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Aon Plc (AON)

Q2 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and thank you for holding. Welcome to Aon Plc Second Quarter 2021 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 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's 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 second quarter 2021 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)

Thank you, operator, and good morning, everyone. Welcome to our second 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 want to begin by thanking our 50,000 Aon colleagues for their dedication and focus on serving clients. Over the last year-plus, certainly every organization around the world has wrestled with how to best support employees, how to manage record volatility and how to deliver more value to customers. At Aon, our colleagues have led through all this while also preparing for a substantial integration. What our team has accomplished is extraordinary. Today, we move forward with the benefit of all that work without the constraint of regulatory uncertainty.

My remarks will cover our outstanding financial performance in Q2 and year-to-date, provide some observations on the termination of our combination with Willis Towers Watson, then speak to our go-forward plan to continue delivering great service and innovation on behalf of clients, enabling growth for colleagues and delivering excellent return to shareholders.

In Q2, our global team delivered outstanding results across each of our key financial metrics. And I'd note particular strength across the top and bottom line with 11% organic revenue growth driven by mid-single digit or greater organic revenue growth from every solution line, highlighted for particular strength in commercial risk at 14%, which translated into 17% adjusted EPS growth in Q2 and 13% free cash flow growth for the first half.

Our 8% organic revenue growth for the first half reflects mid-single digit or greater organic revenue growth from four of our five solution lines. Our Aon United strategy is delivering net new business generation and ongoing strong retention. We also saw double-digit growth overall in the more discretionary courses of our business, including transaction liability, human capital and project-related work within Commercial Risk Solutions.

One fantastic Aon United plan example in the quarter was around cybersecurity organization design. Aon colleagues came together across solution lines to address a significant yet common client challenge. Our clients' cyber risk was increasing, while their security organizations faced the rapidly increasing cost of attracting and retaining top talent to execute their cyber defense strategy.

Colleagues from our cyber solutions group within commercial risk and from our rewards practice within human capital combined with our unique expertise in cyber risk with best practices and benchmarking around talent and compensation. The result for our client is an organizational design solution that aligns their HR and technology teams to manage their cyber risk in a more cost and efficient way. The result for Aon is a repeatable offering that helps address the common need for many of our clients in an area of growing risk.

I would also note that we saw a strong global macroeconomic condition in the quarter. So we continue to assess three key factors as we have since the beginning of the pandemic. Those factors are the virus and vaccine rollout, including the potential impacts of the delta variant; as well as government stimulus; and overall GDP growth. These macro conditions do affect our clients and our business. For example, we continue to see impact to our travel and defense practice within Data & Analytics Services. Considering the current outlook for these factors, we continue to expect mid-single digit or greater organic revenue growth for the full year 2021 and over the long term.

Turning now to the termination of our combination with Willis Towers Watson. We recently announced our mutual agreement to move forward as two independent companies. On behalf of Aon, I'd like to thank our counterparts at Willis Towers Watson for their professionalism over the past 16 months since we announced the transaction. We have the utmost respect for them and have truly enjoyed getting to know the team. The combinations had significant regulatory momentum, including notably approval from the European Commission as well as approval from many jurisdictions globally who had thoroughly evaluated and vetted the transaction.

The exception was the United States. The demands made by the US Department of Justice on our US business would have stifled innovation and reduced our client-serving capability. Meeting these demands would have significantly impacted our existing US business, the potential shareholder value creation of the combination and our ability to continue to drive ongoing progress against our key financial metrics.

Similarly, the path forward on litigation was untenable because current course appear to take us well into 2022, and we could not accept that level of delay. Ultimately, the choice was clear. We simply would never compromise colleague and client priorities to close the combination. Our decision to end the combination and pay the termination fee create certainty and clarity about how we move forward, and we're confident this is the right decision for our firm, for our colleagues, our clients and our shareholders. We move forward with energy and a high confidence in our ability to continue delivering new and innovative solutions for clients, exceptional opportunity for colleagues and the financial performance for shareholders.

As we look forward, there are three important points that were clear when we announced the combination and are equally if not more important now. First, the world is becoming more volatile, and clients need a partner capable to accelerate innovation on their behalf. Just look at the socioeconomic impact of the pandemic, the rise of state-sponsored cyber hacking, the floods in Eastern Europe, the fires in Western America and the challenges globally are working remotely.

Second, the events of the past 16 months have honed the power of Aon United in our ability to work together to deliver new sources of value to clients. Over this time, we crystallized our operating model and cemented our one-firm mindset. We've uncovered countless new growth, investment and efficiency opportunities. And at this point, we're better connected across our firm with all the value of this work and none of the integration distraction.

Third, we're moving forward with a proven platform and are operating from a position of strength and momentum as demonstrated by our client feedback and colleague engagement scores at or approaching their highest levels for the past decade. Our colleagues are delivering client retention and net new business generation across all solution lines, driving 8% organic revenue growth over the first half and 11% organic revenue growth this quarter, our strongest performance in almost two decades.

And Aon Business Services operating platform is digitizing our firm, improving the client experience and enabling efficiency as demonstrated by operating margin expansion and 13% free cash flow growth in the first half. Aon has never been in a better position to propel top and bottom line growth and build on over a decade of progress on our key financial metrics.

