon.

You'll have seen we took significant steps over the last quarter to build on that strength, executing our announced changes to deliver more consistently. On a value proposition, we know our clients like and are demanding more and more, and we know it's distinctive. And this is really about how we make available to them the global capability of our firm tailored to them, fully suiting their business needs and objectives, and it will bring us together, the capability of Aon against client needs in a very broad-based way. It is highly effective, it's powerful, it's meaningful, and we call this Leading Aon United.

More specifically, you saw the thinking and the commitment reflected in our May 15 announcement, which described a number of these changes, all of which were designed to make it easier to bring the best of the firm to our clients. So you saw real movement around leadership. We established co-presidents, Eric Andersen and Mike O'Connor, two great colleagues of the firm who will be wonderful in these roles.

They'll also be overseeing a new global Aon Operating Committee, which also includes direction of global business services, all of which reinforces the single P&L that we announced in 2017 and really encourages Aon United decisions that accelerate growth by bringing the best of the firm to our client. So a series of moves around leadership.

Single brand; you saw us announce that we'd begin retiring the remaining business unit brands, primarily Aon ReSolutions and Aon Benfield, following on a similar step with Aon Hewitt in 2017. And I'm going to tell you, we're very excited about the prospect of 50,000 Aon colleagues going to market as Aon, I'm from Aon, reinforcing our priority to address client opportunities and innovation and really create a more distinctive solution. So a whole series of things around the single brand, around Aon.

And, finally, you saw a movement around innovation, a structural movement. We created leadership capacity to drive more effort and drive forward on our new Data & Analytics offerings. We expanded John Bruno's role to become CEO of Data & Analytic Services, and all this again designed to focus our investments and strengthen our innovation agenda and drive long-term growth. So, in the end, that's what this is all about, long-term growth.

The idea of Leading Aon United, for us, this is well beyond proving the value and the power of this idea and this ethic. We see very clearly so many examples of the economic leverage embedded in this pursuit. Now, our leadership focus and what you're seeing us do is how we deliver this more consistently, how we deliver this at scale across the firm.

And we believe this is highly relevant for a call like this with our long-term partners, as Leading Aon United is a source of client value. It's also very compelling for our colleagues. It's really a magnet to attract and retain talented leaders. And I will say, we've been laying the foundation for Aon United for over a decade, evolving our portfolio, investing in new content capability, bringing those pieces together, more closely together through programs like Aon Client Promise which we've talked about before, but a number of others as well.

But it's really just been in the last few quarters that we've truly entered the era of Aon United in taking more structural change to bring that about. And I would just say, again, in the spirit of the format here, let me just give you one example. And this is an example discussed last week with our colleagues of the large U.S. health system. And the example brings to life how colleagues come together to talk to clients. And this historically have been a strong Commercial Risk clients who imagine we're in the room with the risk manager and our Commercial Risk team, historically been a great client, as I described before.

As part of the Aon Client Promise work, which is a systematic way to understand client needs, our team began to understand this major U.S. health system had a desire and a strategy to begin to have their hospitals really seek out sort of the idea of beginning to pay for outcome, so outcome-based payments. Obviously, this is a major trend. This client really wants to lead the way in that. And, obviously, a whole series of substantial operating challenges ahead for them to do that.

But our team, having heard that, stepped back. So this risk team gathered capability from around the firm. They brought commercial risk capability together more broadly. They brought our reinsurance analytics colleagues to the table. And after a few hours together, it was really clear. If our client is successful doing what they want to do, they're going to inject greater volatility into their business. They may be right in the first six or seven years, but in the eighth year if something happens to the population that they're actually trying to support, there's a lot more volatility, in fact, put the hospital at risk.

And when we talked to our client about it, they were absolutely concerned. They really want to understand what we could do. And in the end, our Reinsurance colleagues bringing to table analytic capability to model the risk to really understand what was on the table for them and then giving them solutions and ways they could potentially transfer the risk.

In essence, what our colleagues did is we went from a risk discussion on the commercial side to really a more strategy discussion of how we could enable their strategy and lower their volatility and lower their risk. And this was really, if you think about it, a constellation of colleagues which we brought together, broader Commercial Risk team with a Reinsurance team and a set of topics we never would have talked about before with this client.

And this Commercial Risk capability, the Reinsurance modeling, access to the markets literally changed the discussion with this client. And if you think about it, this opportunity for our colleagues was incredibly compelling. They're very excited to serve this hospital system in a much more broad-based way. Our clients are very excited and I don't need to tell you what that probably does back to our original relationship on the Commercial Risk side, what that retention would look like sort of over time. So, very, very powerful in terms of what this could be.

So, just to reflect sort of on those examples, these are the kinds of things that Aon United leadership enables us to do. In terms of financial impact, and what this brings for us, I want to just highlight three overarching takeaways that come out of the first half of the year.

