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Aon Plc (AON)

Q2 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and thank you for holding. Welcome to Aon Plc's Second Quarter 2023 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 any 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 second quarter 2023 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

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

We're pleased to report that our global team delivered another strong quarter of performance, results, and momentum. And we begin the call today by thanking our colleagues for everything they do to help our clients address immediate and long-term demand around the risk in people. Aon United, delivered by our colleagues, gives us the ability to meet this demand and balance across our portfolio, capitalizing on innovation and momentum and investing to meet demand. This ensures we win more, retain more, and do more with our clients.

There's now almost universal agreement that client demand to address risk in human capital has never been greater. For example, our catastrophe insight report estimated global economic losses from natural disasters in the first half of 2023 were $194 billion, notably above the 21st century average of $128 billion and 5th highest on record. Even more profound, in addition to economic cost, we know these disasters have tragic human cost that reinforces the high value in building resiliency and protection in advance of disaster.

To this end, we recently announced the placement of a parametric insurance program for the government of Puerto Rico. It's the single largest program of its kind that the US Commonwealth has ever placed. This program was designed by our reinsurance and commercial risk teams, and in the event of a sizable earthquake or hurricane, Puerto Rico will quickly receive liquidity, enabling its government to focus on rapid recovery and reconstruction.

This placement was the result of Aon's data, analytics, and capabilities from across our firm, cemented by our deep understanding of public entity demand, risk capital, and reinsurance markets, and really, really great work by our team.

Turning to financial performance. In the second quarter, we delivered strong organic revenue growth across our solution lines, including 10% growth in health solutions and 9% growth in reinsurance solutions, contributing to 6% overall organic growth in the quarter and 7% in the first half.

In health solutions, organic revenue growth of 10% on top of 11% last year was driven by strength in the quarter. Our team has done terrific work helping clients navigate the demands of their talent agendas, balancing optimal benefits for their people with inflationary cost pressures, while also taking steps to deliver on their people strategies at a time when bringing total rewards, health, and wealth benefits together as human capital are more important than ever.

In reinsurance solutions, our team delivered another very strong quarter of 9% organic growth on top of 9% last year, driven by strong net new business generation. Our teams continue to help clients navigate a challenging and complex market, and are already preparing data, analytics and insight as we help our clients understand and address ongoing volatility and capital considerations. We're also seeing capital come into the market, particularly in cat bonds, as our team has placed over $5 billion across 21 deals year-to-date.

In wealth solutions, we delivered 2% organic growth, driven by ongoing trends and demand we've seen and project work around market volatility and regulatory changes as well as the ongoing trend of pension derisking, which we expect to continue in quarters coming ahead given the market conditions. We continue to see opportunity to help clients react and prepare for regulatory changes and market volatility with our data, analytics and expertise. And finally, commercial risk solutions delivered 5% organic growth in the quarter.

Globally, we saw strong growth across most major geographies, with double-digit growth in Asia and the Pacific. In the US, we saw strength in core retail brokerage, including from property casualty and construction. As we've communicated previously, results were pressured by the impact of external M&A and IPO markets on M&A services, a headwind we now expect to continue in the back half of the year given ongoing external conditions.

Overall, in the quarter, our strong performance was driven by the strength of our Aon United strategy and Aon Business Services platform. In Q2, we translated 6% organic revenue growth into a 110 basis points of operating margin expansion, net of ongoing investment in the business for long-term growth. These results contributed a first half financial performance of 7% organic revenue growth and 90 basis points of adjusted operating margin expansion. And we remain very well-positioned to maintain this momentum and to deliver on our ongoing financial guidance of mid-single digit or greater organic revenue growth, margin expansion, and double-digit free cash flow growth for 2023 and the long term.

This financial performance is ultimately the product of our ability to address client needs through Aon United. And this strength is foundational in supporting our ability to evolve in response to changing client demand, fully demonstrated by our move to risk capital and human capital.

This focus is bringing our four solution lines more closely together to better address client needs and is already yielding meaningful client impact. Take human capital. Our clients are changing how they're thinking about their colleagues. We're facing an increasingly complex external environment with pressures around cost, growth, remote and hybrid work, and workforce composition. In their own internal environment, their people strategies are increasingly complex, considering traditional total rewards and health benefits and newer additions around future skills and wellbeing.