In summary, our second quarter results demonstrate the success and momentum of our Aon United strategy. We're operating from a position of strength and we have never been better positioned to deliver for clients, support our colleagues and generate shareholder value.

Now I'd like to turn the call over to Christa for her thoughts on our results, the financial impact of termination and our long-term outlook for continued shareholder value accretion. Christa?

Christa Davies

Chief Financial Officer & Executive Vice President-Global Finance, Aon Plc (United Kingdom)

Thanks so much, Greg, and good morning, everyone. We delivered continued progress for both the quarter and year-to-date, including an impressive 11% organic revenue growth in Q2. Through the first half of the year, we've translated strong organic revenue growth into double-digit operating income, earnings per share and free cash flow growth, demonstrating the power of our Aon United strategy.

As I further reflect on our performance in the first half of the year, as Greg noted, organic revenue growth was 11% in the second quarter and 8% year-to-date. We continue to expect mid-single digit or greater organic revenue growth for the full year 2021 and over the long term. I would also note that total reported revenue was up 16% in Q2 and 12% year-to-date, including the favorable impact from changes in FX rates driven by a weaker US dollar versus most currencies. Our strong revenue growth and ongoing operational discipline contributed to adjusted operating income growth of 11% in Q2 and 14% through the first half of the year.

Turning to expenses and margins. There are two key points I wanted to describe further. First, I want to speak to the impact of our previously communicated repatterning of expenses as compared to COVID-impacted spend in 2020, which I'll describe before any 2021 growth. As we communicated in Q1, the timing of expenses is changing year-over-year, such that $135 million of expenses moved into Q2 from Q4. This impact is due to the actions we took and highlighted last year, as we reduced discretionary expenses to be prepared for the potential impacts of COVID-19 and potential macroeconomic distress.

The $135 million is approximately 1.5% of our total 2020 expense base. In Q2, this repatterning negatively impacted margins by approximately 470 basis points, resulting in Q2 operating margin contraction of 100 basis points. Excluding these impacts, margins would have expanded by 370 basis points in Q2 and 250 basis points for the first half of 2021. As we said before, we expected a further $65 million to move from Q4 into Q3 for a total of $200 million of expenses moving out of Q4.

A second key factor impacting margins has been the relative speed of revenue growth and investment. In Q2, excluding the impact of repatterning, our strong revenue growth significantly outpaced expense growth. We continue to evaluate investments using our ROIC framework. While we made deliberate investments in people, operations and technology to enable long-term growth, the expenses associated with these investments were not fully incurred in Q2 and will ramp up during the second half of the year. We also anticipate some potential resumption of T&E and modest potential increases in real estate costs as more colleagues returned to the office.

Collectively, the headwind from expense repatterning and tailwind from slow investment as compared to growth were the main factors driving 100 basis points of margin contraction in Q2 and the 40 basis points of margin expansion in the first half of 2021. Looking forward, as we've said historically, we expect to deliver full margin expansion for 2021 and over the long term.

Heading back to the results in the quarter. We've translated strong operating income growth into adjusted EPS growth of 17% in Q2 and 16% year-to-date. As noted in our earnings material, FX translation was a favorable impact of approximately $0.04 in Q2 and $0.22 year-to-date. If currency remains stable at today's rates, we'd expect a $0.02 per share favorable impact in Q3 and $0.01 per share favorable impact in Q4.

As Greg mentioned, Aon and Willis Towers Watson mutually agreed to terminate our business combination agreement and move forward immediately as two independent firms. In accordance with the business combination agreement, we have paid the $1 billion termination fee to Willis Towers Watson.

With respect to the termination fee, our US businesses were the primary focus of the Department of Justice's challenge, and we paid this fee to defend that business from additional remedy divestitures that are essential to our ability to serve clients as well as the continuing delay and uncertainty in completing the combination.

As part of the termination, we also expect to incur approximately $350 million to $400 million of additional charges in Q3 related to transaction costs and compensation expenses as well as a small number of actions related to further steps on our Aon United operating model. These charges are related to cost to terminate and conclude the combination, including related divestitures. They will all be incurred in Q3 as part of a clean break with Willis Towers Watson.

Given the outstanding work our colleagues have done over the last past 16 months, we've taken steps internally to ensure our colleagues share in the growth potential of the firm going forward. And this includes those who were previously offered retention bonuses in connection with the combination. The majority of the cash relating to these charges were paid in Q3 and Q4. Aside from these transaction costs, we do not expect any further significant impacts from the termination of the transaction on our financials going forward.

Excluding the termination fee, our performance and outlook for free cash flow growth in 2021 and going forward remain strong. Free cash flow increased 13% year-to-date to $1.3 billion driven primarily by strong operating income growth and a decline in structural use of the cash. We continue to expect to drive free cash flow growth over the long term, building on our long-term track record of 14% CAGR over the last 10 years based on operating income growth, working capital improvements and reduced structural uses of cash.