The first, continued momentum, and we saw this in our quarterly results and truly just continues to increase the conviction we have that we're going to exceed $7.97 of EPS for the year, highlighted by a Q2 performance of 5% organic growth, margin expansion of 130 basis points, EPS growth of 31% and free cash flow growth of 17%, so strong momentum for the first half of the year and for the quarter.

Second, we are continuing to invest and to generate long-term growth, supported by our strong balance sheet and significant free cash flow. As I mentioned earlier, we believe Leading Aon United scale will translate into stronger organic growth, and we continue to invest in our inorganic opportunities that allow us to innovate faster than our clients on the topics that matter most to them.

Then again in the spirit of the new format, the example of the World Bank cap on, I talked about on the last call, very compelling to think about, that doesn't happen without Aon United behavior. When you're connecting the World Bank trying to protect Chile, Colombia, Mexico and Peru from earthquake risk that was heretofore not covered before, and you're trying to bring together a constellation of leaders in each of those countries and the World Bank, imagine who we have to bring to the table to make that happen.

But we have the analytic capability, the data capability to do this, but that wasn't enough. We also had the relationships in each one of the countries and with the World Bank to do it, but that wasn't enough. And it wasn't until we brought this whole group together that we have come up with a incredibly innovative solution, a $1.4 billion bond that, by the way, the World Bank invests back into the country. So it strengthens their economy and protects them from a risk that heretofore was never covered before in a real investment instrument that had never been brought to market before. So you get the idea in terms of sort of what this means for innovation on top of just client leadership.

And finally, it's important to highlight the long-term productivity improvements from our global business services model, also continue to enable additional investment in emerging client needs like cyber intellectual property. So, a whole series of things sort of come out of the quarter and come out of the first part of the year that reinforce the momentum. And what we want you to try to understand is this context underscores that Aon United is all about growth. As we discuss with our team, Aon United equals growth.

When we drive this set of behaviors on behalf of our clients, good things happen. Client leadership happens, retention happens, new client opportunities happen, innovation happens. And again, it's a simple concept to describe but difficult to replicate, and especially in our industry. And I would just say I'm very grateful to our team for their willingness to take on the opportunity and really excited by the progress we've made in these new expanded roles over the course of the quarter, over the course of the year, and what this means for us as we move Aon forward.

So, giving you a little perspective on a topic, again, we wouldn't have discussed on this call traditionally. For us, it's fundamental to the long-term growth of our firm and will drive long-term growth in our firm. And we want to give you a little context that you wouldn't have otherwise got to put sort of the results sort of into perspective.

And with that high-level summary in mind, I'd like to get Christa to offer a few thoughts and then we'll open it up for your questions. Christa?

Christa Davies

Chief Financial Officer & Executive Vice President, Aon Plc

Thanks so much, Greg, and good morning, everyone. In the spirit of this new format, I'll cover the key metrics and then to offer examples of how we're driving operating leverage and investing in Aon both organically and inorganically.

The steps we're taking and our strong progress here today continues to reinforce both our short- and long-term performance targets. Our performance through the first half reflects organic revenue growth of 4%, an acceleration from 3% in the first half of 2017.

In addition to accelerating organic growth, M&A is continuing to contribute, both improving the mix and driving total growth of 11% for the first half of 2018. Adjusted operating margins increased 200 basis points year-to-date, an acceleration from our historic average of 70 to 80 basis points a year over the last 10 years.

Accelerating revenue, combined with margin expansion, is delivering operating income growth, which was exceptionally strong at 20% year-to-date with core operating income growth reflecting half of the performance. EPS growth of 28% year-to-date places us firmly on track to exceed our short-term target of $7.97 in earnings per share for 2018.

And lastly, reported free cash flow decreased $52 million year-over-year, driven by increased restructuring, reflecting this is our peak year of restructuring cash usage. Adjusting for restructuring, underlying free cash flow grew 17% year-over-year, reinforcing our commitment to double-digit free cash flow growth and even stronger performance when combined with the 6% reduction in shares outstanding.

Overall, the strong financial performance and long-term outlook are supported by the investments we're making in our operating model in an Aon United way, as Greg described. Through the creation of our next generation of global business services model, we are creating greater scalability, productivity and operating leverage.

One example is the consolidation of all of our North American call centers across all of our solution lines. We implemented a single industry-leading cloud platform with global reach. It's resulted in higher support for clients, better flexibility and managing capacity, and cost savings of approximately $10 million annually.

Another example is consolidating our procurement spend globally. We now manage approximately 80% of our spend or $2 billion across nine major categories and full regional hubs. That's up from about $1 billion of spend across four categories in our two largest countries.

To do this, we implemented a cloud-based procure-to-pay solution across 60 countries, supported by an offshore model. And that cloud platform is giving us greater insight into that total spend to be able to manage it more effectively over time. Through this, we've delivered $30 million of value in 2018.

