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Aon Plc (AON)

Q3 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and thank you for holding. Welcome to Aon plc's Third Quarter 2020 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 third quarter 2020 results, as well as having been posted on our website.

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

Gregory C. Case
Chief Executive Officer & Executive Director, Aon Plc (United Kingdom)

Thanks very much and good morning, everyone. Welcome to our third quarter conference call. I'm joined virtually by Christa Davies, our CFO; and Eric Andersen, our President. As in previous quarters, we posted a detailed financial presentation on our website.

We'd like to begin by thanking our Aon colleagues for their extraordinary focus and dedication in supporting clients and each other. What they do every day is exceptional, whether it's building strong, lasting relationships with clients as we help them navigate these complex times, or the way our Aon colleagues come together to collaborate and innovate in ways that are helping us build an even stronger firm, really tremendous work by the Aon team around the world.

Turning to our performance, in the third quarter we delivered strong results that once again demonstrate the resilience of our business and strength of our Aon business services platform. Organic revenue growth was flat overall, reflecting strength in the core areas of our portfolio and ongoing expected pressure in the more discretionary areas.

We saw continued strength in Reinsurance Solutions with 13% organic revenue growth, driven by strong net new business generation and double-digit growth in treaty, facultative and capital markets.

Commercial Risk delivered modest growth of 2% with strength in the core and continued pressure in more discretionary areas.

Health Solutions growth was 1%, modest growth internationally partially offset by pressure in the US, with respect to ongoing headwinds in the global economy and lower employment levels.

Retirement Solutions and Data & Analytic Services both experienced organic revenue declines as we saw expected pressure in more discretionary businesses like Human Capital, travel and events.

As we assess our revenue outlook for Q4, the primary theme is continued uncertainty in the global economy. As many governments consider new restrictions in response to increases in COVID-19 cases, while government stimulus remains uncertain.

In evaluating Q4 revenue expectations two points are important. First, given the seasonality of our business, we have a larger portion of more discretionary revenue occurring in Q4, so the pressure on organic will be more significant than in prior quarters. For example, areas like construction and transaction liability in Commercial Risk recognize revenue when shovels hit the ground and deals are closed. As expected, we're seeing pressure in these larger investments in the current environment.

In addition, organic revenue growth in Q4 last year was exceptional at 7% overall. As we highlighted last year, this includes double-digit growth in transaction liability as well as double-digit growth in voluntary health benefits, two areas of the more discretionary portions of our business that are seasonally larger in Q4.

Second and importantly, we believe these segments are temporary and reflect pressure from current economic conditions. We're confident in the strong underlying fundamentals of our business. Overall revenue bases are diversified across industry, geography and solution lines, roughly 80% is non-discretionary and has a significant portion that renews every year, with 95% retention rates on average.

From an operating standpoint we delivered strong results including 40 basis points of operating margin expansion in the quarter, contributing to 170 basis points of margin expansion year-to-date, 6% EPS growth in the quarter and exceptionally strong free cash flow of $1.9 billion through September, up 91% from the same period last year.

These results demonstrate the continued resilience of our Aon United strategy, focused on working across our solution lines and geographies, delivering the best of the firm to clients. Further, this strategy continuously evolves in response to client feedback. Over and over our best outcomes come when we listen intently and deeply understand client challenges.

One recent example of this is a partnership with a global market leader in the Internet of things. Using our client's telematics colleagues in Commercial Risk, Human Capital and Data & Analytics developed a mobility as a service solution that includes attributes like on-demand car sharing that forms part of a Total Rewards program for employees.

Our client provided the technology and we provided the insurance solution that's digitally distributed through our Total Rewards platform. This enabled the company to offer a distinctive flexible benefit to their workforce that meets their needs at a time when attracting and retaining talent in new and creative ways is paramount for their growth. Not only have we co-created a cutting edge solution, we've also elevated our partnership with this client to a more strategic level, working together to innovate for mutual growth.

This example of Aon United in action also highlights a larger area where client demand continues to outpace industry innovation. It's one of the areas we described in our recent Innovation White Paper co-written with Willis Towers Watson. Many industry sectors face highly specific challenges that lack adequate solutions. As a result, we recognize that there is a need in our industry to create more affordable, scalable solutions to broaden access to a wider range of recipients.

For example, we're investing in digital distribution capabilities to efficiently reach areas that aren't well served today, highlighted by our CoverWallet capability for the small commercial space. As we've seen across the economy, COVID-19 has accelerated digital adoption. Through September premium volume flowing through the CoverWallet platform is up more than three times over last year, [ph] assuming (06:27) that this new platform is addressing previously unmet client demand for more efficient digital appliance solutions to the risk management needs.

As part of our Innovation White Paper we identified and prioritized four areas we can more quickly and effectively address because of our combination with Willis Towers Watson, further proof that the combination will make us better faster.