As we communicated in Q1, we continue to expect CapEx for the full year to increase modestly year-over-year as we invest in technology to drive business growth. Given our outlook for long-term free cash flow growth, we expect share repurchase to continue to remain our highest return on capital opportunity for capital allocation. In the second quarter, we repurchased approximately 1.1 million shares for approximate $240 million.

We also expect to continue to invest organically and inorganically in innovative content and capabilities to address unmet client needs. Our priority areas of investments are focused on addressing new forms of volatility like cyber, helping clients build a resilient workforce with better solutions around engagement and employee benefits, rethinking access to capital such as within intellectual property solutions and addressing the underserved with digital solutions like CoverWallet. Our M&A pipeline is focused on bringing innovation at scale to our clients' biggest challenges, delivered by the connectivity with Aon United.

Now turning to our balance sheet and debt capacity. We remain confident in the strength of our balance sheet and managed liquidity risk through a well-laddered debt maturity profile. Our financial profile has improved over the past 18 months. And considering our June 30 balance sheet and the payment of the termination fee, we estimate we have $1.5 billion of additional debt capacity for discretionary use for the second half as we return to historical leverage ratios while maintaining our current investment grade credit ratings.

Over the long term, we expect to return to our past practice of growing debt as EBITDA grows. Further, I'd note that free cash flow generation in the second half is seasonally stronger than the first half, and we intend to allocate this cash to our highest and best use based on return on capital.

In summary, we ended the second quarter in a position of strength as our Aon United Strategy and investments in long-term growth are driving strong top and bottom line performance. While the termination of our combination with Willis Towers Watson was not the outcome we originally intended, the opportunity for Aon has only grown. Our disciplined approach to return on capital, combined with our expected long-term free cash flow growth and increased debt opportunity, provides financial flexibility to unlock significant shareholder value creation over the long term.

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

QUESTION AND ANSWER SECTION

Operator: The phone lines are now open for questions. [Operator Instructions] Our first question in the queue is from Elyse Greenspan with Wells Fargo. Your line is now open.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

Hi. Thanks. Good morning. My first question, Christa, is on buyback. So you pointed out that you guys typically had stronger free cash flow in the second half than the first half. So last year, you guys had around $1.5 trillion of second half free cash flow. And then you alluded to maybe an incremental $1.5 billion of additional debt that you guys could issue. So is that mean to imply that we could see around $3 billion of incremental share repurchase in the back half of this year?

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

A

So Elyse, we don't give guidance on share repurchase. But what we can say is, as you mentioned, cash flow in the second half of the year is our seasonally strongest cash flow generating two quarters, Q3 and Q4. We've been very clear that we have the opportunity for additional debt of $1.5 billion in the second half of the year. And therefore, we have substantial cash to invest back into the firm, whether that's organic investment, M&A or share repurchase. I would note that we do allocate cash based on return on capital, cash on cash returns, and buyback remains our highest return on capital opportunity. Even at today's prices, it is a fantastic return on capital for shareholders. And on that basis, we expect to do substantial share repurchase in the second half of the year.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

Great. And then my second question, I think you mentioned that folks that were eligible for retention payments with the transaction would be receiving some payments. I think that was the basis for the charge that you're going to take in the third quarter. But can you – so I just want to confirm that. And then can you give us a sense of how the employee retention has trended? I know the past year has been during the pandemic but why the merger is going on or even over the past couple of months with the regulatory review, have retention levels been in line with normal expectations? Just can you give us a sense of how things have been trending there?

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

A

Sure. So regarding the $350 million to $400 million of additional charges in Q3, they're really related to the transaction costs and compensation expenses as well as a small number of expenses related to further steps in our Aon United operating model. I would say these charges are really related to the cost to terminate and include the combination as part of a clean break with Willis Towers Watson.

Then in terms of the outstanding work our colleagues have done over the past 16 months, we've taken steps to ensure that our colleagues share in the growth potential of the firm going forward. And that includes those who were previously offered retention bonuses in connection with the combination.

So with that, I'll hand to Eric to talk for retention overall at Aon.

Eric Andersen
President, Aon Plc (United Kingdom)

A

Sure. Thanks, Christa. And I would just say, Elyse, we continue to attract great people in all the key strategic areas for growth and expertise that Christa outlined in her remarks. We don't really pay too much attention to the headlines or the commentators that talk about talent and certainly reject the premise of disruption that we've been hearing.

Look, we have a great team. And just to give you a couple of facts, voluntary attrition continues to be excellent for us. We just did a poll survey in June and ended up with top quartile engagement scores for our colleagues. These trends, I think, are the result of all the flexibility and connectivity and the support we've been giving to our colleagues over the last six months, not just with the Willis Towers Watson combination but also with the pandemic. And so we feel really good about the team that we have, the bench, the development of all of our talent and know we're really well positioned going forward.

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

A

Maybe, Elyse, I just would add a thought on top of that. When you think of it as a colleague, you're sitting across the table from a client, listening to their challenges, their opportunities. Where would you want to be? A firm with the capability we have in the here and now, what we can do, also a greater level of spend and investment, innovation than anyone in the world. And it's just been – it's been a great story that's evolved. And the pandemic, as I tried to highlight in the opening comments, it just amplified the importance of this around the need for innovation, climate, intellectual property, cyber, et cetera. So all these things come together to make the value proposition quite unique.