These are just two examples of the long-term margin expansion that will continue through productivity improvements from our single operating model and the remaining savings from our restructuring program.

We're also making investments organically and inorganically to shift the portfolio toward higher growth, higher return on capital areas, with a strong discipline against capital allocation and maximizing return on invested capital.

An example of investment is in our delegated investment management business, where we've added over 50 colleagues and deep research capabilities in our core strength areas of DB and DC, while continuing to invest and expand capabilities in broader asset pools like insurance, sovereign wealth funds and the non-profit arena. This is driving double-digit organic growth through new client wins as well as driving significant inorganic growth with the acquisition of Townsend.

Since inception, our AUM has grown from $0 to over $150 billion AUM driven by strong performance, transparency fees and innovative solutions for clients. Another example of investments is the $950 million we invested in share repurchase in the first half of 2018. This remains the highest return on capital opportunity across Aon, given our valuation of Aon based on our free cash flow growth over time.

In summary, acceleration in revenue growth, greater operating leverage and continued working capital improvements of $500 million over time give us confidence in our ability to deliver double-digit free cash flow growth. Double-digit free cash flow growth, combined with the reduction in total shares outstanding, will drive significant long-term shareholder value creation.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin a question-and-answer session of today's conference. [Operator Instructions] Our first question is coming from Sarah DeWitt from JPMorgan. Your line is now open.

Sarah E. DeWitt
Analyst, JPMorgan Securities LLC
Q

Hi. Good morning and thank you for the new format. Just given your comments on the growth initiative in Aon United, where do you see the long-term organic growth profile of the company over time? I mean, clearly at 4% organic growth year-to-date, you're growing faster than the global economy. But where do you see that spread headed over the long-term?

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

So, first of all, Sarah, I hope you liked the format, love to get your comments, thoughts, if we can make it more helpful to you. But, again, we're trying to provide a little more perspective on sort of the long-term underpinnings of sort of what's driving results. And this idea on Aon United is exactly at the core of what you're asking about.

Aon United is growth for us. It really is about accelerating organic growth. That, plus M&A, we think is a very, very strong engine. And this idea of Aon United really fundamentally emanates from a client need, client view. They've talked to us about sort of how their needs are changing. They made it very clear when we bring our firm more effectively. It's very, very powerful.

And if you think about that, we've done a number of things to reinforce this organically around the firm. Things like Aon Client Promise, we've talked about, or the Aon Impact model and how our colleagues conduct themselves, things like articulating value, a whole series of things. But more recently, you've seen us take structural move. This is the new news. This is the news of the quarter, if you will, in terms of sort of how we're taking something we've done for a while and really accelerating it. And it underpins organic growth, full stop.

So we expect a continued progression. If you think about the last four years, 3%, 3%, 4%, 4%, and we've got momentum sort of building on that, and we expect to continue.

Sarah E. DeWitt
Analyst, JPMorgan Securities LLC

Q

Okay, great. Thanks. And then, just the expense savings, you've gotten $257 million to-date and you target $300 million for 2018. So should we expect a meaningful slowdown in the savings in the back half of 2018, or are you running ahead of schedule, or should we think about that ultimate target of $450 million as maybe being conservative?

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

A

Sarah, what we would say is where we're up to year-to-date gives us very strong confidence in being able to deliver this $300 million in savings in 2018 and the $450 million in savings in 2019. And so, we're really pleased with the progress and confident about where we're up to year-to-date, and we're not updating guidance for this year or next.

Sarah E. DeWitt
Analyst, JPMorgan Securities LLC

Q

Okay. Thank you.

Operator: Our next question is coming from Kai Pan from Morgan Stanley. Your line is now open.

Kai Pan
Analyst, Morgan Stanley & Co. LLC

Q

Thank you, and good morning. And thank you for the refreshing format. We're still adjusting to it. And the first question, a follow-up to Sarah's question, organic growth. You have seen acceleration. And could you tell us a little bit more about has the macro environment helped you on that? And going forward, is your growth or acceleration depend on macro environment, including further from here, or is a self-driven story?

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

A

Look, Kai, as we said before, listen, our strategy, our approach is not to rely on market condition. Our approach is to rely on client need and to address and deliver on client need, full stop. And you've seen us consistently do that quarter-after-quarter. And to Sarah's question, we now believe we have the mechanism in place to accelerate that.

And what you saw in the quarter overall from a market standpoint, look, at the end of the day, we still continue to see exposures are modestly positive. The impact from pricing, on average, flat. There are spikes in different places, but on average basically modest. So this isn't about the market, per se. This is about what we're doing to win more clients, retain more with those clients. We call it rollover, doing more with them, rollover. So, from our standpoint, we're going to continue to build that profile.