As outlined in this piece we think about delivering innovation on at least two levels. The first level is about how our business gets better today as we're in more comprehensive solutions to clients. A big part of this is reinforcing our colleagues' subject matter expertise by industry and geography with analytic tools that help them provide better solutions that enable clients to make better decisions. We're in that type of innovation in our core business every day and see the opportunity to do even more with the complementary capabilities of Willis Towers Watson.

Building on that first level there is a second level in which we bring those comprehensive solutions to net new addressable markets like US mortgage reinsurance and deliver specific insight and analytic driven solutions like Aon Client Treaty. These newer challenges can't be assessed with historic insight alone. We have some of the capabilities today but we'll be stronger in combination with Willis Towers Watson and more capable of delivering these solutions at scale.

A fantastic example of this second level is a solution we recently developed for a private agricultural technology client. Rather than issuing equity they were able to use our Intellectual Property Capital Market solution to raise funds through non-dilutive debt. Our proprietary industry-defining method of valuation enabled us to value their IP so it was insurable and could be used as collateral for a loan of over $100 million.

While this is another example of how we're driving innovation today, we observe the client need continues to outpace innovation in our industry. We believe that our combination with Willis Towers Watson will be fundamental in helping reverse this negative trend. As we've consistently emphasized, our priority is to continue listening to and understanding our clients. We take pride in the strength of our client relationships and we're listening to them more than ever before.

We also want to make sure we hear from them regarding the pending combination, and we are. Clients from across industries, solution lines and geographies have expressed tremendous support for the pending combination and especially for the opportunities it presents to drive enhanced innovation.

Similarly, we're listening to our colleagues and we're hearing that they're incredibly excited about the pending combination and what it means in terms of opportunities for them, both on what they can bring to their clients and their own growth and professional development. We continue to see higher colleague retention year-over-year in total across the firm and across geographies and solution lines.

In Q2 and Q3, we saw a 39% decline in voluntary turnover year over year. Maybe most remarkable, our latest survey of how colleagues are feeling about Aon and our mission, yielded the strongest sentiment in over 10 years. This is a meaningful credit to our people leaders and all of our global colleagues.

In summary, our focus on Aon United and on providing innovative solutions for our clients is delivering results today as we manage through challenging times. Equally important, our progress and development establishes in a position of strength for long term growth, which is accelerated substantially in the combination with Willis Towers Watson.

With that overview, I'd like to turn the call over Christa for further financial review. Christa?

Christa Davies

Chief Financial Officer & EVP-Global Finance, Aon Plc (United Kingdom)

Thanks so much, Greg, and good morning, everyone. As Greg mentioned, we delivered a solid operational performance in both the quarter and year-to-date despite continuing macroeconomic challenges, demonstrating the resiliency of our business and the strength of our Aon United strategy in any economic environment.

We remain committed to deliver shareholder value over the long term which we believe will be accelerated by our pending combination with Willis Towers Watson. Similar to last year my commentary today is more focused on the quarter given differences in the external environment today versus the beginning of the year. I would also note that Q3 is our seasonally smallest quarter. Having said that, we manage our business on a full year basis and target continued progress against our long-term financial metrics.

Our third quarter results reflect continued strong performance in challenging economic conditions. Organic revenue was flat, highlighted by 13% organic revenue growth in Reinsurance Solutions and 2% organic revenue growth in Commercial Risk Solutions.

As I described in Q1, our business has strong fundamentals with roughly 80% being core and 20% relatively more discretionary. As expected, we continue to see large impacts in the more discretionary portions of our business such as Human Capital consulting, travel and events, transaction liability, and project work across the portfolio which contributed to organic revenue declines in Retirement Solutions and Data & Analytic Services. I would also note the reported revenue continues to be pressured by lower fiduciary investment income as a result of lower interest rates globally, representing a decrease of $18 million in the third quarter.

Moving to operating performance, we delivered another quarter of improvement, demonstrating strong operational discipline as we return to more normalized levels of expense compared to the second quarter. We had strong year-to-date performance of 6% operating income growth, operating margin expansion of 170 basis points and EPS growth of 8%.

As I look towards the fourth quarter there's continued macroeconomic uncertainty, and as Greg mentioned we see increased revenue pressure in the fourth quarter compared to prior quarters. Similar to what I communicated last quarter, we expect expenses for the remainder of 2020 to be more consistent with underlying expenses in 2019 excluding adjusted items. This is due in part to an increase in certain discretionary expenses as well as continued targeted investments in priority areas for long-term growth, while maintaining strong operational discipline.

While certain areas such as reduced travel and entertainment expenses continue to be a modest tailwind, we're investing in priority areas such as intellectual property and CoverWallet and making necessary operational investments for instance investing in tools for colleagues and strong cybersecurity as we continue working remotely.

Finally as noted in our earnings materials, FX had an unfavorable impact of approximately $0.01 in the third quarter and $0.06 year-to-date. At today's rates we'd expect a $0.02 per share unfavorable impact in Q4.