But really, I just want to call out, our colleagues have been just magnificent over the last 16 months in every way, shape or form in terms of how they've not only managed through all of the different pieces around integration, but also what they've done for clients. It's just been extraordinary to see, and that's shown up in multiple ways.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

Okay. Thanks for the color.

Operator: Next question in the queue from Suneet Kamath with Citi. Your line is now open.

Suneet Kamath
Analyst, Citigroup Global Markets, Inc.

Q

Thanks. Good morning. I guess for Christa to start. If I think back to your guidance sort of pre-Willis Towers Watson in terms of free cash flow growth, you typically talked about a double-digit growth rate. In today's deck, you just talk about free cash flow growth. So I'm just trying to figure out is there something that's different relative to what you said in the past or do you still think double-digit free cash flow growth over the long term is what you guys are positioned to achieve?

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

A

Suneet, we absolutely believe in double-digit free cash flow growth over the long term and we're incredibly excited about the growth potential in terms of revenue, margins and free cash flow over the long term. So nothing's changed there.

Suneet Kamath
Analyst, Citigroup Global Markets, Inc.

Q

Okay. And then, I did note in the second quarter, free cash flow was down maybe 13% relative to the second quarter of last year. Is there anything unusual that sort of drove that?

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

A

No, nothing. What we would say, look, you should really look at free cash flow growth over the course of a year and we will absolutely grow free cash flow during 2021. And I would just say quarter-to-quarter, there are some lumpy things. We're very excited about the free cash flow growth year-to-date at 13%.

Suneet Kamath
Analyst, Citigroup Global Markets, Inc.

Q

Okay, makes sense. And I guess maybe a bigger picture question for Greg. Post this experience with Willis Towers Watson, just want to ask about your thoughts on you've mentioned transformative M&A in your deck. What are you thinking there in terms of M&A? Should we be expecting things that you do would be on the smaller side given the past 16 months or just how you're thinking about inorganic growth?

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

A

Suneet, for us, you come back to what Christa teed up just a bit ago on Elyse's question. We've just got an enormously positive performance and that sort of carried through over the last 16 months. That's shown up in what really is a focal point for Aon, which is translating revenue into free cash flow and the ability to grow free cash flow. And with that cash, it really comes how we invest it and it truly comes back to return on invested capital. So we'll always going to take steps that actually maximize return on invested capital with the cash on cash return.

And we'll look to opportunities. We have tremendous organic opportunities, inorganic opportunities, all shapes and sizes and very much looking forward to sort of driving shareholder value, applying the cash in the appropriate way. And we'll continue to look for all means to do that.

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

A

And maybe I might just add and say, look, we are incredibly excited about the cash flow growth potential of the firm, both in the second half of the year and going forward. And then obviously, our ability to grow debt as EBITDA grows, we've got an enormous amount of cash to invest and we'll invest organically, inorganically with M&A and in buyback on a return on capital basis.

And as I mentioned, we've actually got a number of priority areas for investment really focused on meeting unmet need clients, addressing new forms of volatility like cyber, helping clients build a resilient workforce, rethinking access to capital in innovative new areas like intellectual property and addressing the underserved through our investments like CoverWallet. So we've got an exciting array of investments that we are continuing to invest in. And so we're really excited about the growth potential going forward.

Suneet Kamath
Analyst, Citigroup Global Markets, Inc.
Q

Okay. Thank you.

Operator: Next question is from Jimmy Bhullar with JPMorgan. Your line is now open.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC
Q

Hi. Good morning. So I had a question on just the organic growth in the commercial lines – commercial business. And it was obviously 14% for you guys, strong for most of your peers as well. And obviously, comps were pretty easy. But other than comps, what are sort of the main drivers of that? I think you mentioned in your release pricing was a modest positive. But I'm just trying to assess what are some of the things that might not be sustainable because they're related to either to a catch-up in business activity or other things versus things that might continue at least in the near term.

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

Jimmy, maybe I'll just start with a couple of overview thoughts and Eric can talk about the different pieces in geographies around the world. What we've seen is really strength on strength continue to evolve. For us, there was really no catch-up in any way, shape or form. If you go back to early last year, we're in a very strong position and that just continued to build through the pandemic. As client need increase, our ability to react to clients and serve them also continued to increase.

And so Jimmy, we ended up with new business generation, net new business generation really at all-time high and it continued to build, moved into the third and fourth quarter of last year. Now you see it in the first half of this year and really for the last five quarters, a real kind of tour de force effort on behalf of colleagues around the world on all areas as they relate to – as it relates to growth. It's why we underscore and reinforce the mid-single digit organic for the year and ongoing beyond 2021, but it really is the fundamentals. It really is how we're connecting with clients and supporting clients, how we're applying the Aon United strategy of bringing the best of our firm to clients every day, and that actually has just strengthened and grown. That's why we really come out of the last 18 months, when you think about the chassis of Aon, the Aon United Foundation, it's stronger than ever before.

But, Eric, a lot is going on around the world by geography, a lot of good stories. Thoughts?

