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Aon Plc (AON)

Q1 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and thank you for holding. Welcome to Aon plc's First Quarter 2019 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. I would also like to remind all parties that this call is being recorded. If anyone has an objection, you may disconnect your line at this time.

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 2019 results as well as having been posted in our website.

Now, it is my pleasure to turn the call over to Greg Case, CEO of Aon plc. You may now begin.

Gregory C. Case

Chief Executive Officer & Executive Director, Aon Plc

Thank you and good morning, everyone. Welcome to our first quarter 2019 conference call. Joining me here today is our CFO, Christa Davies. In addition, we have our two Co-Presidents, Eric Andersen and Mike O'Connor, joining the discussion to help lead our Q&A session with their frontline perspective of Aon United at work. Similar to previous quarters, we posted a detailed financial presentation on our website as we focus our time on these quarterly calls to provide you more insight into the longer-term view for the firm.

I'd like to start today by acknowledging the tremendous work of my Aon colleagues around the world. Their collective efforts continue to strengthen the firm and create long-term momentum, reflected some positive performance across our key metrics in the first quarter, including 6% organic revenue growth, reflecting the strong start to the year with an increased rate of growth across all solution lines, substantial operating margin expansion of 190 basis points, 8% operating income growth and double-digit or a 11% growth in EPS, overcoming meaningful FX headwinds. Our strong start to 2019 is a direct reflection of initial success from the strategic actions we've progressively taken to drive Aon United.

As we discussed previously, we've been laying the foundation for Aon United for over a decade, evolving our portfolio, investing in new content and capability, and increasing our relevance with clients. In 2018, we took major steps to reinforce and amplify this progress through structural changes that broke down barriers and began to make it easier to deliver the best of the total firm to clients. One brand, one leadership team, one P&L to deploy capital against, one operating model under Aon Business Services, and most compelling, a more united global professional services firm, all focused on increasing our relevance and strengthening our ability to serve clients more effectively.

We also organized focus teams of leaders to dedicate more time to value creation for client-driven solutions that can then be applied more broadly and faster with similar clients or industries, with the formation and the development of our Enterprise Client Group to lead Aon United efforts with our largest clients by identifying superior tailor-made solutions that address their specific business objectives. And our New Ventures Group to accelerate industry-leading innovation and scale our capabilities with greater speed to market.

During Q1, we announced our first commitment to develop our innovation portfolio with Intellectual Property Solutions. As businesses recognize the paradigm shift from tangible to intangible assets, IP is more important than ever with the tangible assets now comprising the majority of assets on the balance sheet. Our clients need to both identify and manage risk surrounding business-critical and proprietary data, and develop and execute strategies for maximizing shareholder value from their IP portfolios.

Beginning with the acquisition of 601West in 2018, the IPS team has already developed a set of consulting, valuation and risk transfer offerings that establishes Aon as the trusted global authority in the intellectual property asset class. An area of opportunity that we believe will be substantial for Aon over the long-term. With our strong start to 2019, we are truly in the era of Aon United. The foundations we've been putting in place combined with our more recent actions have already demonstrated accelerated revenue growth. As you can see from the improved trend of 3% in 2014 and 2015; 4% in 2016 and 2017; 5% in 2018; and now 6% to start the year in our largest quarter, and these actions will continue to be a driving factor reinforcing our goal of mid-single-digit organic revenue growth or greater over the long-term.

This improved growth outlook for the firm is predominantly driven by three key areas. First, as a baseline, we operate in core markets with attractive long-term growth globally. Risk continues to increase around the world in both magnitude and complexity. Health care has significant cost inflation in most geographies with deteriorating wellness, and many of the world's pension plans are underfunded with employees unprepared for retirement. Our core businesses across these areas are characterized by high recurring revenue of approximately 85% in primarily nondiscretionary markets with strong client retention rates of approximately 95% on average across the portfolio.

As the world increasingly faces political and regulatory changes or economic pressure, we find our clients needing our advice and core competencies even more as they navigate challenges and uncertainty across the topics of

risk, retirement and health. This view is reinforced by the Data & Analytics inside of our Inpoint team. A team comprised of more than 300 data professionals across three innovation centers globally. Through unique insight into the global commercial P&C market, our team has developed a standardized data set which describes the size and segmentation of commercial life insurance, unique in the market today.

For example, our research which segments the global market in detail by product, industry and client size, estimates the global premiums totaled approximately \$625 billion in 2013, \$730 billion in 2017, and will increase to nearly \$900 billion by 2021, reflecting an increase in market growth rate to more than 5% annually. Using this proprietary data, we are identifying unique insights across solutions, industries and geographies for clients and Aon, as well as prioritizing capital toward these highest growth opportunities.

Second, our strategic focus was reinforced by the divestiture of our outsourcing business in 2017, with proceeds from the transaction directed toward high growth areas of client need. In 2018, we delivered a record level of organic revenue across the portfolio. With that momentum continuing into the first quarter of 2019, drawn from many of the areas where we continue to invest heavily, delivering double-digit growth, including cybersecurity, transaction liability, delegated investment management and voluntary benefits, to name a few, while other areas of the business are just beginning to emerge, such as Intellectual Property and Data & Analytics applications.