Our connectivity across health, wealth, and talent enables us to bring data, analytics and solutions to address this need. In one great example, our team developed a diagnostic tool for clients that produces a human sustainability index or HSI. This tool combines individual and team assessments with peer data and analytics-based benchmarking to enable our clients to directly connect people strategy goals to execution.

The measurable results encompassing eight wellness pathways such as physical, emotional, and financial aspects supports individuals and teams to assess exactly what's working and for whom, along key metrics so our clients can adjust or change their tactics to drive their people strategy and ultimately their bottom line. In many respects, this work represents bringing next-level data science into talent development and leadership.

Ultimately, the HSI solution identifies gaps in what our clients offer to their people, encompassing health, wealth, rewards, and other wellness programs. And it provides a trackable plan to strengthen the company's talent strategy on their most significant, often external commitments at a time when these commitments are more important than ever.

In summary, our strong performance is a direct result of our ability to help clients better understand their challenges and opportunities, and to take actions to protect their business and improve their performance. Further, our recently announced enhanced focus on risk capital and human capital is already driving benefits and strengthening this capability. Our strong year-to-date financial results, including 7% organic revenue growth and 90 basis points of margin expansion, was a direct outcome of the strategy and position us very well to continue delivering in 2023 and over the long term.

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

Christa Davies

Chief Financial Officer & Executive Vice President-Global Finance, Aon Plc

Thanks so much, Greg, and good morning, everyone. As Greg highlighted, we continued delivering on our key financial metrics both in the quarter and year-to-date. Through the first half, we translated 7% organic revenue growth into 90 basis points of adjusted operating margin expansion.

These results position us very well to continue to drive results in 2023 and over the long term. And we look forward to building on this momentum. As I reflect on our performance through the first half of the year, as Greg noted, organic revenue growth was 6% in Q2 and 7% year-to-date. We continue to expect mid-single-digit or greater organic revenue growth for the full year 2023 and over the long term.

I would also note that reported revenue growth of 7% in Q2 and 6% year-to-date – sorry, 6% in Q2 – 7% in Q2 and 6% year-to-date includes an unfavorable impact from changes in FX of 1% for Q2 and 2% year-to-date, primarily driven by a strong dollar versus most currencies. I'd also highlight fiduciary investment income, which is not included in organic revenue growth, was $64 million in Q2 and $116 million year-to-date, or 2% of total revenue in both periods.

Moving to operating performance, we delivered strong operational improvement, with adjusted operating margins of 33.6% in the first half, an increase of 90 basis points, driven by revenue growth and efficiencies from Aon Business Services overcoming expense growth, including investments in colleagues and technology to drive long-term growth. Looking forward, we expect to deliver sustainable margin expansion in 2023 and over the long term as we continue our track record of cost discipline and managing investments in long-term growth on an ROIC basis.

As we've said previously, Aon Business Services remains one of our key drivers of margin improvement, and this operating model has now reached an inflection point. In response to client demand and the opportunity, we're evolving from an organization that drives efficiency, operating leverage and margin expansion to one that's also increasingly driving improved client service delivery and accelerating innovation at scale. This evolution of Aon

Business Services requires investment in three areas, which we expect to manage in line with our ongoing financial guidance and like we do for all investments in long-term growth, on a disciplined ROIC basis.

First, standardized platforms. We're digitizing and connecting existing platforms and creating an ecosystem that encompasses technology and operations and brings our data, analytics and expertise together for our clients and our colleagues. Second, standardized operation. Across our solution lines, there are places where we have common processes. We see opportunity to continue to bring operations and expertise together across our firm to support clients across all solution lines. Bringing people and process together drives further efficiency and enables us to scale best practices.

Third, new products at scale. We see significant opportunity to deliver new data-driven products, which we can then effectively develop and scale. The work we've done on standardized platforms and operations enables us to rapidly develop, deliver, and scale innovative solutions across the portfolio, in response to client demand and to deliver content and capability to all clients, be it from organic or inorganic investments.

Even more importantly, operating Aon Business Services as one organization, with disciplined prioritization and governance [indiscernible] (00:12:11) initiatives ensures we can move quickly on opportunities that create value for our clients and colleagues, such as the one we see on AI.