Eric Andersen
President, Aon Plc (United Kingdom)
A

Yeah. Sure. Listen, I think there's a couple of things to point out. One is we had double-digit growth in commercial risk in each of our geographies around the world. So it's really a great quarter all the way around. Really strong rollover, really strong retention, which really sets you up in the future for continued growth. And it was a couple of things, right? The core P&C business performed really well. So really pleased about that everywhere. But also, the discretionary work that Greg and Christa had talked about, whether it was transaction liability, fiber construction, other project-type work, all of which were performing very well equally across the world. So we had a really solid performance everywhere and we're really excited about it obviously.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC
Q

Okay. And then, just on pricing, you mentioned a modest positive. It would have seemed like it would be a better than modest positive just given what we've seen – been seeing with the underwriters. But what are your – what's the sort of color on that?

Eric Andersen
President, Aon Plc (United Kingdom)

A

Yeah, sure. It's always a great question because people always wonder why the direct carrier sort of per unit price doesn't show up and translate across to the intermediaries on the risk side. And listen, I would just say clients make choices when prices move up or down, right? And one of the things that we do with them, and I think I've mentioned this in the past, we first help them to identify the risk that they have and then try and manage them, right, without the use of risk transfer. And then as prices go up, clients finance more of it themselves if they can handle it. And then ultimately, when you get to the risk transfer part of whether they decide to trade the risk, they make choices there too, the amount of insurance that they buy, the co-insurance deductibles, things they try and manage for them, the budget that they have to spend on topics like risk transfer.

So it's never a direct line from what a carrier publishes as a rate to what a client actually does for the risk that they're trying to transfer. And so all those areas that we're talking about, clients have a real heightened focus on during a time when pricing is increasing, they get very specific around how they try and manage it themselves or finance it themselves before they try and risk transfer it into the market.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

Are you seeing more pushback from clients on price hikes? Because it seems like commentary from the underwriter side is still pretty positive on what's going on.

Eric Andersen
President, Aon Plc (United Kingdom)

A

Well, listen, clients certainly don't want after three years of a rising market to pay more for a similar risk. But ultimately, I think what they've done is they've continued to just get more sophisticated. I think we've been able to help them with our data and analytics and insight to be able to make better choices around how they handle the risks.

Operator: Next question is from Greg Peters with Raymond James. Your line is now open.

C. Gregory Peters
Analyst, Raymond James & Associates, Inc.

Q

Good morning. Thanks for taking my questions. My first question will just stay focused on organic. Beyond Commercial Risk Solutions, you had some very strong results in reinsurance and in health. And Greg, I think you did call out a headwind or two in data analytics. Your guidance is for mid-single digit or better going forward. I guess what I'm trying to get at here is how much of the second quarter result was a snapback and how much of it is permanent in terms of how we should think about organic going forward?

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

A

So Greg, I appreciate the question and the thought. Terrific. Listen, as we think about the growth profile, we keep coming back to this idea of the commitment around mid-single digit or greater for the rest of the – for the year and for 2022 and beyond. If you think about it, we did four of the five solution lines sort of meeting that standard in the first half when we've got great trajectory. No doubt, there's variance sort of within the solution lines. I highlighted in Data & Analytics Services. Look, our travel business is still under a tremendous amount of pressure, as you would expect. But still our colleagues are fighting through that and finding opportunities, finding ways to connect with clients and you're seeing that.

So for us, we feel good about mid-single digit or greater. We've made that commitment before. And there was really no snapback, as we've said before, the ability to connect with clients and drive growth has sustained throughout the pandemic and certainly sustained and probably even amplified into 2021. So that's why we feel quite strong about the outlook.

C. Gregory Peters
Analyst, Raymond James & Associates, Inc.

Q

Got it. And then, Christa, on the expense repatterning, as we gradually return back to whatever the new normal looks like, when we – and I know you don't like to comment on projections. But when I think about 2022, are we going to have another expense repatterning if things get back to what the old normal was? Or is what you're experiencing here in 2021 sort of the new bar which we can go to and measure on a quarter-over-quarter basis going forward?

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

A

So it is the new basis and you should expect expenses to be consistent with this patterning going forward. And so really what I would say is it's reflecting changes from a COVID-impacted 2020 expense base. So 2020 was the unusual patterning, Greg. And 2021, we're repatterning to get back to our normal expense patterning. So this is the correct performance across the year going forward.

C. Gregory Peters
Analyst, Raymond James & Associates, Inc.

Q

Got it. Thank you.

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

A

And just to reinforce, Greg, as Christa highlighted very well, when you think about this over the course of the year and what we're trying to do not within quarters, exceptional performance that continues to improve.

C. Gregory Peters
Analyst, Raymond James & Associates, Inc.

Q

Makes sense. Thanks for your answers.

Operator: Next question is from David Motemaden with Evercore ISI. Your line is now open.