While many think of cyber in a traditional sense of risk transfer premium, we're working well beyond that with some of the technology industry's leading participants with solutions like [indiscernible] (00:07:28) a software assessment tool critical for implementing cyber resilience across their product portfolios. And third, we're creating new opportunities with clients through our Aon United model. With a business partner approach, we're looking more effectively across geographies and solution lines to up clients in ways that improve their growth profile, reducing volatility or strengthening their balance sheet.

And while I've already noted colleagues working together through formed groups, like our Enterprise Client Group and our New Ventures Group, I want to highlight the spirit of Aon United through two colleague examples, both of whom have already won accolades from clients as perennial players on the Power Brokers list. It's not that Aon has more industry recognized colleagues than anyone else over the accolade itself for their specific industry expertise, it's the underwhelming behavior they exemplified to solve unique solutions for clients. The first example highlights work within an autonomous vehicle startup, where there was no law stated to model. With no protection, there was no future for this client. Our colleague was able to bring together capability across the firm, encompassing cyber and product liability, resulting in protection, capital and a future for the client.

My second example highlights the work of a colleague on an M&A transaction for a client. The seller was unwilling to identify specific major tax liabilities identified by the buyer. No solution, no deal. Working with colleagues across the firm to understand the risk, our colleague was able to bring 13 carriers together in one of the largest tax insurance programs ever placed, ultimately enabling the deal to get completed, quite simply, this is the power of our colleagues and our Aon United approach. Our clients are driving this and our colleagues are responding.

In summary, our results reflect increasing strengths from our Aon United initiatives as highlighted by increasing growth. We continue to strengthen our firm through investments in industry defining content and capability by delivering strong financial results and increased value to our shareholders. Our team is excited about the future outlook for our firm which is amplified by the considerable momentum we have built together.

With that overview, I'd like to turn the call over to Christa for her thoughts on our progress and long-term outlook for continued shareholder value creation. Christa?

Christa Davies

Executive Vice President, Global Finance, and Chief Financial Officer, Aon Plc

Thanks so much, Greg, and good morning, everyone. We delivered a strong operational and financial performance in Q1 to start the year. Q1 results were highlighted by strong organic revenue growth that translate into solid operational improvements, while funding significant investment across the firm and overcoming an unfavorable near-term impact from FX translation.

As I further reflect on the quarter, first, organic revenue growth accelerated 6%, continued improvement compared to our historic trend as we deliver on our goal of mid-single-digit or greater organic revenue growth over the long-term. In addition to accelerating organic revenue growth, discipline around capital allocation continues to shape the portfolio towards our highest growth and return opportunities [indiscernible] (00:10:25) by the divestiture of certain businesses in our talent practice after the close of the quarter.

While financials were not disclosed, the divestiture of these businesses provides Aon with capital that can be reinvested while enabling the buyer to create value for clients. Second, we delivered solid operational performance with total operating income growth of 8%, operating margin expansion of 190 basis points and double-digit earnings growth. As we noted in the earnings material, FX was mostly worse than previously anticipated due to a stronger U.S. dollar, resulting in a significant net unfavorable impact of approximately \$0.13 in the quarter or a \$38 million impact on operating income.

Looking beyond 2019 and our restructuring initiatives, organic revenue growth, portfolio mix and ongoing productivity improvements are expected to drive continued operational performance and long-term core margin expansion annually, similar to the 70 to 80 basis points of operating margin improvement achieved annually over the last decade. We continue to successfully execute our restructuring initiatives with \$45 million of incremental savings in the quarter before reinvestment, placing us well on track to deliver on our total cumulative savings of \$500 million in 2019. These initiatives are driving expense savings near-term, but more importantly, they're enabling growth of the firm as we unlock additional operating leverage through our Aon Business Services single operating model.

In addition to [ph] clear (00:11:54) restructuring activities, another Aon United initiative I'd like to highlight is sales process standardization, [ph] as the firm (00:12:01) was initially built through acquisitions and then organized around multiple businesses and segments, our colleagues routinely found it challenging and time-consuming to understand who our clients were and how best to serve them across Aon. With Aon United in a single operating model under ABS, our colleagues spent the last year standardizing our client-facing sales process, with global agreement from colleagues to cover every sales process across the firm, we undertook an in-depth process to dissect and reassemble very disparate sales data into one instance

We began with 1.3 million accounts, and through mastering account data and clean-up, we eliminated more than 800,000 accounts, reducing the total to 500,000 client accounts in a standardized approach and process. Our client-facing colleagues are now more productive with increased time for clients as well as greater operating leverage through simplification of our sales process, a great example of our colleagues working together across the firm to drive long-term growth and operational leverage.

Lastly, free cash flow was \$17 million for the quarter. Q1 is our seasonally smallest quarter from a cash flow standpoint due primarily to incentive compensation payments, with results further impacted by approximately \$85 million of net cash payments related to legacy litigation. As we think about cash flow generation going forward, we're focused on maximizing translation and accelerating revenue growth into the highest level of free cash flow

through three ways: operating income growth; continued progress on working capital initiatives; and structural uses of cash winding down.

2018 was the peak year for cash usage as shown in our presentation slide 24. It was the peak year for restructuring cash outlays and certain discretionary pension contributions. Defining uses of cash for restructuring, CapEx and pension collectively are expected to free up roughly \$620 million of free cash flow by the end of 2020. This had significant upside to a base of more than \$1.45 billion of free cash flow in 2018 prior to any operating income growth or working capital improvements. Together, these three inputs give us confidence in our ability to deliver on our goal of double-digit annual growth in free cash flow over the long-term.