Just as a few examples, we see real opportunity here to enhance colleague productivity by leveraging the services of our technology partners, in a protected environment, to enhance existing offerings like our human capital assistance, by building an AI risk framework for our clients. And finally, to create complementary datasets to enhance our risk analytics like the catastrophe modeling.

We translated strong adjusted operating income growth into adjusted EPS growth of 5% in Q2 and 6% year-to-date. As noted in our earnings materials, FX translation was an unfavorable impact of approximately $0.05 in the quarter and $0.19 per share year-to-date. If currency is to remain stable at today's rates, we would expect no impact in the third quarter and a favorable impact of $0.05 per share in the fourth quarter for an unfavorable impact of $0.14 per share for full year 2023.

I'd also note other nonoperating expense had a $0.25 per share or 10% unfavorable impact in Q2 and a $0.44 per share or 6% unfavorable impact year-to-date. This reflects an unfavorable impact from increase in noncash, net periodic pension expense, as well as a gain on sale of businesses in the prior year period and balance sheet effects remeasurement in the current period.

Turning to free cash flow and capital allocation. Cash from operations was flat year-over-year and the free cash flow decreased 7% to $986 million, primarily driven by a $77 million increase in CapEx. As we've communicated before, free cash flow can be lumpy quarter-to-quarter, and free cash flow generation in the second half of the year is seasonally stronger than the first half. We continue to expect to deliver double-digit free cash flow growth for the full year.

CapEx was elevated in the first half of the year compared to the prior year period as we initiated a number of projects with spend heavily weighted in the first half across technology to drive long-term growth, like the investments we're making to evolve Aon Business Services. I'd note CapEx could be lumpy quarter-to-quarter. We expect CapEx to moderate in the back half of the year and now expect an investment of $220 million to $250 million in CapEx in 2023. As we've said before, we manage CapEx like all of our investments on a disciplined ROIC basis.

Our outlook for free cash flow growth in 2023 and beyond remains strong, and we continue to expect to deliver double-digit free cash flow growth for the full year and over the long term, driven by operating income growth and working capital improvements. Given our strong outlook for free cash flow growth in 2023 and beyond, we expect share repurchase to continue to remain our highest return on capital opportunity for capital allocation.

We believe we're significantly undervalued in the market today, highlighted by approximately $1.1 billion of share repurchase year-to-date. We also expect to continue to invest organically and inorganically in content and capability that we can scale to address unmet client needs. Our M&A pipeline continues to be focused on our highest priority areas that will bring scalable solutions to our clients' growing and evolving challenges. We will continue to actively manage the portfolio and assess all capital allocation decisions on an ROIC basis.

Now turning to our balance sheet and debt capacity. We remain confident in the strength of our balance sheet and manage liquidity risk through a well-laddered debt maturity profile. As we've said before, we expect to add incremental debt as EBITDA grows over the long-term, while maintaining a strong investment-grade credit profile. I'd note our term debt is all fixed rate, with an average weighted interest rate of approximately 4% and an average weighted maturity of approximately 11 years.

In summary, our strong financial results from the quarter and year-to-date reflect strong operational performance driven by our Aon United strategy and our Aon Business Services platform. We expect to continue to make progress on our key financial metrics and our commitment to drive long-term shareholder value creation.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. At this time, we'll now be conducting a question-and-answer session. [Operator Instructions] One moment, please, while we poll for questions. Thank you. Thank you, and our first question comes from the line of Charlie Lederer with Citi. Please proceed with your questions.

Charlie Lederer
Analyst, Citigroup Global Markets, Inc.

Q

Hey, thanks. Good morning. You mentioned continued headwinds in M&A services in the back half of this year in your prepared remarks. When should we think about that dynamic lasting? And is it more of a pricing issue or can you comment on what's driving that?

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

A

Really appreciate the question, Charlie. I'll just start overall on just commercial's fundamentals generally. Obviously, that's part of the real question. Very strong. Retention very strong, new business exceptional, with lot of strength around geographies [indiscernible] (00:18:04) and in core P&C. It really is this one area in M&A services which is a particular strength of ours. But as you know, deals – deal count and volume was down 30% to 40%. We expect that – first half of the year, we expect to see it in the second half of the year. As that comes back, we will come back with an absolute vengeance, just given our overall position. But Eric, anything else you'd add to that?