Turning to cash and capital allocation, free cash flow increased $908 million or 91% to $1.9 billion, driven by working capital improvement of which a portion is related to short-term actions taken proactively to manage liquidity, a decrease in restructuring cash outlays and strong operational improvement. Much of the strength we see in free cash flow comes from our Aon Business Services platform. I would also note that we're seeing ways in which Aon Business Services allows us to better support colleagues today and make us more resilient in the future.

For instance, over time we've increased the amount of standardization across geographies and solution lines in sharing best practices and driving efficiencies. This has enabled us to better manage employee [ph] well-being (13:48) as colleagues can more easily cover for one another, allowing our colleagues greater flexibility to take time-off or care for their families.

We remain very confident in the strength of our balance sheet and manage liquidity risk through a well laddered debt maturity profile. We ended Q3 with approximately $300 million lower total debt compared to the end of Q2 due in part to paying down substantial amounts of commercial paper in the third quarter.

Historically, we've looked to increase debt as EBITDA grows while maintaining leverage ratios. However due to the uncertain macroeconomic conditions, we expect to continue to manage our leverage ratios conservatively in the near future. We are diligent about maximizing return on invested capital and make capital allocation decisions through this framework.

Share repurchase remains the highest return on capital investment today, given our free cash flow valuation and outlook, highlighted by the $500 million of share repurchase in the quarter and nearly $1 billion year-to-date. We will continue to repurchase shares while maintaining higher than normal levels of cash for the near future given macroeconomic uncertainty.

Stepping back, I wanted to take a moment to reflect on our pending combination with Willis Towers Watson and reiterate how excited we are about the significant shareholder value creation potential. First, as Greg described, we see ongoing opportunity for revenue growth as we bring together these highly complementary businesses.

Historically, Aon has driven growth in three key areas; driving continued improvement in our core businesses, portfolio mix shift for higher growth areas, and unlocking net new opportunities that expand our total addressable market. As Greg mentioned, COVID-19 has highlighted the reality that our clients have growing and unmet needs across risk, retirement and health, which the combination with Willis Towers Watson positions us to address well.

As we've said, we remain committed to the $800 million of expected cost synergies. I would note that we expect these synergies on top of core margin expansion for both firms. And while we see significant near-term macroeconomic uncertainty, we're very confident in our long term strategy to drive margin expansion. We've said before that our margin expansion is driven by accelerating revenue growth, portfolio mix shift to higher growth high margin businesses and leverage from our Aon Business Services operational platform.

In particular, we're confident the investments we've made in our Aon Business Services platform will enable us to capture our expected synergies and continue to drive long-term operating margin expansion for the combined firm. I'd note that over the last decade we've driven 70 basis points to 80 basis points of margin expansion on average each year, though with some years higher and some lower.

Third, we run the firm on a cash basis. We've demonstrated a strong track record of driving efficiencies and growth in areas such as working capital and CapEx. We're confident the investments we've made in Aon Business Services will create even more opportunities to grow free cash flow as we look forward to the pending combination with Willis Towers Watson.

Looking back to our deal announcement on March 9, we said the deal will be accretive to Aon EPS in year one, break even to free cash flow in year two and significantly accretive to free cash flow in year three. Given macroeconomic uncertainty due to COVID-19, we've since withdrawn our financial guidance of mid-single-digit or greater organic revenue growth and double-digit free cash flow growth which were key assumptions of the projections upon which we calculated accretion.

We are not reissuing financial projections at this time given the ongoing macroeconomic uncertainty. However the primary drivers of the accretion that we provided were the $800 million of synergies and our capital allocation strategy. We remain committed to the $800 million of synergies. And while we took actions to proactively manage liquidity earlier this year, we resumed share repurchase in the third quarter and continue to buy back shares.

I would note that mathematically the same amount of synergies on a smaller baseline of EPS would be more accretive. We are confident that the $800 million of synergies, our focus on driving free cash flow and our disciplined capital allocation strategy will lead to meaningful shareholder value creation.

Finally as we continue to make progress against our key milestone, receiving shareholder approval from both sets of shareholders on August 26, with 99% approval from Aon shareholders and 96% from Willis Towers Watson shareholders, we remain on track to close the deal in the first half of 2021.

In summary, our business is showing resiliency despite continued macroeconomic challenges, our Aon United strategy underpinned by our Aon Business Services operational platform have enabled expense discipline and strong free cash flow growth while positioning us for long term growth. Our disciplined approach to return on invested capital provides financial flexibility to unlock significant shareholder value creation over the long term. We're incredibly excited about the pending combination with Willis Towers Watson.

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

David Styblo
Analyst, Jefferies LLC

Q

Hi. Good morning. Thanks for the questions and the color about 4Q. I'd like to just start with that one and get a better sense of what are the areas that have the most exposure to the economic weakness right now and is there any way that you can provide some general book ends around how much organic pressure there will be in the fourth quarter? I was thinking something like mid-single digits would be appropriate or is there just that much more discretion [ph] than to (19:46) have it there where the pressure could be more than that?