Further, we have the opportunity for substantial incremental debt as EBITDA grows. Restructuring costs wind-down and pension liability improves, providing significant financial flexibility over the next few years to further invest in value creation or return of capital to shareholders. We are diligent about maximizing return on capital and make all capital allocation decisions through this discipline. Share repurchase remains the highest return on capital investment today, given our free cash flow valuation and outlook.

In summary, our Aon United initiatives continue to increase momentum as highlighted by our strong top and bottom line performance in the quarter, including significant investments to strengthen the long-term growth profile for our firm. Our disciplined approach to return on invested capital combined with significant free cash flow growth and increased debt opportunity over the next few years provides financial flexibility to unlock significant shareholder value creation over the long-term.

With that, I'll turn the call back over to the operator and we'd be delighted to take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] Speakers, our first question is from Dave Styblo of Jefferies. Your line is now open.

David Styblo
Analyst, Jefferies LLC

Q

Hi. Good morning. Thanks for the questions...

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

A

Hey, Dave.

David Styblo
Analyst, Jefferies LLC

Q

...and congrats on the quarter.

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

A

Thanks, Dave.

David Styblo

Analyst, Jefferies LLC

Q

Yeah. I just want to take a look back at the margins here for a second. And so, the restructuring savings accounted for 140 basis points of the 190-basis-point margin expansion year-over-year, which leaves about 50 basis points related to more core expansion. And I think you guys have typically characterized that that's net of reinvestments in the business. So, just want to make sure I've got those moving parts right. And then, if you could directionally talk about maybe how large those reinvestments were this year and if there's anything else impacting the margin line, including FX, did that affect the margin at all this quarter?

Christa Davies

Executive Vice President, Global Finance, and Chief Financial Officer, Aon Plc

A

Thanks so much for the question, Dave. As we think about it, it was a terrific margin expansion, total margin expansion in the quarter of 190 basis points. As you highlighted, we have been investing significantly back into the business into high growth, high margin, high return on capital areas that was significant in 2019 Q1 as it was for the whole year of 2018. And so, you're seeing with the restructuring savings of 140 basis points contributing and then your core, the core is really net of significant investments in the business, and so we really think about this Dave, as a 190 basis points of margin expansion. And then, I did mentioned in my prepared remarks, for the last 10 years, we've delivered 70 to 80 basis points a year of core margin expansion and we expect that trend going forward post the restructuring. So, we're very excited about the margin expansion in the quarter and for the calendar year 2019 outlook.

David Styblo

Analyst, Jefferies LLC

Q

Sure. Okay. Thanks. And then, just on the Reinsurance, maybe taking more of a longer-term approach and understanding how the sales organization is helping that business to whatever extent that might be. But obviously, the business has been running in high-single-digits organically for a year plus now, which obviously is quite strong relative to historical levels. I'm wondering if you can talk about if there's – how durable that business is, oftentimes when we see growth that high, we think of one-off items maybe being spiked out and helping it, but it's been consistent for a longer period of time at this juncture. So, maybe you can talk about some of the underpinnings in the market there from what you're seeing on the pricing side to capital supply to demand.

Gregory C. Case

Chief Executive Officer & Executive Director, Aon Plc

A

Dave, I appreciate you raising the question. I think actually, it's inappropriate really to talk even without Reinsurance for sure, but more broadly about really the drivers of growth in Reinsurance, because they really are consistent across – what's happening across the portfolio for Aon. We need to step back and think about it, Reinsurance colleagues did a phenomenal job and have for quite some time in the core treaty business, the fac business and what we're doing on insurance like securities as well. But if you think about it, consistent with Aon growth overall, the team is really doing a great job. The solution lines, every solution line we have is up over the comparable period from the prior year and it's the third consecutive quarter with Aon at 6%.

So, there's a lot going on here and it's not driven by one-offs, it's not driven by market conditions, it's driven by fundamentally sort of how we're approaching the market, frontline client leadership and the commitment really to Aon United, and it really is bringing the best of our firm to our clients. Innovative things are happening that haven't happened before. We're strengthening our ability to scale that innovation more effectively across the firm. And as I described in my comments, in essence, if you think about the core markets we operate in, these are markets with high recurring revenues, strong client retention and fundamentally the demand is up, and we still operate in a

world in which we don't serve clients in a complete way. We, as the industry and all of us, have opportunities and we're trying to take advantage of that. So, these are core markets with great opportunity.

And then our investments, Christa just alluded to, both organic and by acquisitions, are really focused on higher growth demand areas from clients, cyber, IP, delegated, health, talent, et cetera. And in the end, what happens here is we're expanding markets and we're increasing relevance, and in doing so, we're winning more with clients, more with existing clients where our rollover is high, the highest levels and improving, we're winning net new clients, win versus generation is high as it's been and improving. And again, we're back to kind of creating net new areas to serve clients, think about mortgage, ACT, delegated, health exchanges, [ph] we'll then cap on NVG (00:20:06). And if you think about it, all of these areas really connect back to Data & Analytics. It's an absolutely vital piece of that overall equation.

But maybe – again, just because this idea of growth is so fundamental to what we're doing, Eric and Mike, let's go through a couple of examples literally sort of bring to life what's really different and what's really driving the fundamental underlying growth.