Eric J. Andersen
President, Aon Plc

A

Yeah, Greg. I would just say that while the deal volume is down, as you're saying, we have been spending time with the team expanding the potential client base. The historic nature of the product has been driven more towards private equity type buyers, but we've been spending time working with the corporate clients, making sure they're aware of the capabilities and how those products and services get used, so that when the market does come back and it will come back, we'll be situated to lead that market as we do today.

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

A

And Charlie, I would just say...

Charlie Lederer
Analyst, Citigroup Global Markets, Inc.

Q

Great.

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

A

...that while we've lapped the downturn, we do expect the pressure to continue in the second half as the external outlook has continued to be soft.

Charlie Lederer
Analyst, Citigroup Global Markets, Inc.

Q

Got it. Thanks. And then I'm wondering if you can comment on the momentum in your IP business, intellectual property. How meaningful is that to organic revenue growth? And there have been some articles in the press about it recently. So just trying to understand how you see that business affecting second half results if at all.

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

A

Love this question, Charlie. Really appreciate you raising it. We love this business. It is a phenomenal – been a phenomenal opportunity for us. If you think about intellectual property overall, this is just hugely significant. This is representative.

We talked before, 85% of the value of the S&P 500 is really tied back to intangible assets. And if you go back to 2016, we started with an amazing investment bringing in 601West to Aon. It's 20, 25 colleagues. We've now invested in hundreds of colleagues with a truly unique market-leading platform to really help understand this opportunity and these risks and the value of these assets. And we built a marketplace with so many insurers 26, 27, almost 30 insurers sort of in the marketplace, $2 billion in aggregate insured transaction value. And by the way, demand is stronger than ever.

And there – we're evolving the market. And there are always so many different third parties out in the marketplace and different things that affect that, but we love the position. We love the progress we've made, and we feel stronger than ever about the future opportunity.

Eric, anything else you'd add?

Eric J. Andersen
President, Aon Plc

A

Yeah, maybe two things, Greg. One, as a percent of revenue, it's still a – the market is still in its infancy. So I wouldn't overly rotate on it other than the potential that we see down the road.

And to your other question about some of the activity in the market, obviously, we're not going to comment on specific third parties. But I would say, as part of our fundamental role of matching risk to capital, we work with many of parties that bring capital to the marketplace. Some of them use letters of credit to backstop the capital used by the third parties, but it does provide the kind of capital that we need, that the clients need to deploy to gain reinsurance capital that they're looking for. So it's just one of the ways that we match risk and capital together on behalf of our clients.

Charlie Lederer
Analyst, Citigroup Global Markets, Inc.

Q

Thanks, guys.

Operator: Thank you. Our next question is from the line of Mike Zaremski with BMO Capital Markets. Please proceed with your questions.

Michael Zaremski
Analyst, BMO Capital Markets Corp.

Q

Hey, thanks. Good morning. I guess back to the organic growth environment, just curious, you mentioned some headwinds on the M&A side and probably some tailwinds too which we can see. But would you say – you were clear to about 5% or greater is still the outlook, but would you say growth is kind of – thinking back to the back half of the year is kind of steady or accelerating or decelerating or any trends you'd like to point out in any of your businesses in terms of momentum or tailwinds other than the M&A callout that we should be considering into the back half of the year?

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

A

Yeah. Literally, Mike, I love this question. If you step back and think about sort of the growth platform and how it's evolved, first, just for context, we put – we think about growth in really all the benchmark objectives over the course of the year. So as you think about it, for us, growth is organic revenue. Growth is, by the way, margin improvement. And growth is absolutely the translation into free cash flow.

And we would say, if you think about just performance in Q2 and really the first half, it's really reinforced our confidence in, and you see momentum around meeting our full year 2023 objectives. So this is mid-single-digit or greater and across the board. Look at the strengths in health which were exceptional for the first half and certainly for the quarter in reinsurance and other areas to, even in commercial risk with the headwind that we just highlighted. So, very strong on the solution line side. And then you also saw exceptional movement on margin expansion when you think about the growth here too, 110 basis points for the Q and 90 basis points for the first half.

And most important, you heard Christa reemphasize double-digit free cash flow growth for the year. So for us, we see this trend continuing to turn where we are, and there's a lot that goes behind that. Maybe, Eric, additional context around that foundation and what's driving that.