I just would note, you saw a real movement in Commercial Risk, you saw a real movement in the Reinsurance world, in the Health world, real movement in the Retirement world in terms of what we're trying to do. And so, for us, what we have in place is designed to drive organic growth. And what we do know for sure is client need around the world is substantial and continues to grow. And so, while we may lead a number of these markets, the world that we live in and our set of competitors are massively under-penetrated. So we believe there is substantial opportunity, irrespective of market conditions to drive organic growth.

Kai Pan
Analyst, Morgan Stanley & Co. LLC

Q

Okay. That's great. My second question is focusing on margin expansion. I hope you can comment on three particular points. Number one is the 130-basis-point margin expansion in the second quarter, mostly driven by the 160-basis-point savings, seems not a lot sort of operating synergy or leverage I should say, given that organic growth 5%.

The second item is that, in the second half, the incremental cost saving will be much less than the first half. Does it mean the margin expansion would not be as strong? And the third item is you mentioned a little bit in your prepared slides about drag from the recent merger acquisition. I hope you can give a little bit, like, figures around it.

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

A

Kai, I'll certainly try and answer all those questions. So let's start with the facts. We are up 130 basis points in margin expansion in Q2 and we're up 200 basis points in the margin expansion for year-to-date.

In any quarter, there's movement and we'd highlight a few underlying drivers such as restructuring and FX, as you mentioned. And with these, our margins from the core standpoint are up 50 basis points year-to-date, a little more in Q1, and a little less in Q2.

That said, there are other impacts, as you mentioned, in the quarter. We have a minus 60-basis-point impact from M&A, and a minus 30-basis-point impact from FX, and a minus 30-basis-point impact from timing from E&O. And so we've got sort of substantial headwinds in the quarter, in addition to the investments we're making in growth.

And so, while it's easy to strip out certain items in and out of a quarter, we do manage margins overall for the year and that's why we feel very strongly about our margin expansion year-to-date at 200 basis points, and it gives us confidence at our full-year margin expansion, as you described, leading to margin expansion in 2019 and beyond.

And so, 2018 margin expansion will be driven by accelerating organic revenue growth, mix shift and operating leverage, both coming from restructuring and productivity.

Kai Pan
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Thank you for that detail. Last one if I may in the spirit of your new model. You also mentioned potentially inviting sort of the business leader to this conversation. I don't know if Eric or Michael is on the phone. So I would like to ask them, what has changed into their day-to-day operation under the new model compared with the quarters ago. You talked about the benefits. I just wonder is there a potential drawbacks or downside risks in the sort of implementation of the new model.

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

A

So, Kai, they're not on the call today. But what we'll do next till tee up, we'll actually start the call next time on sort of operational implications of Aon United, Eric and Michael comment on those directly, sort of all the things that are happening in the marketplace sort of on a positive way, and sort of how they're leading and managing that and how it's coming through.

I think what you're going to find as you talk to them is the opportunity here is so substantial. Again, the client need is great. This is all driven on client need. And when our colleagues get around the table and talk about client issues and those colleagues come from the full complement of capability we've got, we create all kinds of possibilities. And even when there's not a commercial outcome, the client thinks about us differently.

So, fundamentally, when we deliver Aon United capability, client perception changes and economics change, growth changes. So I think you're going to hear a lot about that. They can also talk a little bit about sort of the Aon operating committee they pull together. That really gives us a chance to sort of think about Aon United types of decisions in a way we've never done before. So, a lot of momentum on this.

And what we're excited about and I think you'll hear it in their conversation is, again, we've worked this for a decade on a number of different things we've done to create the conditions. Now we're taking structural change. Now we're doing things like the Aon operating committee, like the Co-Presidents, like the single P&L, like the single brand. These are things we've never done before that we believe will accelerate a proven concept and drive organic growth. So I agree with you. There'll be two highlights, Eric and Mike, for the next call.

Kai Pan
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Great. Look forward to.

Operator: Our next question is coming from Yaron Kinar from Goldman Sachs. Yaron, your line is now open.

Yaron Kinar
Analyst, Goldman Sachs & Co. LLC

Q

Hi. Good morning. First question, I guess it's more of a clarification point. Christa, the 30 basis points in E&O timing and 60 basis points in M&A drags on the margins, were those year-to-date or for the quarter?

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

A

They were for the quarter, Yaron.

Yaron Kinar
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Got it. And then, if you look at the second half of this year, you're running up against maybe tougher organic growth comps. You highlighted FX. There's a potential drag as well if currency remains as is. Do you think that – is margin improvement achievable ex restructuring fees?

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

A

Yes, it is, Yaron. So what I would say is, as we look at the full-year 2018 and the second half, we're going to drive margin expansion through organic growth, continued investment in M&A, mix shift across the portfolio as we continue to invest in higher growth, higher margin areas. The operational leverage we're getting in our business, both restructuring and the productivity, we're getting from the Aon United operating model.