Gregory C. Case
Chief Executive Officer & Executive Director, Aon Plc (United Kingdom)

A

Yeah, Dave, what I tried to highlight, [ph] I'll (19:53) start and Christa will reinforce, I think, is listen overall [ph] we have (19:56) revenue going forward nothing's really changed except this unusual year and this unusual year it's all about uncertainty and what we were trying to highlight as we think about Q4, there's just a lot of uncertainty. There's uncertainty on what's going to – how COVID is going to evolve, the reaction of government, the reaction of clients. Colleagues across Aon have done a remarkable job, just incredible job through the first nine months of the year supporting each other and clients.

But when you think about Q4 for us, the pressure we've described and the pressure is real, is really it's because of the disproportionate amount of what we do our discretionary part of overall book happens in Q4. So this is as I described before, like M&A services, voluntary benefits, things like that, they just happen to happen to be in Q4 and it's an uncertain environment. So the actions have to happen. We're very confident they're going to happen over time. Whether they happen in Q4 or not really is the question.

The second piece is you saw Q4 last year was just exceptionally strong. Now we make no apologies for that. We're incredibly excited about that. But it was exceptionally strong, double-digit in a number of these discretionary areas it's just where we are. Then there are aspects of our core business as we've said before like travel and events that are still under pressure and they're going to be back and stronger than ever before. We're very confident of it but it's a lot of uncertainty as we move [ph] into the year (21:07).

We do want to highlight though as you think about the overall profile that Christa described; growth, profitability, EPS, free cash flow, that profile hasn't changed at all as we think about Q4. Christa, anything else you would add to that or Eric?

Christa Davies
Chief Financial Officer & EVP-Global Finance, Aon Plc (United Kingdom)

A

Greg, I might just finish with as we think about our business, we really manage it over the course, Dave, of a full year. And we certainly expect to grow margins over the course of 2020. We expect to grow EPS and we have an extremely strong free cash flow outlook. And I think while there's pressure for sure in Q4 on revenue and therefore on margins, we expect to continue to grow in 2021 and continue to manage all four of those metrics, revenue, margins, EPS and free cash flow over the course of the year.

David Styblo
Analyst, Jefferies LLC

Q

Helpful. Thanks. And then I'm sure it's tough to opine on next year but assuming we get back a little bit more of a normalized environment, organic growth still might be soft. Is there some sort of rough threshold where it gets hard to expand margins? I mean, obviously you curtail those back at the expense of perhaps longer term revenue growth. But, how do you think about that balance for next year if growth is sort of below the 3% to 5% range that many insurance brokers are at?

Christa Davies
Chief Financial Officer & EVP-Global Finance, Aon Plc (United Kingdom)

A

Yes. So, Dave, we do expect to grow margins next year. If you look at 2020 margins as an example, we expect to grow margins in 2020 and we're up 170 basis points year-to-date. Long-term our goal is to drive margin expansion each year as evidenced by our record 27.5% margins in 2019, up 250 basis points on top of 10 years of margin expansion with 70 to 80 basis points each year net of ongoing investment in the business.

And we would say our long-term margin expansion is driven by revenue growth, a portfolio mix shift to higher growth, higher margin areas and Aon Business Services driving productivity. And we believe we've got substantial opportunity for margin expansion with the combination of Willis Towers Watson number one, in growing Aon core margins, number two, in growing Willis Towers Watson core margins, and number three, adding on the $800 million of synergies which we're very confident delivering.

Gregory C. Case
Chief Executive Officer & Executive Director, Aon Plc (United Kingdom)

A

And Dave, if you think about sort of the overall economy, respective of sort of how it struggles and evolves over time. I just also want to remind you on top of, and I really emphasize on top of what Christa just described, you consider the broad based risk that are no longer on the horizon [ph] or in (23:35) our face, things like pandemic, climate change, intellectual property, all the things we outlined in our White Paper that John Haley described so well on the call yesterday in Willis Towers Watson. These are things that are real. They're in front of us. They're going to create demand over time because clients have got to find ways to address these [ph] levels of volatility (23:52). So on top of all that Christa described, that's what we're really excited about the combination of being able to address.

David Styblo
Analyst, Jefferies LLC

Q

Helpful. Thanks so much.

Operator: The next question is from Elyse Greenspan, Wells Fargo. Your line is now open.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

Hi, thanks. Good morning. My first question, just in terms of the merger with Willis Towers Watson, I was hoping you could provide us an update just in terms of timing I guess first half of next year I'm assuming obviously that still holds, but I guess more in terms of just like the regulatory process where we stand today in terms of kind of the timeline you guys had expected when you put the deal together, just given it seems like COVID in some instances is slowing things down. But just want to kind of get an update and see if things are still on track and where we stand from a regulatory perspective.