David Motemaden
Analyst, Evercore ISI

Q

Hi. Thanks. Good morning. I wanted to stick on cash flow. And I guess, first, it looks like – I was just wondering, do you think CapEx looked a little bit lower than I had thought? Do you still expect that to be up for the full year? And also, I think – when I think about the seasonality and the second half is higher than the first half, I just wanted to confirm that that's excluding the $350 million to $400 million of termination costs and retention bonuses. So we should think – I think that would take away a lot of the seasonality, but just wanted to confirm that.

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

A

Yes. So firstly, we expect very strong cash flow in the second half. And yes, it excludes the – we expect the termination expenses to be adjusted out of Q3. Having said that, we do expect free cash flow to be strong for the full year and we're extremely excited obviously about the 13% growth in the free cash flow year-to-date.

In terms of your question around CapEx, we would say that CapEx should increase modestly year-over-year driven by investments in technology to drive long-term growth. And I would say, look, going forward, we expect free cash flow to grow double digits over the long term really driven by three key things: growth in operating income, declining uses of cash and improvements in working capital. And so we're really excited about the growth in free cash for long term as well as our ability to add debt as EBITDA continues to grow. So a substantial amount of cash to invest back into Aon.

David Motemaden
Analyst, Evercore ISI

Q

Got it. That's helpful. And then, maybe just a question, it definitely sounds – just on the Willis merger and any sort of impact that might have on the business. I know you guys spoke about it in response to your previous question, but I'm hearing that it sounds like you didn't want the deal to stretch into 2022. And also, obviously, there are the retention payments and some of the other termination payments. I guess, could you just maybe elaborate on if you would expect any sort of disruption going forward in the organic growth?

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

A

Well, maybe let's start with it's worth actually just putting things in context when you think about sort of where we've come over the last 16 months and we'll translate it directly into growth, which will be a great story as we've shown in the first half. When you take a step back in the last 16 months, the primary thesis behind the combination, exceptionally strong. In fact, the pandemic just made it stronger over that period of time. Obviously, strong shareholder approval, regulatory momentum in virtually every jurisdiction around the world.

And I noted, obviously, DG COMP in the European theater but others around the world as well. And just so you understand, we reached an impasse in the US Department of Justice. We could have completed the deal in a couple of ways but we made the choice to reject what we believe were two unacceptable options. One was the remedies. So we could have completed the deal through the remedy just like we did in Europe. But it wouldn't have been the right answer for us. It simply would not have been the right answer. We roughly knew what it would take, but candidly would it damage our client-serving capability, as we described before, stifled innovation. And as I've said, you've heard Eric and Christa talk, that we will never – we'll just never sacrifice our Aon United strategy to close the transaction. That's not going to happen. And in the end, that's where we were on the remedies side.

And the second option, equally unappealing, was litigation. We have an exceptionally strong hand from our view. But the timeline pushed the deal into 2022. It looked like it did in every way, shape or form, also unacceptable. We're just not going to wait in a holding pattern well into 2022 to sort of have this resolved. It is just too long.

So we wanted to make a choice, David, for our firm. And it was on our terms to move forward independently and obviously a position of strength. If you think about where we were in 2020 and now where we are now, very much a position of strength. And we're excited about how we move forward with real enthusiasm driven by our team and the strength of our Aon United strategy. So that's the rough picture in terms of sort of where we are. But when we get to growth, Eric or Christa, anything else you want to comment on that?

Eric Andersen
President, Aon Plc (United Kingdom)
A

Yeah. Sure, Greg. Maybe I'll talk a little bit about the integration planning process and how we're using that work to help propel us forward post this event. Maybe to go back a little bit, we went into the – certainly the pandemic and the Willis Tower Watson combination in a great place, right? We were very strong going in both operationally and with revenue growth. And when we started the integration management effort, we were essentially able to maintain the client momentum and continue to work on our strategy.

During the last 16 months of planning, the teams really perfected our Aon operating model, the delivering Aon United Strategy as well as our go-to-market, how do we actually pull all these teams together for the benefit of our clients. All that's going to be incorporated going forward, which will continue to build the momentum. So I think while we came into this process in a strong position, I think we're actually coming out of it in an even stronger position.

Christa Davies
Chief Financial Officer & Executive Vice President-Global Finance, Aon Plc (United Kingdom)
A

Completely agree. And I would say, our financial results have strengthened in growth, in margins and in free cash flow. If you look at 2021, we delivered 11% growth in Q2 organically, 8% growth organically year-to-date and 13% growth in free cash flow year-to-date, just stunning financial results in 2021. Building on a really strong 2020, 1% growth organically through COVID, 100 basis point margin expansion to 28.5% and 64% growth in free cash flow to $2.6 billion. Building on a decade of progress, 4% average organic growth over the last 10 years, 890 basis points in margin expansion over the last 10 years and 15% free cash flow growth each and every year over the last 10 years.

So phenomenal set of financial results. So we would say, our financial results have strengthened in growth, margin and free cash flow. But Greg, do you just want to come back to the growth question?

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

Yeah. So again, David, I think – just want to give you a sense of sort of what that history has been over the last 16 months, to your question, then you kind of say, how does that translate into growth? I think Eric's point made it really important. The fundamental capability actually has strengthened. We've spent so much time thinking about opportunities on the growth side, on the efficiency side, on the investment side. And we came up with a ton of them, and we're incorporating all of those. All that then reinforced by the Aon United strategy and the connectivity.