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

A

And I would say, overall, Yaron, sort of we're continuing to build momentum sort of on the organic growth side. If you think about sort of where we've come in the first half of the year, very, very positive. The second half we think we'll have continued progress.

There are a couple of categories. You've got Reinsurance 8% sort of in the quarter and what we've done for the first half. We're also going to be by the way up against a high comp in the second half. We also had some events that happened sort of last year that may or may not happen. Assuming they don't happen, there'll be a little bit of a headwind to get some of those comps. But, frankly, we're going to continue to push and build momentum there.

Data & Analytics, on the other side of the equation, were negative for the quarter. As you see when we talked about, it's due to a single incident and we expect the second half to be more positive. So there are lots of puts and takes through the course of the year, but you can expect us to continue to build momentum sort of on the organic growth side.

Yaron Kinar
Analyst, Goldman Sachs & Co. LLC

Q

Okay. And Christa, you highlighted M&A as a potential source of margin improvement in the second half. Is that just the timing of the M&A that's already come in that now becomes accretive, or are there other elements there?

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

A

Yeah. So what I would say is, look, I wouldn't over-rotate on M&A in any one quarter. I'd say, over the course of the year, we expect investments we're making organically and inorganically in the business to contribute to margin expansion.

Yaron Kinar
Analyst, Goldman Sachs & Co. LLC

Q

Okay. And maybe one last quick one. The $7.97 EPS target, is that still in place even with the potential pressures from currency?

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

A

It certainly is, Yaron. So we feel really confident about exceeding $7.97 for 2018, driven by core performance, restructuring savings, the returns on the investments we made in M&A and allocation of capital.

Yaron Kinar
Analyst, Goldman Sachs & Co. LLC

Q

Great. Thanks so much.

Operator: Our next question is coming from Adam Klauber from William Blair. Adam, your line is now open.

Adam Klauber
Analyst, William Blair & Co. LLC

Q

Good morning, everyone. Free cash flow, I believe, peaked in 2016 around $2.1 billion. Do you think you will get back there by 2019 just roughly? Not looking for exact guidance. And then, once you hit that core rate again, will growth of free cash be higher than EPS or more in line with operating earnings?

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

A

Yeah. So, Adam, what I would say is we're not giving new cash flow targets. What we have said is we're going to drive free cash flow on a double-digit basis. You can see that on underlying basis year-to-date of 17%, which we're very pleased with.

And what you have seen and you will see in calendar year 2018 is we're at a peak year of restructuring cash usage. So you'll see free cash flow on a reported basis accelerate in 2019, and that reported and adjusted free cash flow will start to come together in 2019 as the restructuring cash outlay winds down.

As we think about free cash flow growth longer-term, you're really going to have operating income growth plus improvements in working capital. We've really outlined about $500 million of working capital primarily receivable sitting on our balance sheet that we will free up over the next couple of years that will contribute to strong cash flow growth. And strong double-digit free cash flow growth, combined with reduction in shares, will dramatically increase free cash flow per share over time.

Adam Klauber
Analyst, William Blair & Co. LLC

Q

Thanks. How should we think about – again, looking a bit more forward, not looking for guidance, but how should we think about CapEx and pension? Will they be positive or negative for free cash over the next couple of years?

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

A

So we'd given specific guidance on CapEx, and what we have said is CapEx is elevated in the current year and next year due to the restructuring program, and that is coming down. And then pension is also coming down over time.

Adam Klauber
Analyst, William Blair & Co. LLC

Q

Okay. And then just a follow-up on Health Solutions. A good quarter. I think you mentioned that there was strong growth in the U.S. I guess, what was driving the U.S. growth?

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

A

Again, Adam, step back and essentially think about sort of what we've done. As we described in the first quarter, we just had continued momentum in the first half of the year across sort of all aspects of the business. Certainly, in elected benefits sort of the work the team has done around the world, terrific. And H&B, the work the team has done is terrific, but really across the board sort of in the exchange businesses as well.

So it's just continued momentum on the Health side. So if you sort of think about what we've done historically sort of in Health for the year, last year at 7%, in the quarter you see 7%, so you're just seeing momentum overall. It really is performance across the board.

Adam Klauber
Analyst, William Blair & Co. LLC

Q

Yeah. Great. Thanks a lot.

Operator: Our next question is coming from Meyer Shields from KBW. Meyer, your line is now open.

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Great. Thanks. Greg, I don't want to overanalyze the comments you made with regard to the hospital strategic discussion. But am I right to think that having a strategic consultancy, something like McKinsey, within the portfolio of Aon companies would make those conversations more robust?