Eric Andersen
Co-President, Aon Plc

A

Sure, Greg. Why don't I kick it off and then Mike can follow-up, but just staying with the Reinsurance theme, one of the areas where we're really focusing our teams is being able to use our Data & Analytics capability to be able to provide actionable insight for our clients, whether insurance or reinsurance partners. And one of the key areas is by providing that insight, they're able to alter their strategy, they're able to look closely at their capital allocation capability around how they drive product in geographies, et cetera.

And just to maybe pick a simple example, we're working with one reinsurer who had some challenges in their property portfolio and we were able to use our world-class capabilities along with our teams to be able to help them understand what was going on inside the portfolio and then make decisions around how they entered the market, where they entered the market, and how they allocated capital towards those risks. So, it affected their strategy as well as affected their capital allocation strategy and honestly created a great result for them.

I mean they're fundamentally different kind of conversation than we've had before beyond the placement, it was about the corporate strategy of the firm. And ultimately the placement is the last thing that we're doing, it's all the work that's done upfront around helping them understand what the risks are and how it's working, and then how do you allocate capital to those risks.

David Styblo
Analyst, Jefferies LLC

Q

Great. Thanks for the insight. I'll step back for others.

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

A

Okay.

Eric Andersen
Co-President, Aon Plc

A

Sorry. Mike, do you still want to answer to that?

Michael O'Connor

Co-President, Aon Plc

A

Yeah. I mean, Eric covered risk, so maybe I'll touch on other parts of our business, and a recent example I thought was quite good actually and I found it inspiring. We had a client in the technology services space which we were serving across Risk and Health, doing a great job, great client. But the teams stepped back in really Aon United fashion and said, what's the biggest challenge that this client has, and the biggest challenge this client has was talent. The growth of that firm, the growth of this client, the success of this client is going to depend on can they actually attract and retain talent.

So, our teams said, what can we do to help and we rallied, we brought together colleagues from Health, we brought together colleagues from talent rewards, brought together the whole firm and sat with this client and said, what can we do differently, and we reached back and grabbed the Data & Analytics that we have in all these practice areas and said, can we use this to actually improve performance. And on the Health side, last year, we rolled out a set of tools and we called it Aon Architect, which we built in our Innovation Center in Singapore and that doesn't happen without bringing together our actuarial team, our data scientists and our practitioners to say, can we pull together all the data, all of our experience from around the world and how is it we can use it.

And what we end up building was a cloud-based data-driven machine learning tool which has an algorithm that draws upon all that data that says, if a client gives us sort of parameters that they want to build their health program around can we optimize it, can we actually improve it. And that's what we brought to bear with this client, and with a click of a button, we can run thousands, even millions of simulations to come up with the optimal answer. Now, that's interesting, but what's even more interesting is we coupled that with an employee perception database. We went and did research around we make changes to a health program, how will different populations and employees react, will they be excited, will they be actually annoyed or will they be any different. And that combination allowed us for this client to bring not only an optimized answer, but be able to show them how their employees would react at different levels of the organization, different populations of their employees.

That was the insight they didn't have before and allowed them to improve the offering they had and have more impact with their colleagues. We couple that with our talent rewards practice who said, listen, we've got to make sure that our rewards and recognition for this client are as competitive as they can be. We need to know what's going on in the market. We've got to think about what the investment they can make as a client, how can we best optimize to that answer for their employees. We coupled that, an improved Health offering with improved rewards and recognition, and this client was able to go to market with a more compelling offer to attract clients or attract employees into their firm and also retain them. And for me, it's just a great example of utilizing Data & Analytics to have real impact with the client.

Gregory C. Case

Chief Executive Officer & Executive Director, Aon Plc

A

So, Dave, I know it's a little bit of an extended answer, but we want to give you a sense on sort of, again, back to the spirit of what we're trying to do with these calls. This is about the long-term future of the firm what we're trying to accomplish. Fundamentally underpinning everything we're doing from a growth standpoint starts and stops with clients and it is really a much, much broader approach and picture than anything that we've ever taken before. So, hopefully that gives you some background.

David Styblo

Analyst, Jefferies LLC

A

Sure. Thanks for the flavor on that.

Operator: Thank you. Our next question is from Elyse Greenspan of Wells Fargo. Your line is now open.

Elyse Greenspan

Analyst, Wells Fargo Securities LLC

Q

Hi. Good morning. My first question, just on the free cash flow that you guys saw in the quarter, I know the Q1 is typically your lower cash quarter, but it did have a legacy litigation-related payment. Was this contemplated when you guys had set kind of the double-digit growth on an adjusted free cash flow basis for the year and you can just kind of give us the outlook on the growth trends over the remaining three quarters?

Christa Davies

Executive Vice President, Global Finance, and Chief Financial Officer, Aon Plc

A

Thanks, Elyse. Yeah. We definitely are on track to double-digit free cash flow for the full year 2019 and legacy litigation was encompassed in that guidance, Elyse. I mean we would say as exactly what you said about Q1, it's our seasonally smallest quarter. We had big outflows of cash. We always have big outflows of cash in Q1 due to annual incentives. And this quarter, we had additional outflows of cash related to legacy litigation and restructuring. And so, what you see is we're on track to double-digit free cash flow for 2019 and we're really excited about the free cash flow growth over the course of 2019 and particularly 2019 and 2020, given the declining uses of cash in restructuring CapEx and pension at \$620 million of free cash flow just in the next 18 months.