And ironically, COVID created a situation where we are on WebEx, I know there's different systems. WebEx connected our firm in way, sitting across the virtual table from clients in a way that's been incredibly powerful. And that's what's led to literally net new business growth and also growth with existing clients. The strongest we've ever seen. So it really positions us exceptionally well to continue to increase market share and take share around the world, which we've been doing and continue to do as well as create net new.

And I just want – I don't want to get away. This is not a zero-sum game for us. We're winning the zero-sum game, but it isn't about that. It's about net new. As we put solutions in place around cyber, intellectual property and in climate. I mean it's just the three we talk about a lot. And we're spending tremendous amount of time to focus on those. So we're very excited about the growth prospects. That's why we talk about mid-single digit or greater across all our solution lines in 2021 and beyond.

David Motemaden
Analyst, Evercore ISI

Q

Great. I mean, yeah, thanks so much. I really appreciate that color. It's really helpful. And yeah, I mean, it's obviously not showing up any sort of disruption. There's no evidence of that in the results. So I definitely appreciate that. Thanks a lot.

Eric Andersen
President, Aon Plc (United Kingdom)

A

Sure.

Operator: Next question is from Meyer Shields with KBW. Your line is now open.

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

Q

Thanks. I guess my first question is on, how do I put, communication philosophy. Because it looks like the expectation for organic growth for 2021 is mid-single digits or higher. And I would assume that this is on a year-over-year basis, probably just a phenomenal operating environment with the economy hopefully coming back and sustained rate increases. And I'm wondering whether the use of the sort of traditional language event indicates that we shouldn't expect too much from these tailwinds.

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

A

Well, Meyer, I wouldn't say that. In fact, what we're trying to highlight is, listen, there's still a lot of volatility out there in the world. It's moving around. We essentially have said in the face of that volatility, wherever it goes, we're very confident in mid-single digits or greater. By the way, not just for this year, but ongoing as a piece and then double-digit free cash flow. And our view is that economic model, as we think about it from an investor standpoint, is extraordinary in terms of sort of what that means. And so we're just – what we want to do is make sure you understand, we're reflecting the high confidence in our ability to achieve that. And we'll keep pushing forward on that basis. So there is a – it's not about rebound or anything else.

But Christa, anything else you want to throw in that?

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

A

The only other thing I'd add, Meyer, is there is still some macroeconomic uncertainty and there are still some areas of our business like travel events that haven't fully come back. And so we will navigate through this and still deliver phenomenal financial results for the year, mid-single digits or greater in 2021 and going forward.

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

Q

Okay. That's very helpful. Second question, I appreciate Eric's comments on employee retention and attrition. When we look at the, I don't know, number of brokers that are out there in, I guess, reinsurance or large accounts, is there any increased competition for talent that would require higher organic growth rates for margin expansion than we've seen in the past?

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

A

I think we just say, overall, it's competitive out there. It's always competitive, as Eric highlighted very well. We love the model we have because the opportunity for colleagues at an individual level and literally together, and that's really what we're talking about individual capability but also collective greatness, collective ability to succeed, is exceptional at Aon. And that, for us, has served us exceptionally well. But there's I wouldn't say, Eric can comment on this, any more or less competition than there's always been in terms of sort of what's been out there.

Eric Andersen
President, Aon Plc (United Kingdom)

A

Yeah, I agree, Greg. I mean it's always been a very competitive business across all the risk platforms, whether it's the primary brokerage or the reinsurance brokerage. And so yeah, I think just ultimately, we continue to have to bring our best each and every day to our clients with the best tools and insight. And if we do that, I think we'll be fine. But Christa, anything you'd add?

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

A

Yeah. And maybe just on the margin point, I guess what I would say is we can grow margins in any operating environment. You saw last year when we produced 1% organic revenue growth, we expanded margins. And because of the investments we've made in Aon Business Services, really bringing together all of our operating sort of infrastructure in one place, centers of excellence, all of the people and capabilities in one place, we're able to drive productivity benefits each year at scale. And so we'll continue to drive margin expansion for the foreseeable future, building on the 890 basis points of margin expansion we drove for 90 basis points a year over each year. And so we expect to drive margin expansion in 2021 and each year thereafter regardless of growth.

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

Q

Okay. That's perfect. Thank you so much.

Operator: Next question is from Phil Stefano with Deutsche Bank. Your line is now open.

Phil Stefano
Analyst, Deutsche Bank Securities, Inc.

Q

Yeah. Thanks and good morning. Christa, if I heard you correctly earlier, I think you had talked about a ramp in investment that's going to pick up in the near future. I guess, in my mind, the gap of growth in revenues versus underlying expenses is going to narrow. Looking in the long run, this normalizes as you've talked about the expectations for margin expansion But can you just give us a frame to think about how this looks like in the short run in the extent to which this gap may narrow and maybe some economic sensitivity to the broader recovery?