Eric J. Andersen
President, Aon Plc

A

Sure, Greg. And you mentioned two of them in your remarks around the parametric that we did for Puerto Rico as well as the human sustainability index. Those are just two examples of the Aon United teams working together.

But I think I would also say that the client demand is evolving and it's getting more complicated, I think as the world gets more complicated. And so our strategy of evolving to risk capital and human capital I think uniquely positions us to take advantage of that capital to drive growth – I'm sorry, take advantage of that situation to drive growth.

And when I think about it, just to put a little clarity on it, from a risk capital standpoint, I think it gives us a couple of things. It gives us access to global capital no matter what form. So, insurance, reinsurance, ILS, parametrics, to help clients transfer the risk that they want to transfer and also create more dynamic markets. And I think it also helps us to create and deliver the analytics that have historically driven our reinsurance business over to the large corporate clients, who have a more acute need today to understand their risk from property exposure as to climate change as well as the cyber and liability exposures. And it also gives our leaders, client leaders and brokers the best insight of the market dynamics. So that's on the risk capital side.

On the human capital side, bringing health, wealth and talent together is effectively meeting clients where they are today. Clients are looking for a holistic view for their employee relationships, both from hiring, training, health, wellness all the way through to retirement. And we're seeing that. We're really excited to see that strong growth in our core health and benefit business globally. Winning new clients, expanding the relationship within across all aspects of that employee lifecycle is gratifying and exciting. So, we see a lot of opportunity with both risk capital and human capital, both in our strong core but also as we develop sort of new capabilities.

But Christa, anything you'd add to that?

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

A

Well, I mean, Mike, you also did just ask about second half outlook and we would say year-to-date growth of 7%. We do think about our results over the course of a full year and we are on track for our full year guidance, mid-single-digit or greater, organic revenue growth, margin expansion, and double-digit free cash flow growth. And so we're really excited about the momentum in the first half and that continuing into the second half.

And I think just each quarter, we have different seasonality of revenue, but we really do think about over the course of a full year. And so mid-single-digit or greater organic revenue growth for the full year.

Michael Zaremski
Analyst, BMO Capital Markets Corp.

Q

Okay. Great. And my quick follow-up is, curious on the expense efficiency side, a number of competitors have kind of talked about leaning in to be able to kind of find more ways to be efficient over the last I guess in this post-pandemic world. And there's different nuances to each company's strategy, but it feels like some of them are taking off of the Aon United playbook, which you guys were a first mover on. Just curious, is there anything you'd want to call out in terms of do you see incrementally more opportunities today for expense efficiencies or nothing really to call out that's getting you guys even more excited about kind of some margin levers in the coming year?

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

Look, we do actually, Mike, so thank you for the question. Look, we are on the next evolution of Aon Business Services. And as I mentioned in my opening remarks, expanding from just driving efficiency to really improved customer service delivery and innovation at scale helping us accelerate growth.

And so as we think about margins, we think about margins again over the course of the full year sustainably and over the long term. And year-to-date, we saw 90 basis points of margin expansion and offset by investments in the business, including people and in our technology.

In particular, you saw an increased investment in IT, 13% year-to-date. And the majority of this is around our core business platforms to help clients and support revenue growth. And you saw CapEx up as well, again, driving long-term margin expansion through the continued investments around standardized operations, standardized platforms, and innovation at scale, which we are really excited about in Aon Business Services.

Eric J. Andersen
President, Aon Plc
A

Hey, Christa, maybe one final...

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

Eric, maybe you want to add – yeah.

Eric J. Andersen
President, Aon Plc
A

Yeah. One comment on it because I know the question was on efficiency, but the ability to leverage the analytics that we have inside of ABS helped us develop the human sustainability index, helped us create the insight that we're able to bring to corporate clients as they think about managing their climate exposure from a property standpoint. How all of that comes together is part of the ABS strategy and how we execute it. So while there is efficiency, there is great opportunity I think to drive new products, new solutions, and better solutions that our larger clients are looking for us to help them with.

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

And just to remind you, Mike, we brought in – we've been working on this since 2017, actually, prior to that, but 2017. We have literally, with the leadership under Christa, our new COO and others have brought maybe a tremendous amount of capability to bear. And now we're on kind of the next wave, building on a very, very strong platform that we pulled together. So it's – for us, we're very excited about this for both the efficiency reasons that Christa described very well and the effectiveness outcomes that Eric described. And that really is the muscle and the foundation of Aon Business Services, very excited about it.