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

A

Listen, Meyer, I also don't want to overplay it. This is one example I pulled out. It was sort of a last week example. Our team is bringing solutions. So forget sort of the traditional kind of strategic consulting firms, full respect to them, but our team is bringing solutions. They not only brought a diagnosis of the situation, which frankly opened the eyes of the client, they brought a way to actually enable the client strategy. And in this case, my gosh, without that, there's a lot more risk in the process. So we've moved very much sort of around sort of a solution approach.

You combine that with our Data & Analytics we have in each one of the categories, when we're bringing to bear a set of – the ammunition is amazing, and it has always been amazing out there. Sort of the capability we've got, the data and analytics on the Commercial Risk side, on the Reinsurance side, on the Retirement side, on the Health side, we've just got an incredible platform to sort of draw from. And what we hadn't done before is taken that platform and pulled it together and brought it and put it in front of a client in a thoughtful way.

Aon Client Promise gave us, Meyer, the basis around which we can do that. It's the systematic way we listen to clients, understand their needs and react to those. And what we're doing is now breaking down structural barriers and making it easier for our colleagues to come together and talk about clients. I mean, there's another example I could use, which is a European headquartered, multinational building products company. You'd know it very, very well.

And, frankly, we had a very good relationship with them on the risk side. But they're under some real pressure from a performance standpoint. Our team brought together a full complement of folks from across our solution lines and came up with sort of a whole way for them to think about their benefits for their colleagues, for their employees, and did it in a way that we believe will increase engagement.

And it was a 50, 60-country answer. The client never would have thought about it and for God's sake never would have thought anybody could execute it until we set it on the table with, call it, 10 passports, talking to them about what we can bring to the table from 10 different countries I mean.

And so, there is just so much opportunity and in some new respects, Meyer, it's so obvious and so clear, but doggone hard to execute. You're getting colleagues to sort of work together in ways they hadn't before, bringing expertise in a more integrated way and we have to break down the barriers to do that. And as I said, we've proven this works exceptionally well. We've done it in one-off different situations.

Now, the new news what you're hearing is we're taking very structural steps to make it easier for our colleagues to do this. And the beauty is, when it happens, it doesn't have to result, as I said before, in commercial gratification immediately. This is changing the dialogue with clients. Our colleagues love doing that. It's reinforcing. It's contagious. In fact, it's a wonderful sort of outcome. And so, given all the capability, ours is do we have the leadership, will to make it happen, and that's what we're excited about.

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. No, that's very thorough, very helpful. Thanks. Two other quick questions. One, do the year-to-date results in organic fully reflect the strong acquisition activity of last year? And, Christa, can you identify the individual service lines that are most exposed to the FX headwinds on second half revenues?

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

A

Yeah. So, Meyer, the first thing I'd say is the M&A impact from last year does not impact organic. It adds to organic. And so, it doesn't reflect. And if you think about the M&A we did in 2017, most of it was in Q4. And so, what's showing up in organic this year is not M&A related to last year. There may be some portion of it that shows up in Q4. But some of those acquisitions were done in December Q4. So very little will show up this year.

And then, as we think about sort of the FX, we don't really break out the impact by solution line, but it's fair to say we do have local revenue and expenses in 120 countries. And so, we generally prefer a weaker U.S. dollar. And the big exception to that for us, Meyer, is the pound. But what you're seeing I think in the FX headwind in Q3 and Q4 is primarily related to Latin America.

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. Thank you.

Operator: Our next question is coming from Elyse Greenspan from Wells Fargo. Elyse, your line is now open.

Elyse B. Greenspan
Analyst, Wells Fargo Securities LLC

Q

Hi. Good morning. My first question, just a numbers question. There was about $103 million of legacy litigation that you guys pulled out of adjusted earnings in the quarter. Can we just get a little bit more color what did that stem from and is that something that we should think about impacting your earnings going forward?

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

A

Yeah. So, Elyse, what we would say is, we can't discuss the specific litigation, but one of the things you should get comfort from is we have taken a number of steps over time to reduce volatility at Aon. We've put in place limits of liabilities. We've purchased additional insurance.

And what you'll see when we file our Q later today is that we've decreased the estimated losses related to disclosed litigation from $300 million to $100 million as a result of the actions we're taking. And so, we're dramatically reducing really legacy litigation as we continue to take steps to drive growth across the firm.

Elyse B. Greenspan
Analyst, Wells Fargo Securities LLC

Q

Okay. And then in terms of – maybe a follow-up question on the margin side of things. You highlighted this quarter was impacted by 60 basis points from M&A and 30 basis points from currency. Should give us about $0.03 hit for the next couple of quarters.

How do we think about currency, I guess, the margin impact on a quarterly basis implied by that? And then also, based on your commentary, it seems like the drag from M&A will get better over the next couple of quarters. I'm just trying to tie together those numbers.