Elyse Greenspan

Analyst, Wells Fargo Securities LLC

Q

Okay. And then, in terms of organic, last quarter – last Q1, sorry, there was some timing where some business in a few of your segments had shifted from the Q1 to Q2. Was there any kind of timing impact on organic this first quarter that we should think about when thinking about Q2 or any other quarters of the rest of the year?

Gregory C. Case

Chief Executive Officer & Executive Director, Aon Plc

A

There really wasn't, Elyse, as we described before, the fundamentals of the drivers of growth are what we're talking about in terms of how we're interacting with the clients and the things we're bringing to the table. So, there is no – there is nothing that is factored in Q1.

Elyse Greenspan

Analyst, Wells Fargo Securities LLC

Q

Okay, great. And then, in terms of – you guys mentioned, you've done some acquisitions that have helped your organic growth. As we sit here today, can you just give us an updated view on the deal flow that you see out there and types of things and sizes and geographies of deals that you guys are looking at and contemplating?

Christa Davies

Executive Vice President, Global Finance, and Chief Financial Officer, Aon Plc

A

Yeah. I mean, Elyse, we are incredibly excited about our M&A pipeline. It is the largest we have had in the company's history. I think we – I mentioned that on the Q4 call and it is 100% focused on our highest revenue growth, highest margin, and highest return on capital areas. It mirrors the areas we have been investing in organically and inorganically in the last couple of years. So, with things like Data & Analytics, Health and elective benefits, affinity, delegated investment management, cyber, intellectual property, and so, we're incredibly excited

about the M&A pipeline at least. Having said that, we continue to be really disciplined about return on capital, and I would say on a return on capital basis, we – that's exactly how we allocate cash across the firm, and share repurchase remains the highest return on capital across Aon. And so, we're very excited about the share repurchases outlook of Aon on the balance of the year.

Gregory C. Case

Chief Executive Officer & Executive Director, Aon Plc

A

And these are really starting to – Elyse, as we think about sort of these opportunities, these are opportunities to bring in content capability that we can scale, back to kind of the Data & Analytics piece that we've talked about in terms of how we take this and how we actually broadened it out from a client standpoint or actually, we're seeing action now, we're seeing clients who've asked us for this kind of insight and that's a direct response to that are some of these acquisitions that we've done to bring in content capability. And particularly, as you think about some of things we've done in cyber and things we've done on the Health side and the talent side and the Risk side, they've really started to make a difference.

Again, just in the spirit of the call, a couple of examples sort of come in mind when thinking about – Eric, we talked about a couple days ago, maybe we can share with the group and [indiscernible] (00:28:52).

Eric Andersen

Co-President, Aon Plc

A

Sure, Greg. There's just a quick story just to underscore some of the points around how we're trying to globally integrate and use all the different solution lines to drive new outcomes for clients. We had a large European manufacturer, who had a sizable Latin American presence that was – what was having volatile challenges around the pricing of their health care for their employees in Latin America. And we were able to use the European client leader, the Latin American teams, who then drew upon the global solution capabilities and we were able to provide a solution that reduce the volatility and help them better manage the outcome with an added benefit of being able to actually collect the health data on their Latin employees which will ultimately give them the tools that they need to improve wellness. And so, that ability for our own employees to be able to work collectively like that really exciting for them and really gets them going. So, it's been – it was a great example, I thought.

Gregory C. Case

Chief Executive Officer & Executive Director, Aon Plc

A

Again, Elyse, trying to help you understand, this is really about content we scale, and when we scale it and it response to client needs, that's – and we're taking in approach that's fundamentally different around bringing colleagues together in unique groups, these are the kinds of outcomes driven by clients. So, that's really what's driving our acquisition appetite.

Elyse Greenspan

Analyst, Wells Fargo Securities LLC

Q

Okay. Thank you very much.

Operator: Thank you. Our next question is from Greg Peters of Raymond James. Your line is now open.

C. Gregory Peters

Analyst, Raymond James & Associates, Inc.

Q

Good morning. I'll take a swing at two questions. First, in your comments, you talked about organic growth driving margin expansion beyond 2019. I think you mentioned, if you look over the last 10 years, you have an annual average increase of 80 to 90 bps. I'm just curious, if you guys have a view about any type of structural ceiling that might exist on margin expansion, considering that many of your competitors are running at lower margins?

Christa Davies

Executive Vice President, Global Finance, and Chief Financial Officer, Aon Plc

A

Yeah. Thanks so much, Greg, for the question. What I would say is we see substantial margin expansion over the long-term at Aon really driven by three key things: the first is accelerating organic revenue growth; the second is the mix shift to higher growth, higher margin businesses; and the third is the productivity we're building into the business through the Aon operating model driven by ABS.

And to your kind of margin ceiling question, one of the things that we're observing is as due the investments we made in Data & Analytics, \$400 million a year for the last 11 years now, we are getting greater operating leverage in the business, because we're really driving greater value for clients, and Data & Analytics is at the heart of that, and these Data & Analytics solutions are having a huge impact on clients in terms of the value they provide.

Gregory C. Case

Chief Executive Officer & Executive Director, Aon Plc

A

If you really back into it, Greg, and think about sort of the definition of client need and how we respond to client need, in the examples that Eric and Mike have gone through today are really untraditional examples. They're sort of net new examples that are out there and they're very high value-added examples with content capability that really create a way for us to add value in ways that clients recognize, and frankly, we get paid for, because we're adding meaningful value to clients. And for us, we think this is a massive opportunity.