Michael Zaremski
Analyst, BMO Capital Markets Corp.
Q

Thank you.

Operator: Our next questions come from the line of Weston Bloomer with UBS. Please proceed with your questions.

Weston Bloomer
Analyst, UBS Securities LLC

Q

Hi, good morning. My first question is on comp and benefits. It looked like that picked up pretty meaningfully over the last five-quarter trend. And you highlighted investments in colleagues and there's a pretty high competition for talent. Can you maybe comment on the pace of hiring you're seeing more broadly? And was there may be a pick-up in retention-based comp in the quarter? Would be curious on maybe attrition rates in, in commercial risk and reinsurance as well. Thank you.

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

A

So, Weston, and so maybe I'll start with sort of the math of just, if you think about this, and again, we look at this over a full year, but if you just did year-to-date, you'd see organic revenue growth of 7% year-to-date. Comp and ben is up 4% year-to-date. And so there's lumpiness in every quarter. And so what we would say is we feel good about that. And in terms of attrition, we would note that attrition in 2023 is below 2019 or below pre-pandemic levels. And so we feel really good about where attrition is across the board. And we also would note that engagement levels are at the highest they've ever been in the firm's history. And so we feel really good about the talent we're attracting. But Eric, you may want to jump in here just in terms of the talent side.

Eric J. Andersen
President, Aon Plc

A

Yeah, sure, Christa. And I always think that the industry spends a lot of time reading the headlines on some of the industry [indiscernible] (00:30:13) about people move here and there and I think it gets over-rotated as Christa, you shared some of the great stats.

I will say we are making some pretty significant talent investments in our core health and benefit business, in our strategy and technology group inside of reinsurance, some of our key geographies where we're seeing great growth opportunities. So a lot of great things happening there, Christa, and you shared the metrics of engagement and attrition and things like that. But one last comment I would make on it is on our risk capital and human capital platforms, it actually allows us to increase the flexibility of where we deploy talent to opportunities. So being able to take reinsurance analytics and help a commercial client think about analytics like an insurance company does I think gives us a real competitive advantage. But other than that, we continue to invest pretty heavily in our talent, and we would expect to do so in the future.

Weston Bloomer
Analyst, UBS Securities LLC

Q

Great. Thank you. And then my second question is on wealth solutions' organic. I know you had highlighted difficult comp on performance fees in the quarter. I was wondering if you could maybe quantify that impact. And then is wealth solutions a business where you could see mid-single-digit organic growth over the next year and maybe more in line with the rest of Aon? That growth had been lower single digits over the past few years, so curious if we're seeing maybe momentum there.

Eric J. Andersen
President, Aon Plc

A

Yeah, maybe I'll take that one, Greg. Look, I think the wealth solutions business is a great business for us and we do see growth opportunities over the mid and long-term. If you think about the pieces of it, the retirement piece, which is the pension actuarial work, continues to be a solid business for us as a – whether it's on the pension derisking that Christa mentioned or whether it's just the regulatory changes that drive activity. The UK, EMEA, very solid this quarter.

And then there's the investment management business. The advisory business continued to be pretty strong. The delegated part of it continued to have some impact from the AUM movement from – in UK and North America that sort of we talked about last time. But overall, really bullish on the business and expect that it will hit mid-single digits for us as we go down the road.

Weston Bloomer
Analyst, UBS Securities LLC

Q

Great. Thank you.

Operator: Our next questions are from the line of Bob Huang with Morgan Stanley. Please proceed with your question.

Bob Huang
Analyst, Morgan Stanley & Co. LLC

Q

Hi. Thank you. I know that you've talked quite a bit about tech innovation and efficiency. Maybe if I can just dig a little bit deeper on the cost of AI implementation, right? Obviously, tremendous potential down the road. But from what we've seen recently, for example, Microsoft just announced that their AI-enabled products are twice as expensive as non-AI-enabled products. Just going down that line of thinking, can you maybe help us think about how your AI investments, the cost of that fits into your three areas of investing with AI business right now?