Christa Davies
Chief Financial Officer & EVP-Global Finance, Aon Plc (United Kingdom)

A

Terrific. Thanks for the question, Elyse. We do believe we are exactly on track to close in the first half of 2021. We filed our joint definitive proxy on Wednesday, July 8 and completed the shareholder vote with overwhelming support on August 26 with 99% of Aon shareholders voting for and 96% of Willis Towers Watson shareholders voting for. We do not expect to provide update to the regulatory process unless we have something to report.

As John Haley mentioned on the Willis Towers Watson's earning call yesterday, several global antitrust filings would be required in connection with the closed transaction. The specific filing process and timing varies by jurisdiction and we do not expect to provide updates until we have something to report. But as we've previously indicated we are on track and expect the deal to close in the first half of 2021.

Eric Andersen
President, Aon Plc (United Kingdom)

A

Hey, Christa, maybe a follow on and around how we're doing with the integration process because I think it's pretty important. We've actually done a lot of work around the culture of the firms, understanding how each of the firms operates, the client centricity, the capability that each of the firms have is so complementary. And we've been using this period of time really to focus on getting to know each other, trying to figure out how do we work better together, as Greg mentioned on the White Paper finding those opportunities. So while that regulatory process has gone on, we've been spending an awful lot of time setting up and doing the planning around how we're going to come together.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

Great. And then in terms of organic growth, going back to the color in terms of the greater discretionary piece in the fourth quarter, you guys said you expect I guess things to slow in the Q4. The Q3 was obviously better than the Q2. Was the point you're trying to make I guess that the fourth quarter would be like the weakest of the year or just slow down sequentially versus the Q3? [ph] I was interested, there was a lot of what (26:36) you were also trying to make as we referenced that to like the second quarter which I guess was the low so far that you've seen during this slowdown.

Gregory C. Case
Chief Executive Officer & Executive Director, Aon Plc (United Kingdom)

A

Yeah. Elyse, what we're really just trying to highlight is this is about this is truly is uncertainty. We are observing by the way the pressure that we described which is real is we – Christa has described before, 80% is core and 20% is discretionary. That 20% disproportionately for us shows up in Q4. And that 20% are things like M&A services. We have an awesome business here, wonderful support for clients. But if shovels don't go in the ground, that doesn't happen. Eventually it happens. But it's – and it builds the business over time, over the coming years. We're not talking about the category. It's great. But in Q4, it's about uncertainty on where it is. Same is true around some of the Health business as we described, travel, events, et cetera. So we're just highlighting there's a lot of uncertainty in Q4. No one really knows. If anybody out there knows, please call us, we'd like to know exactly what's going on.

But our colleagues have just done a masterful job, being ready for clients to move and modify and shape, help them shape their strategies. But we just have a huge amount of uncertainty in terms of Q4 with growth in 2021 and all the things that Christa described, nothing has changed in our overall growth profile on what we expect long term.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

Okay, great. And then just one last one. Christa, I think last quarter you had mentioned that you guys were returning to buybacks and I think you used the word modest. Correct me if I'm wrong. And so you guys bought back $500 million of your stock in just one month in the quarter which was a pretty healthy level. Can you just help us think about buybacks like the level from here given that it was a pretty robust return to buyback when you guys went back into the market in the third quarter?

Christa Davies
Chief Financial Officer & EVP-Global Finance, Aon Plc (United Kingdom)

A

Thanks so much, Elyse. Look, in response to macroeconomic uncertainty we did pause buy back in March in order to maintain liquidity, stability and flexibility. And then we did announce last quarter a resume a limited amount of buybacks for the remainder of the year. We're not giving guidance about capital allocation going forward. We'll assess it based on actual and forecasted cash flow as well as capital market conditions.

And so what you did see, Elyse, is exceptionally strong free cash flow, stunning in the first nine months of the year, up 91% to $1.9 billion, but the macro uncertainty remains. And so what you'll see is we continue to allocate cash based on return on capital, cash on cash return and buyback remains the highest return on capital opportunity across Aon, even at Aon's peak valuation or peak stock price. And so at today's prices it is a fantastic return on capital opportunity. And so we will continue buybacks but it will be based on the cash we generate and capital market conditions.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

Okay, thanks. I appreciate the color.

Operator: The next question is from Jimmy Bhullar, JPMorgan. Your line is now open.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

Hi. Good morning. I had a couple of questions both on the Willis deal. First, there is a lot of skepticism out there about your comments on not really having a lot of revenue dis-synergies as we go through the regulatory approval process and the potential for you being forced to sell parts of the Willis business. So, can you or – or parts of the combined business. Can you discuss what gives you confidence that that won't be the case?

And then [ph] related be, (30:03) on your expense savings targets, if we look at the $800 million number, that's I think close to roughly 5% of the cost base and in past deals you've done a lot more than even 10%, and I would have thought that given the similarities between the two companies, you'd actually potentially be able to do more. So maybe talk about if there is any conservatism baked into your numbers or are there things that you see that are causing you to be more cautious on expense savings?