Again, back to the growth drivers in the quarter, it's both kind of net new opportunities, we're creating a new market, if you think about what we did in mortgage, that's net new market. What we're doing in cyber, taking a \$4 billion business and driving it forward to more of a – hopefully a \$10 billion, \$20 billion, \$30 billion, \$40 billion, \$50 billion, \$100 billion business over time. This is a very, very substantial net new opportunity. So, for us, as we add value to clients, we believe we're going to continue to be compensated for and margins are going to continue to go up.

C. Gregory Peters

Analyst, Raymond James & Associates, Inc.

Q

Okay. I realize your Health business is a global business, and also in the U.S., there has been a lot of attention around the political arena and recently Medicare for All. And I'm curious about your perspective on the Health business in North America. I know you guys have been a leader in a bunch of different initiatives, including private health insurance exchanges. And considering the political landscape is changing, I'm curious about your long-term perspective on that business.

Gregory C. Case

Chief Executive Officer & Executive Director, Aon Plc

A

For us, Health comes back as does everything else to clients and client need. And when you think about sort of what's really happening with all these different options, are we fundamentally addressing questions around our – is the population becoming healthier and we're decreasing the pre unit cost of health care, and really nothing is addressing that at this point in time. But if you think back to your broader question, start with Aon. We've got the broadest set of solutions globally serving clients of all sizes, segments, industries, full spectrum of funding choices

out there. As you said, roughly half our business is outside the U.S., including frankly very, very productive strong growth in areas that support clients today in existing single payer systems, like the UK and Canada. So, let's assume that all happened, we operated extremely successfully in those markets, why, because we're helping companies help their employees succeed and then do better on the Health side and that demand is going to continue and we can succeed in that marketplace.

Our U.S. business, as you could describe it, it is really broken into two pieces, one addressing the question you're asking specifically, clients who advice in solutions for medical and dental, and the other serving clients who advice in solutions around voluntary benefits, executive benefits, global benefits, et cetera. So, we see a tremendous opportunity to help clients, help their colleagues or help their employees on this really, really difficult topic of Health. We will always come back to if we can help clients inject choice, transparency and accountability for their employees who are going to improve the situation and we are very confident that we're going to have success in whatever end state sort of that ends up. I would also observe, if anything this monumental – and obviously would be monumental – happened, the transition also creates massive client uncertainty and ambiguity which we would be in the breach trying to help them sort through. So, in the end, we are very confident in the end state and we're confident in the transition.

C. Gregory Peters

Analyst, Raymond James & Associates, Inc.

Q

Great. Thanks for the answers.

Operator: Thank you. Our next question is from Mike Zaremski of Credit Suisse. Your line is now open.

Michael Zaremski

Analyst, Credit Suisse Securities (USA) LLC

Q

Hey. Good morning. Thanks. First, I've a follow-up. In terms of the Intellectual Property Solutions and mortgage, which are areas that Aon is pioneering insurance demand for, what do you estimate is the size of insurance spend for those lines of businesses today and maybe you can help us frame how to think about their long-term potential size?

Gregory C. Case

Chief Executive Officer & Executive Director, Aon Plc

A

Well, let's start actually with Intellectual Property, I think it's a good one to start with, because again back to the whole idea of sort of net new on the horizon. If you step back in time and think about kind of Intellectual Property has always been out there, but in 1975, it's 20% to 25% of the overall kind of assets on the balance sheet. Today, it's more like 80%-plus. And if you ask the question, how has our industry responded, how clients think about that, and the answer is it's actually quite limited. This is why back to kind of our New Ventures Group identified this as a priority area. We've got assets around this focused in ways we never had before. We're doing things to help clients understand how do they value their intellectual property, how do they think about it, how do they assess it.

We've also helped them understand sort of how to benchmark it and understand how they create value against it. And obviously, how do you protect it around liability, cover for patent, copyright, trademark infringement, et cetera, thinking about IP as collateral, think of – if it's truly an asset, how do you actually get value out of it. And then someone does something bad to you, if they steal it, how do you protect yourself against it. So, for us, this is a – we think a massive emerging opportunity largely underserved. And I want to be really clear, we've got – we're in the market now, we've got clients – readymade client sort of we're actually doing real work with in a very

meaningful way. Again, Eric and Mike, you guys are living this every day at the frontline, pick a couple that you think are interesting to talk about.

Michael O'Connor

Co-President, Aon Plc

A

Sure, Greg. Maybe I'll start and then Eric, if you have anything to add on. I mean, I think this as Greg, you noted it, if you think about IP and step back, the reality is this is relevant to all our clients all around the world and when you actually start to engage with the clients around it, you realize that this needs to be top of the agenda for a lot of those clients, and I'm just going to use one example. A very sophisticated financial services organization, we sat down and talked them with our IP Solutions team, and it was really interesting, the dialogue really was in two buckets: one was around offense, and one was around defense.

On offense, that firm is literally spending their time and their IP organization within it, just thinking about how do they actually define the spaces where the business can grow, how do they actually map the landscape and we were really engaged in a strategy conversation, we were talking to them about what their current IP was, how strong their portfolio was, and where there was white space. And that to me is really interesting and building really strong client relationships and that's all about their offense, how they get strong as a firm, how they grow.