Eric J. Andersen
President, Aon Plc

A

Yeah. Look, thank you so much for the question, Bob. And we are super excited about AI more broadly and how it can apply to our business. And we would say we think about this in terms of everything from really basic machine learning, robotic process automation, all that stuff that helps us drive automation and efficiency at the sort of very low end, very cheap, all been super scalable. And we're really looking to implement that broadly across our business to help our colleagues get out of the sort of day-to-day cutting and pasting and inefficient processes they're doing today, and equally, to make things much easier for clients to interact with us and do business.

And so that's sort of the low end. And then you could say at the high end, sort of generative AI, it's really helping us drive insight and impact in the analytical areas that Eric was describing around risk capital and human capital, catastrophe modeling, helping us add datasets, the human capital system. Helping clients interact with the human capital system much like they would an expert in human capital today.

And so, Bob, we're very thoughtful about the cost of this and where it's best to use basic technology, you know, machine learning, robotic process automation, because it's just cheaper and more efficient and more scalable broadly. And where we're really trying to have insight and impact with clients and use generative AI. And so we're sort of scaling it depending on the impact and opportunity.

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

A

And I'd just add two observations Bob to this. First, we've been doing AI, as Christa described, really for a decade. So it's not as if we haven't been incorporating this. It's one of the reasons we drove Aon Business Services. That's my second observation. Because we have Aon Business Services, because we've been working on this since 2017, we actually have a platform to scale these ideas. Absent Aon Business Services, literally, the ability to kind of get this moved around 120 countries around the world is basically zero. So you can come up with a good idea in a geography, but how do you actually systematically move it around the world? So one of the reasons we're excited about our ability to do this and do it cost effectively is Aon Business Services.

Bob Huang
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Thank you. That was extremely helpful. My second question, maybe just to go back to the line of questioning regarding commercial risk solutions, right? And obviously, you've talked in depth about why the US segment is the way it is. But you also – one of the things we noticed is that Asia has been strong for a few quarters. And the last quarter, you also saw strength in Latin America and rest of the world. Just as we gradually come back to a more normal M&A market in the US, how durable is the growth in the rest of the world? I'm just trying to think down to next year how we should think about commercial risk solutions growth going forward.

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

A

Listen, we – as we have described, we feel very good about the progress. And back to kind of the overall Aon United strategy, the core fundamentals, as you highlighted well, geographically very strong. Even in North America, retention very good, new business very good, core P&C exceptional. You know, we just have a wonderfully strong business capability in the area of M&A services, which, by the way, we're fielding now but we embrace completely because as the market comes back, as Eric described, we benefit from that as well.

But the fundamentals, the track is everything we've described around literally winning more clients and been doing more with them and keeping them longer for all the reasons that we talked about around our overall Aon United strategy. So, we're feeling very, very good about trajectory and momentum, recognizing there are market conditions out there, but good about that overall.

Eric, what else would you add to that perspective?

Eric J. Andersen
President, Aon Plc

A

Yeah. Maybe the only other angle I would say, Greg, is the sophistication of the products that are entering into places like Asia Pacific and Latin America continue to evolve as the clients evolve. So whether it's risk financing techniques, whether it's specialty products, whether it's the international as those organizations expand outside their home countries. So as those economies continue to develop, whether it's India, whether it's other parts of Asia, we're able to grow with them and help them as they need more sophisticated products. So, we are very excited about the platforms that we have in Latin America and Asia Pacific. And we do see good growth opportunities over the long term.

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

A

One other point on that, Bob, just to sort of make it, I was in Singapore with Christa a month ago, opening our global climate hub, phenomenal. And we had the opportunity to go around and see so many different clients in that respect. I mean, it really reflected exactly what Eric is describing.

With their needs becoming more global and more interconnected, they want to see global Aon and put it in their backyard. That was a very, very positive sort of overall kind of finding, as we're standing and thinking about that. It really does bode well for what the opportunities are. And then if you take that and some of Eric's other comments around risk capital and what it really needs, bringing a reinsurance analytics into the commercial space in an effective way is also something that was very, very positive. So just a specific example in a region, as you highlighted, where we saw particular opportunity. The same is true in Latin America.

Bob Huang
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Thank you. That was tremendously helpful.

Operator: Our next question is coming from the line of Rob Cox with Goldman Sachs. Please proceed with your questions.