Christa Davies
Chief Financial Officer & EVP-Global Finance, Aon Plc (United Kingdom)

A

Sure, Jimmy. So I'll take the first one on antitrust. So we do believe we're on track to close in the first half of 2021 as I said with no divestitures. And the reason we're so confident about that is because we have the world's leading antitrust counsel. We've had them for more than 18 months. We've worked through this in detail and we believe we have highly complementary businesses.

And even in areas like reinsurance, which I know it's been speculated upon, Jimmy, we look at that business and we think about it from a client perspective and clients have a huge range of choices. If you think about the client for reinsurance, it's an insurer and they can place direct, which a lot of them do. They can place in the capital markets through alternative capital. They can place through insuretech and they can place through a huge range of brokers, including a number of broker startups, given the significant movement of talent in the reinsurance industry. And so we look at that incredibly competitive field and we do see that there is enormous competition from a client choice perspective. And so, again, we feel really confident about where we are and exactly on track to close the first half of 2021 with no divestitures. Then moving to your second question – sorry, Greg, did you want to jump in?

Gregory C. Case
Chief Executive Officer & Executive Director, Aon Plc (United Kingdom)

A

No, no, please go ahead, Christa. I'll pick up when you're done.

Christa Davies
Chief Financial Officer & EVP-Global Finance, Aon Plc (United Kingdom)

A

And so your second question on cost synergy. So we did announce $800 million of cost synergies, which as you pointed out, Jimmy, is 5.5% of the combined cost base. And we did achieve 11% of the combined cost base in Aon Hewitt and 18% of the combined cost base in Aon Benfield. And what I think that tells you, Jimmy, is we are extremely confident about achieving the $800 million.

What it also tells you, Jimmy, is really the main strategic focus of the combination with Willis Towers Watson is on revenue and on delivering on these new solutions for clients to meet unmet client needs. And really we want to make sure that as we bring the combination together, we're really absolutely laser focused on clients and driving that significant upside in terms of revenue potential as opposed to completely distracted by taking costs out.

But, Greg, what would you say?

Gregory C. Case
Chief Executive Officer & Executive Director, Aon Plc (United Kingdom)

A

I think just to add to the piece, two aspects of it, Jimmy. A very important question. One, just when you think about talent and I think you're asking about talent in addition to just the antitrust piece. Ask yourself as we come together, our colleagues are going to be able to sit across the table from clients with more capability to support clients. That's a wonderfully positive thing. And that's what we want to try to do. That's what we're focused on.

Eric in his work with his colleagues at Willis Towers Watson, Julie Gebauer and others, are really working on how that colleague value proposition comes together to make it more compelling. This is not about synergy. It's about literally net new. And that [ph] then hits (33:16) on the client side. And if you step back and think about there's been a 30 year period when you think about risk as a percent of GDP, where it's gotten less significant. We're becoming less significant as an industry. That's what the facts tell us.

And by the way at a time when client need is going up and then that's become even more pronounced during the pandemic. And so again this is what the White Paper was about. And as we begin to think about addressing those opportunities, that's why this is about growth, that's why this is – there will be synergies of course you bring two firms together. But this is about growth, addressing some of the most significant risks in the world today that are unaddressed and literally unaddressed, pandemic, climate, intellectual property, even cyber relatively less addressed.

And in the end, it's a real opportunity in terms of sort of where we are and what we're trying to do and there's lots of opportunities out there as you think about sort of where we are in specific examples that are happening every day. Eric's foreseen these, but in the end this is really about client opportunity and creating net new as part of this combination.

Eric Andersen
President, Aon Plc (United Kingdom)
A

Yeah, Greg maybe just to pick up on it for a second because I do think our Aon United strategy which we've been working on for several years around how we integrate around the client, bringing all the capabilities, whether it's bringing reinsurance modeling to property clients on our Commercial Risk side there's a hundred of these examples that are out there. Willis Towers Watson has very similar client focused and efforts underway and so when you bring those together as Christa said, this is all about finding new ways to serve our existing clients to do more for them and I think the excitement that's building both from an Aon and a Willis Towers Watson side is really starting to come together as people start to see the possibilities.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC
Q

Okay and just lastly on the Health business, you saw a noticeable improvement in your organic growth of 1% but last quarter was down double-digits. I think in the release there's a mention about some timing of booking revenues, is the majority of the improvement just because of that or I don't know to what extent you can quantify it or was there underlying improvement in the business as well versus 2Q?

Gregory C. Case
Chief Executive Officer & Executive Director, Aon Plc (United Kingdom)
A

Similar as we said in our last discussion really, this is a space we absolutely love the overall opportunity in Health we think was tremendous coming into 2020 and as you well know, Jimmy, it's become even more pronounced as you think about everything that's happened with the pandemic. It's now literally in every board room in every company around the world. And our opportunity to support clients here is tremendous. So we love this long term, and we love it even in the short term, and what you saw in Q3 was just continued progression against that.

Still a lot of uncertainty, still a lot of discretionary events happen in the fourth quarter as it relates to Health particularly in the US. But we love this space long term. The team's done a great job, and we're looking forward to kind of seeing this business grow and progress.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC
Q

Thanks.