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

A

Yeah. So really the point I think I was making, Phil, was in Q2, we did see greater underlying margin expansion, excluding the repatterning of expenses, because growth outpaced our ability to invest in that growth. And a lot of the investments, while we did invest in people, in operations and technology to drive out business, some of that was not fully incurred in Q2. So it was really a statement about Q2 specifically, Phil, and really what I would say is – what you said is exactly right. Over the long term, growth and expenses to drive that growth will be aligned.

Phil Stefano
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Got it. So my follow-up – that fits perfectly to my follow-up, you talked about delivered investments in people and technology. Can you give us a little more color what exactly that means, maybe an example or two of what's driving these delivered investments?

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

A

Yeah. I mean there's a number of areas, Phil, where we're investing. So maybe I'll start and, Eric and Greg, you can jump in. But as an example, we're investing a lot in technology to help deliver innovative data analytic-based solutions to our clients to help them manage risk, retirement and health more effectively. So that will be one area. We're investing security because obviously the security environment and cyber has become a great threat for colleagues. And so that is another big area of investment.

The last is, I'd say, we're actually continuing to hire great talent into the firm. But maybe, Eric and Greg, do you want to sort of build on this?

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

A

Just one piece, one real quick. And I do want – Eric, I know, have some really important comments here. When you think about the Aon Business Services, so that platform, as Christa described the technology investment, cyber investment, this is – over the years, it would have been very difficult for us to sort of create global impact about investment because we couldn't scale it. We can scale it now. So as Christa and the team guide this investment is incredibly efficient in terms of how we can actually increase capability and make it real around the world. So I just don't want to lose that point. It's very, very fundamental to what Aon Business Services is all about.

But in addition to that, these net new areas that Christa was alluding to are really exciting. And this is a net new capability we're bringing in. Some of it is connected to risk. Some of it is connected to just fundamental capability, certainly on the climate side, to property side and on cyber side. So a lot we're doing that we are very excited about in terms of the ability to help the clients address issues critical to them that heretofore haven't been addressed in a way they need to be. So a lot happening from that standpoint.

But Eric, anything else you can throw in on that?

Eric Andersen
President, Aon Plc (United Kingdom)

A

Yeah. You just gave a great overview of it, Greg. But if you think about intellectual property and the new skills required there, if you think about the new risk areas, about renewable energy, about climate modeling capabilities that we need, you mentioned cyber and certainly in our human capital business, trying to invest in how we do ESG at scale for clients. So there's a whole lot happening on the ground, as Christa said, that is supporting the growth that we're seeing and recognizing that we need to keep investing to make sure we keep growing.

Phil Stefano
Analyst, Deutsche Bank Securities, Inc.

Q

All right. Thank you. Good luck.

Operator: And the last question that we have in the queue for today is Brian Meredith with UBS. Your line is now open.

Brian Meredith
Analyst, UBS Securities LLC

Q

Yes. Thanks. Two quick questions here. First one, I'm just curious, Christa, what's the revenue impact of the sale of the retirement exchange? It looks like you're continuing forward with that one.

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

A

Yeah. So the revenue, Brian, in 2020 for the retiree exchange was $176 million. It is predominantly a Q4 business, as you know well.

Brian Meredith
Analyst, UBS Securities LLC

Q

Great. And then second question, I'm just curious, as a part of this process that you're going on with Willis Towers Watson, you'd obviously identified a lot of cost synergies and expense potential savings from the transaction. I'm curious if you were able to identify any specifically for Aon that you could see potentially here going forward to help with cost savings and efficiencies as you went through this process.

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

A

Brian, this is what we were alluding to and talked about before. If we go back and Eric is going to jump in on this. Eric led this integration for the last 16 months, and this has really been at the one-foot level literally as we engage and connect with colleagues around the world and with clients around the world. And we've seen and uncovered multiple growth opportunities, investment opportunities, expense opportunities highly applicable to Aon specifically. And all those are going to be baked in as we move forward.

This is back to the theme. We came into March 2020 with exceptional capability strength. And what we've done over the last 16 months around integration is fundamental improvement of our platform, once it's going to be the combination combined platform, but it absolutely is applicable to Aon.

But Eric, you led this, what do you think?

Eric Andersen
President, Aon Plc (United Kingdom)

A

Yeah. Greg, I think there's two buckets, right? I think on the revenue synergy, as you're talking about, the client value creation model that we've been working on, otherwise, or delivering Aon United strategy about how you bring the firm together. We're talking about before how we're perfecting it. That was done in the context of the integration management planning.

But also on the expense side, certainly real estate strategy, technology strategy, all the areas that you would think, having a fresh look with teams that were built specifically to try and challenge the status quo and really pressure test how can we do it better, how can we do it more efficiently, how do we leverage our Aon Business Services model in a way that we'd really started during pre-Willis Towers Watson combination to really accelerate how we actually use that capability. I wouldn't necessarily call that last one new. I would just call it expanding what we've been building and really getting it embedded it across the firm across the world.

Brian Meredith
Analyst, UBS Securities LLC

Q

Terrific. 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)

Thank you. I just want to say to everyone, thanks very much for being part of the discussion today. We appreciate it and look forward to our discussion next quarter. Thanks very much.

Operator: This concludes today's call. Thank you for your participation. You may disconnect at this time.