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

A

Sure. So the first thing I'd say, Elyse, is we don't give guidance on the FX impact on margin. It's frankly pretty difficult to predict. But what we can say is that, on an EPS basis, we expect $0.03 impact in Q3 and a $0.03 impact in Q4, primarily driven by Latin America.

And then, what we would say is we did have an impact, as you mentioned, minus 60 basis points from M&A in Q2. We'd expect over the course of the year for that to neutralize. I think we've spoken previously, when you do M&A, the first year of integration is largely a negative impact on margin. And so, as you integrate the business, and then longer-term it for sure drives margin expansion because we are investing in higher revenue growth, higher margin areas. So I hope that helps.

Elyse B. Greenspan
Analyst, Wells Fargo Securities LLC

Q

Yes. That's helpful. And then, in terms of just on the organic growth side, would you say – I guess, it seems like other than the one-off that you called out on the data side, that the quarter probably represents more or less of runway level, I guess aside from maybe some of the headwinds on the Reinsurance side.

And is that how we can kind of think about the growth level being sustained over the balance of the year? And just based off of how you guys see exposures and pricing and your ability to generate new business, how would you think about the organic growth outlook for 2019 as well? Do you have kind of an initial view at this point?

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

A

Well, Elyse, as you know, we don't give specific guidance on sort of the growth profile and what it's going to look like. What you have seen and I fully agree with you on, sort of the quarters will be variable and you sort of saw things move around in the quarter.

But over the course of the year, the first six months, it really is about continued momentum. And our goal each year is to sort of continue to build momentum. We have the structure in place to do that, the investments in place to do that. And that's really what we intend to do for 2018 and into 2019 and into 2020.

I want to emphasize again though, for us, this is not about pricing. This is really about what we do in the marketplace on behalf of clients to drive long-term value. That's going to be the driver of growth for us by far. And sort of pricing and insured values sort of are important to understand, but are not going to be the drivers for us. And so you'll see – our anticipation is continued momentum on the growth side in 2018 and in 2019.

Elyse B. Greenspan
Analyst, Wells Fargo Securities LLC

Q

Okay. And then one last question. One of your peers saw a slowdown in their defined benefits on consulting business. You obviously don't break out that line item. So I'm not sure how much detail you want to go into. But are you observing a slowdown in that business? Any color you can give us, and I'm assuming it's absorbed by growth within other areas of your Retirement business, if you are seeing that?

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

A

Well, listen, overall, when you think about sort of the Retirement piece, elements of this business are growing, elements are not growing. What we do know for sure back to the client orientation is that when you think about sort of retirements in the world today, roughly 20% of the population is prepared for retirement. Our companies, our clients are sort of dealing with that every day. It's becoming increasingly difficult for them to actually help their employees. Think about how they can deal with retirement.

So we're bringing to bear as best we can a full complement of ideas and perspectives to help them sort retirement. And we think that's our major set of opportunities long-term. Certainly elements within that will be positive and negative, but our view is overall.

But, Christa, thoughts on that?

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

A

Yeah. So what I would say, Elyse is, our results actually reflect solid growth in our core actual Retirement business. So we're very pleased. We've got a fantastic team serving clients. And it's driven by an increase in volume and rates across North America and EMEA. We're really helping clients solve a lot of pension issues around de-risking, taking risk off the table, given interest rates have risen.

And so there's a lot of opportunities for us to do that with clients, and we're very pleased with the progress we're making to-date. And at least it reflects a lot of the things that we're doing in our own pension plan at Aon as we continue to take risk off the table as you've seen, given the rise in interest rates and the ability to do that in the marketplace today.

Elyse B. Greenspan
Analyst, Wells Fargo Securities LLC

Q

Thank you very much.

Operator: Our next question is coming from Paul Newsome from Sandler O'Neill Partners. Paul, your line is now open.

Jon Paul Newsome
Analyst, Sandler O'Neill & Partners LP

Q

Good morning. The only question I really had was I'd like to, if you would, dive a little bit more into the organic growth for the Reinsurance segment. And it seems like, and tell me if I'm wrong, that pricing is a little weak, but customers may be buying more. What I don't know is whether or not there's actually a change in market share amongst the brokers themselves.

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

A

Listen, Paul, we step back and we would say overall market conditions continue to be, when I think about this from one standpoint, challenged from the stand -there's plenty of capital out there and lots of opportunity to serve our clients on that behalf.

But if you look at our fundamental results on the Reinsurance side, there continues to be the basics. It is success in treaty, it's success in fact, it's success in insurance-linked securities, it's across the board. By the way, it's another quarter of net new business win for us when you think about where we are.

The data and analytics our team has is exceptional. And just to reflect back, a few years ago on these calls, everyone was asking about what about growth, what about growth. I just would remind you it was a time when you literally were talking to the number one placer in the world on treaty. And basically, property was 60% of the revenues. And by the way, a big chunk of that was in the U.S. and those prices were down massively. And we're still net new wins.