Operator: The next question is from Suneet Kamath, Citi. Your line is now open.

Suneet Kamath
Analyst, Citigroup Global Markets, Inc.
Q

Thanks. Good morning. Christa, I wanted to go back to something that you mentioned towards the end of your prepared remarks about the deal accretion. And I think you said something along the lines of spreading the earnings over a smaller share count. So my question is, were buybacks not contemplated in your original guidance that you gave when you announced the deal?

Christa Davies
Chief Financial Officer & EVP-Global Finance, Aon Plc (United Kingdom)

A

So Suneet, actually what I said was if you think about the $800 million of synergies – so if you think about the accretion it was really based on two things. It was based on the $800 million of synergies and it was based on our capital allocation strategy. And so while we remain committed to the $800 million and while we took a pause on buyback earlier this year to manage liquidity, we've resumed share repurchase in the third quarter and continue to buy back shares. And so if you think about accretion mathematically, if you think about the original accretion assumptions on a smaller EPS base, then it would be more accretive today.

Suneet Kamath
Analyst, Citigroup Global Markets, Inc.

Q

Okay. Got it. And then I guess on the deal in terms of regulatory reviews and approvals how might a change in the presidential administration impact the timing of the close as we think about potential changes at the DOJ or elsewhere?

Christa Davies
Chief Financial Officer & EVP-Global Finance, Aon Plc (United Kingdom)

A

Suneet, we do not foresee any impact should there be a change in administration, especially given the timeline [ph] mix set for (37:37) the deal.

Suneet Kamath
Analyst, Citigroup Global Markets, Inc.

Q

Okay. And then my last question just on margin, looking out over time. Christa, you had mentioned a couple of times the 70 basis points to 80 basis points of margin expansion annually and you still feel pretty good about the path going forward. But as we think about margins in the future, is there any way to frame for how much longer you guys think that you can continue to improve margins be it at that 70 basis points to 80 basis point range or something in that neighborhood? So when does this sort of tailwind start to peak or drop off? Thanks.

Christa Davies
Chief Financial Officer & EVP-Global Finance, Aon Plc (United Kingdom)

A

Suneet, thanks so much for the question. Because long term our goal is to continue to drive margin expansion this year. We do not see some cap on margins. In fact we continue to see margin expansion for the foreseeable future. And it's really driven by revenue growth, a portfolio mix shift to higher revenue growth, higher margin areas and Aon Business Services continuing to drive productivity.

We obviously see substantial margin expansion with the combination of Willis Towers Watson because you get Aon core margin expansion, plus Willis Towers Watson core margin expansion, plus the synergies. And as we look at our portfolio today, the portions that are more analytic in nature tend to be higher margin areas of the portfolio. So that gives us confidence going forward that we'll continue to have long term margin expansion.

Gregory C. Case
Chief Executive Officer & Executive Director, Aon Plc (United Kingdom)

A

And so on top of that, Suneet, if you think about what Christa just described, if you just painted a picture over the coming years, literally all the pieces are in place for margin expansion. You think about Aon Business Services and the capabilities the next incarnation of that, call it the new Aon Business Services as we bring the firms together sort of in the new world here, the opportunity over the next few years, that's in place and there is tremendous opportunity for Aon by itself who will start [ph] walking by (39:31) itself and for the combination and that's – we're pretty excited about that.

But beyond that, if you go to the Innovation White Paper for just a minute and ask a question, there are issues that must be addressed. Client need is going up, as we address those issues, they're going to be done with analytics and capability that we're building over time. That analytics gives us a margin profile that's different than it has been before. If you look at other analytics businesses their margin profile and their growth is much more substantial than ours are. So there's – the ceiling you're describing. It's a great question, but we don't see that at all. In fact, as we evolve what we do and we help our colleagues, and it really is about our colleagues more than any time ever about our colleagues, we're truly supporting them with greater levels of analytics that help us address these questions.

This outcome, great for our clients, great for our colleagues, happens to be exceptionally good for our shareholders as well in terms of sort of where we are. So that's why we're so excited about the investment, the combination to address this next level of issues that are out there and no longer on the horizon, they are at our doorstep with a higher awareness than ever before to address them.

Suneet Kamath
Analyst, Citigroup Global Markets, Inc.

Q

Got it. Okay. Thanks for the answers.

Operator: Our last question is from Phil Stefano, Deutsche Bank. Your line is now open.

Phil Stefano
Analyst, Deutsche Bank Securities, Inc.

Q

Yeah. Thanks and good morning. I had another question on margins and thinking more about this in the next year or two. I was hoping you could help me think about the competing forces of when we return to a normal world of growth and a normal world of expenses, does the potential for margin expansion in one particular year have natural pressures from a return of normal expenses?