Then, we flip over and talk about defense. That team internally had a responsibility in that client to defend the IP they had, to basically make sure they were actually managing risk, and that quickly turned to how do we actually think about the risks they have, how do we quantify that with them, and then ultimately do we transfer some of that. And last year, we stood up in industry leading IP liability solution in London and the client quickly said, this now is relevant, the capacity you brought, the sophistication of the underwriting community that you brought together is different than it has been in the past, and it quickly led to we should transfer more risk. And to me, that's a perfect example of us engaging with clients in an Aon United way helping them play both offense and defense.

Eric Andersen

Co-President, Aon Plc

A

So, again [indiscernible] (00:38:52) Mike there, from that standpoint, how many companies around the world have this issue, we would say most, what are the real solutions in the market today that help them address it and they're minimal. And so, we see this as a true kind of emerging area that we think could be substantial.

Just quickly on mortgage, if you think about it, once upon a time, mortgage is sort of where we're funded and originated in a certain way. We had some trauma in 2007, 2008, 2009 created some need. We came in and actually helped bring insurance capital to bear on behalf of the U.S. mortgage instrument, which is the single largest financial instrument in the world, and created what literally is over time a market that's greater than \$10 billion in premium, really phenomenal and it was really on single-family, and we're about to sort of roll that now into multi-family sort of in the next wave of that. So, these are opportunities that bring real solutions, reduce volatility, bring real pricing inside into this marketplace, and another example of where you can bring insurance-linked capital sort of to bear on behalf of a client to reduce volatility or to improve operating performance.

Michael Zaremski

Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. That's helpful. And one follow-up, in February, the UK Financial Conduct Authority published their wholesale broking practice study and essentially okayed the industry's practices for the most part. Do you feel that will speed up the trend towards risk facilities?

Gregory C. Case

Chief Executive Officer & Executive Director, Aon Plc

A

Yeah. We don't really look at it that way. In essence, what would – the market overview, the work that was done frankly for us just reconfirmed what we see every day. This is a highly competitive market, transparent market. Our focus, our objectives remain exactly the same, and as is the match capital with risk around the world in any way we can, and that's traditional based capital from insurance world, but also the nontraditional capital as well. And so, for us, it really didn't change our point of view in any way share or form. We're absolutely focused on helping clients understand measure and mitigate risk, and bringing to bear solutions in any way we can. So, it really didn't change anything.

Michael Zaremski

Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you.

Operator: Thank you. Our next question is from Brian Meredith of UBS. Your line is now open.

Brian Meredith

Analyst, UBS Securities LLC

Q

Yes. Thank you. I'm just curious, Eric and Mike, I'm wondering if you could talk about what's going on in the commercial [indiscernible] (00:41:16) market. Clearly, in essence, there's been a lot of discussion recently that things have kind of really picked up with respect to pricing [indiscernible] (00:41:22) markets, given some stress [indiscernible] (00:41:25) and other carries. Are you seeing the same things and kind of what's your take on what's going on in the market right now [indiscernible] (00:41:30)?

Gregory C. Case

Chief Executive Officer & Executive Director, Aon Plc

A

Just quickly Brian – so I'll come back on pricing...

Brian Meredith

Analyst, UBS Securities LLC

Q

Yeah.

Gregory C. Case

Chief Executive Officer & Executive Director, Aon Plc

A

...the same conversation we've had really for the last number of quarters. When you think about pricing overall as it relates to sort of the results for us and where we are, pricings had minimal marginal impact, if that all, really from the standpoint of sort of how it's affected us. This is really about market impact overall, it's insured values and pricing on top of it, and the pricing piece has really been – it's been marginal. The fundamentals of growth from our standpoint really have to do with the factors we've talked about on the call today. It really is around sort of the underlying things we do with the clients every day, and that's really what's driving overall performance and sort of that's the overall market view.

Eric or Mike, anything else you'd add to that?

Eric Andersen

Co-President, Aon Plc

A

The only thing I would do to Greg is that we take a client-by-client approach and they look at their own risk portfolio and their own risk program, a lot of work goes into risk managing as opposed to risk transferring, but ultimately when they risk transfer, they make the best trades for them that make sense.

Michael Zaremski

Analyst, Credit Suisse Securities (USA) LLC

A

And I think the only thing I'd add Eric is, we've enabled our field with Data & Analytics to basically dive deep into each client and be able to actually represent that effectively. And the second part is we have a global network, we will find the right solution and match capital need, wherever it is in the world.

Brian Meredith

Analyst, UBS Securities LLC

Q

Great. And then, Greg, my second question, I just noticed in the presentation you talked about double-digit growth in China health care. Could you just give us a sense of where you are in China, how big is that as a percentage of your kind of overall business, and kind of what are the opportunities there for you all?

Gregory C. Case

Chief Executive Officer & Executive Director, Aon Plc

A

There's a tremendous set of opportunities there, Brian, as you might expect. We've been in China for well-over a decade, various successful joint venture sort of in China, with our joint venture partner COFCO, a tremendous opportunity and we're making substantial investments. In fact our New Ventures Group is focused on China as one of the key areas we're looking at. And we see the opportunities by the way on the risk side. We see the opportunities on the Health side, on the talent side, on the retirement investment side. So, it's really is across the board. And while not a big part of the overall results today, we see tremendous promise going forward, much like Intellectual Property. Not a big part of the results, but huge upside and opportunity for us going forward, and China continues to be a big focus.