And so, all those fundamentals are sort of in place and have been for a couple of years and continue to build and sort of you're seeing that result. And again, I would say, obviously, the result for the quarter was exceptional. We'd ask you to sort of think about over the course of the year, and our view is if you just reflect on 2018 versus 2017 versus 2016 in Reinsurance, you're going to see momentum.

Jon Paul Newsome
Analyst, Sandler O'Neill & Partners LP

Q

Great. Thanks. Congrats on the quarter.

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

A

Thanks.

Operator: Our last question is coming from Kai Pan from Morgan Stanley. Kai, your line is now open.

Kai Pan
Analyst, Morgan Stanley & Co. LLC

Q

Thank you. I have two more follow-ups. Number one on the buybacks. Looks like, year-to-date, you bought back $950 million, dividend stayed close to $100 million and the acquisition probably about $50 million, so together $1.2 billion outlay.

If you look at free cash flow, including the restructuring charge, $300 million and you [indiscernible] (44:17) short-term debt like $500 million. So I just wonder compared to those source of cash and use of cash, do you see that buyback has to slow down in the back half of the year unless the free cash flow were coming in, or you have additional room for further leverage?

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

A

Yeah. So, Kai, it's a great question. And what we would say is, as we think about cash flow over the course of the year, our strongest cash flow quarters have always been Q3 and Q4, and that remains true. So, as you think about cash in the second half of the year, it'll be stronger in terms of just cash flow from operations.

And then, as we think about uses of cash, obviously, as we allocate cash to different activities, we're going to do it based on ROIC. And so what you're going to see is we'll continue to allocate cash to buyback because it remains our highest return on capital opportunity across the firm.

You'll see us continue to invest in M&A and organically, as the return on capital opportunities are substantial. And then you did see us increase leverage slightly and we'll return 2016 levels over the course of time. And then what you'll see on debt really is, as EBITDA grows, we'll continue to add debt, keeping our leverage ratio aligned.

Kai Pan
Analyst, Morgan Stanley & Co. LLC

Q

Okay. My last one is back to the full-year guidance, the $7.97. If you step back to the beginning of the year when you first sort of gave out the guidance and until now seems like there is a little bit benefit, about $0.06 net benefit from foreign exchange, and also about $0.10 benefit from the overall tax rate. So why in your full year guidance why now be like 3% higher? Am I reading too much into it?

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

A

Here's what I'd say, Kai. We don't normally give guidance. When we announced the transaction in May 2017, that drove amazing benefits to shareholders, left Aon with a portfolio with higher revenue growth, higher margin, higher return on capital and a terrific cash benefit for shareholders, $3 billion. We really at that point in time, May last year, wanted to be clear that we would exceed EPS guidance for 2018. EPS is up 28% year-to-date and we feel confident about exceeding the $7.97 for 2018 and we're not updating guidance.

Kai Pan
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Great. Thank you so much and good luck.

Operator: We have one last follow-up question in queue from Yaron Kinar from Goldman Sachs. Yaron, your line is now open.

Yaron Kinar
Analyst, Goldman Sachs & Co. LLC

Q

Hi. Sorry for fixating on this, but I want to go back to M&A for a second. So, Christa, if I understand your comments correctly, basically you're going to get some lift as you're integrating some of the previous acquisitions and getting them into higher margins.

But if we expect an overall lift in margins for the second half of the year, does it also mean that you're not getting as much of new M&A revenues coming in the door the second half of the year that would offset the lift that you're getting from previous M&A?

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

A

Yaron, I think you're hoping for a level of guidance on M&A that we're probably just not going to give. What I would say overall is, as we think about M&A, the first year of M&A integration is largely negative on margins. You saw that particularly show up in Q2. Over the course of the full year, it'll be a little less than what you saw in Q2.

And then, over time, what you see is M&A from previous years, example 2016, starts to contribute to margins. And so you have a mix shift going on. Of course, we're investing in higher margin businesses, in the businesses we bring into the firm. So they will contribute positively to margin over time.

The last thing I'd say on margins is we do expect – we're up 200 basis points year-to-date in margins. We expect margin expansion in the second half of the year to contribute to $7.97, exceeding EPS guidance for the year.

Yaron Kinar
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Appreciate it. Thank you.

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

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

Just want to say that Christa and I appreciate everybody being part of the call today. As we said at the beginning, we took a bit different approach today, different format, trying to give you a view which sort of highlights some of the long-term efforts we're taking or efforts that we think will impact the long-term success of the firm.

So, hopefully, you found it helpful. Thoughts or comments or other ways we could sort of do this or create this kind of perspective, let us know. But we really appreciate being part of the call today and look forward to our conversation next quarter. Thanks very much.

Operator: And that concludes today's conference. Thank you all for your participation. You may now disconnect.