Christa Davies
Chief Financial Officer & EVP-Global Finance, Aon Plc (United Kingdom)

A

Hey, thanks so much for the question and what we would say is we expect to continue to drive margin expansion each year including – if you thought about returning to a normalized environment, you'd add expenses back as revenue came back. And so we'd be very disciplined about making sure that occurred but if you think about the new better operating model we're consulting with clients about today in terms of the work coalition, you can think about sort of areas like long-term lower real estate costs, more service delivery centers and ongoing Aon Business Services providing productivity improvements over time. And so there are many areas in which we think the opportunity for margin expansion continues to accelerate.

Phil Stefano
Analyst, Deutsche Bank Securities, Inc.

Q

Okay, understood. A quick numbers question. Reinsurance, the organic in the year was a bit strong and one of the things that was noted was a timing benefit. Can you just help us understand what the timing benefit was and when it was from?

Eric Andersen
President, Aon Plc (United Kingdom)

A

So this is Eric. I would say it was pretty minor. The reinsurance business continues to be great on a full year basis but obviously in the third and fourth quarter, are the smallest quarters for us because most of the treaty business is done. It's now facultative and any kind of investment banking work that gets done so I would say it was pretty immaterial.

Phil Stefano
Analyst, Deutsche Bank Securities, Inc.

Q

Okay and then the last one, just philosophically, thinking about share repurchases versus the uncertainty that's come up a lot of times on this call for the next year or two. How do you think about the uncertainty and get comfortable with the fact that at least third quarter was a strong quarter with repurchases that that is the right action to take just given the uncertainty that you have?

Christa Davies
Chief Financial Officer & EVP-Global Finance, Aon Plc (United Kingdom)

A

Hey, thank you so much because we are managing cash and liquidity incredibly conservatively. You can see that as we built up cash and short term investments on the balance sheet. You can see it because we decreased debt by $300 million between end of Q2 and end of Q3. You can see it because we've got a very conservative debt ladder long term for the firm. And so we're being very conservative in response to the macroeconomic [ph] uncertainty (43:30).

Gregory C. Case
Chief Executive Officer & Executive Director, Aon Plc (United Kingdom)

A

And I'd like...

Christa Davies
Chief Financial Officer & EVP-Global Finance, Aon Plc (United Kingdom)

A

And therefore – go jump in, Greg.

Gregory C. Case
Chief Executive Officer & Executive Director, Aon Plc (United Kingdom)

A

Go ahead, Christa. You can finish. My apologies.

Christa Davies
Chief Financial Officer & EVP-Global Finance, Aon Plc (United Kingdom)

A

And so what we see is we're managing this based on our free cash flow which is exceptionally strong. I mean, free cash flow up $908 million year-to-date, up 91%. And then obviously the return on capital opportunity of share repurchase is exceptional. And it was exceptional at peak stock price levels for Aon. And at today's prices is just a stunning return to shareholders. And so for us we'll continue to manage liquidity incredibly conservatively and then we'll continue to invest based on return on capital, cash on cash returns as we think about the firm. But Greg, please jump in.

Gregory C. Case
Chief Executive Officer & Executive Director, Aon Plc (United Kingdom)

A

Yeah. I just want to put it, and if you think about this in context of our overall strategy and what we're doing. Christa is describing literally the discipline and the approach we've taken in managing our balance sheet and driving free cash flow. And that has been exceptional and it continues to be exceptional. And we have the capacity to do a lot as we invest in the business, as we do share buyback. And anything that sort of drives return on invested capital and ultimately free cash flow over time.

But I would highlight you're seeing the buyback. Again, we have capacity to do a lot. The example that I described around intellectual property is an example we're investing in the core business and really doing things from an innovation standpoint. The loan we made, the investment to do that took hundreds and hundreds of colleagues coming together to model intellectual property in ways it's never been modeled before, literally never been modeled before. In a way that we could actually insure a patent portfolio and then get a loan against the patent portfolio. And so we're making lots of investment in the businesses sort of as we build it over time.

I love the example that John gave yesterday, John Haley on the Willis call around climate, so we're investing, we see this is one of the next big horizon around how we help clients think about the transition from to kind of in the new climate challenged world and we can help reduce volatility against that by matching capital with risk.

And fundamentally this is what we're talking about and the beauty of it is from a cash standpoint we have an exceptionally strong balance sheet, exceptionally strong free cash flow, which will be reinforced as we come together in the combination that allows us to actually do the things that Christa described, allocate capital to improve return on invested capital, buyback shares obviously makes sense for all the reasons Christa described, but also invest in the business and bring in additional capability as needed. So you say cash, it is the thing we live every day. We focus on in terms of what we're trying to do and we're working to strengthen and build that over time.

Phil Stefano
Analyst, Deutsche Bank Securities, Inc.

Q

Got 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
Chief Executive Officer & Executive Director, Aon Plc (United Kingdom)

Just wanted to say to everyone as always thank you so much for joining us, we appreciate it and look forward to our conversation next quarter. Thanks very much.

Operator: That concludes the conference. Thank you all for participating. You may now disconnect.