Brian Meredith

Analyst, UBS Securities LLC

Q

Great. Thank you.

Operator: Thank you. Our next question is from Josh Shanker of Deutsche Bank. Your line is now open.

Josh Shanker

Analyst, Deutsche Bank Securities, Inc.

Q

Yeah. Thank you. Good morning, everybody.

Gregory C. Case

Chief Executive Officer & Executive Director, Aon Plc

A

Good morning.

Josh Shanker

Analyst, Deutsche Bank Securities, Inc.

Q

Two questions basically around the same area. I'm trying to just get a better sense of understanding how your working capital needs are going to change with regards to cash flow over the next nine months and into the 2020 year, and also looking at the market rally in the first quarter of the year, trying to understand how to think about contributions to pensions above expenses in the income statement.

Christa Davies

Executive Vice President, Global Finance, and Chief Financial Officer, Aon Plc

A

Sure, Josh. So, firstly, on working capital, we see opportunity for improved cash flow from working capital. As I've said it previously, we've got about \$500 million of excess receivables in working capital sitting on our balance sheet. We do believe that we're going to get to working capital neutral over the long-term. And there's about \$500 million of excess cash coming from working capital over that period of time. So, we do see the opportunity to improve cash flow from working capital. There's no need for increased working capital if that was really your question.

And then, on pensions, you can see on page 24 of the presentation, our pension contributions are coming down significantly. You saw in 2018, which is a peak year of pension contributions \$252 million, they're coming down to \$117 million in pension cash contributions by 2020, so a substantial drop. And obviously, if interest rates were to continue to rise, that impact the discount rate and you could see that come down even further.

Josh Shanker

Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Thank you.

Operator: Thank you. Our next question is from Andrew Molloy of Bank of America. Your line is now open.

Andrew S. Molloy

Analyst, Bank of America Merrill Lynch

Q

Hey. Good morning and thank you for my question. My question follows Elyse's question really and is really focused on financial and balance sheet policy. We've seen a pick-up of debt finance to M&A in the space recently and wanted to know your thoughts and philosophy on your M&A pipeline using balance sheet to finance the potential deal flow and commitment to the 2 to 2.5 leverage range that's in your presentation. Thank you.

Christa Davies

Executive Vice President, Global Finance, and Chief Financial Officer, Aon Plc

A

Great. Thanks so much for the question, Andrew. Our current investment-grade rating is incredibly important to us. We do have opportunity for more debt, as I mentioned in my prepared remarks, given growing EBITDA driven by growing revenue, operating leverage, disciplined expense management and decreased restructuring expense, keeping leverage levels the same. We think about the right leverage levels as debt-to-EBITDA on the 2.25 times on a GAAP basis. So, we absolutely see the opportunity for increased debt as EBITDA grows, but leverage will remain the same. And as I mentioned in terms of how we utilize the substantial free cash flow we're going to generate where deploying that on the return on capital basis, and we're optimizing share repurchase, organic investment and M&A based on return on capital. Share repurchase remains our highest return on capital opportunity across Aon given our free cash flow valuation of the firm.

Andrew S. Molloy

Analyst, Bank of America Merrill Lynch

Q

Thank you.

Operator: Thank you. And our last question is from Sean Reitenbach of KBW. Your line is now open.

Sean Reitenbach

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Hi. Obviously, Aon has posted strong organic growth recently. Would organic growth, the margin expansion for that matter, be stronger without Brexit as an overhang?

Gregory C. Case

Chief Executive Officer & Executive Director, Aon Plc

A

Yeah. Sean, when we think about Brexit is tremendous, obviously, trauma and implications for our clients around the world, and we've gone to great pains and efforts to sort of protect them sort of in frankly whatever scenario. And if you know, then let us know what that's going to be, but we protected every scenario around that on behalf of our clients. It's been an added expense for us, no doubt about that, added a level of investment, and frankly has drawn attention from our senior leaders down to our frontline leaders in every way. But net-net, we want it to be great for our clients and we're going to work through in every way we can. For us specifically, we feel very good about our ability to work around that.

Sean Reitenbach

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. Thank you. That's helpful. And then finally, on share repurchases have decelerated, it looks like each quarter since first quarter 2018. I know you've mentioned it as your highest return on capital investment. So, just wondering what's driving the deceleration, whether you expect it to pick back up for the rest of 2019.

Christa Davies

Executive Vice President, Global Finance, and Chief Financial Officer, Aon Plc

A

Thanks for the question, Sean. We certainly do expect it to pick back up on the balance of the year. And as you think about Q1, it's our seasonally smallest cash flow quarter. We traditionally have big outflows of cash on our annual incentives in Q1, and in this Q1 specifically, we had additional cash outflows on legacy litigation and restructuring. We are on track for double-digit free cash flow for 2019 and share repurchase remains our highest return on capital opportunity. So, you'll see share repurchase pick up in the balance of the year.

Sean Reitenbach

Analyst, Keefe, Bruyette & Woods, Inc.

Q

All right. Thank you very much.

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

Gregory C. Case

Chief Executive Officer & Executive Director, Aon Plc

I just want to thank everybody for joining us this quarter and look forward to our discussion in the next quarter. Thanks very much.

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

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