Robert Cox
Analyst, Goldman Sachs & Co. LLC

Q

Hey, good morning. Thanks for taking my questions. So in reinsurance solutions, really strong results, obviously, but I would have thought you would see more acceleration or essential – sequential acceleration given the Aon Benfield exposure to property cat in the US. Can you provide some color there? And then also on the prospects for growth in the back half of the year in reinsurance, as we've seen some news articles regarding kind of an above average chunk of the facultative business being hired by a competitor.

Eric J. Andersen
President, Aon Plc

A

Sure. Greg, do you want me to take that one? So on the first half question, we're really proud, excited, whatever word we can use on our reinsurance capabilities. Really great first half, great second quarter, great first half coming off of a couple of great years. Just remember that most of the treaty business happened in the first half and so a lot of that is now finished.

But I would say that as clients have been dealing with the changing reinsurance market, they've made their own decisions. Sometimes they don't buy certain layers, sometimes they buy less, sometimes they buy differently. And so that's always a decision that we help our clients make as they think through how they want to use reinsurance capital for their business. It does, by the way, explain a little bit of what's going on in the primary market around property. As more of the risk is now sitting on the primary insurers, they are now dealing with how do they price it and what kind of risk do they take. So it is an interconnected system of reinsurance and insurance. So just to point that out.

And I think on the second half tends to be more around the ILS business and facultative business. And I do think as we had a very strong first half in fac and our expectation is that should continue as the primary clients now may have less low level reinsurance protection on property catastrophe or secondary perils like wildfires or hailstorms or what have you. And so the ability for the insurers to manage that exposure, the tool that they would use now is facultative reinsurance on an individual risk basis.

And the last point I'll make, and Greg, maybe I'll throw it to you, is facultative reinsurance is also being used on things like captives or large corporates where they are also retaining more of the risk themselves. So don't just think about it as a reinsurance tool. You should also start to think about it as large corporates that are trying to access not just traditional insurance markets but also reinsurance markets, but – and fac is the way they do that.

But Greg, maybe anything you'd add on that?

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

A

You summarized it very well, Eric. I would just add a couple of things on the talent point overall and in reinsurance. Look, reinsurance, our colleagues, this has been strength – the strength really over the last five years. It's been a tour de force. It's also one of the areas we've invested heavily in continuing content and capability. Not just core reinsurance, but if you think about what we're doing in cat bonds and ILS, we lead the world in this. The work we've done in strat and technology group Eric described before, this is just substantial investment. And with this core in reinsurance, we now have this incorporated into the overall risk capital effort. And so this is really for us, we're very – we're excited about the possibilities and the capability we have to help clients and it continues to build, which is why we feel so strongly positive about the second half of the year and the ongoing results here.

Robert Cox
Analyst, Goldman Sachs & Co. LLC

Q

Thanks for the color. And maybe moving back to commercial risk. If we exclude these external factors on the M&A services business, is it fair to assume that the remainder of the business accelerated sequentially kind of along with the accelerating renewal premium change that we saw in the market this quarter?

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

A

I mean, Rob, we're not giving specific guidance on commercial risk at that level. What we would say is we're extremely excited about year-to-date growth of 7% overall for Aon and on track to mid-single-digit or greater organic revenue growth for the full year. And obviously, we've had a real headwind in this M&A area given transaction volume, as Greg described, is down 30% to 40%. And we expect that softness to continue into the second half of the year.

Robert Cox
Analyst, Goldman Sachs & Co. LLC

Q

Okay, thanks. And maybe just one last question on health solutions. You know, really strong growth. Just you guys pointed to the growth outside of the United States being particularly strong. And I'm just curious, what's driving that? Is that market share gains, medical inflation? Any color you could provide there?

Eric J. Andersen
President, Aon Plc

A

So I would say more of market share gains and the ability of the team to work together globally through global benefits. Remember, the health systems are different everywhere in the world. So when you look at the US system versus the UK versus Europe or anywhere in Asia Pacific or LatAm, they're very different. But the needs are often of one organization expanding globally, they need that expertise. And so our global team really well-connected, working together through to help global clients as well as local clients. So we think its market share gains in the local countries and really excited about what they've been doing over the course of the last year or two.

Robert Cox
Analyst, Goldman Sachs & Co. LLC

Q

Thank you.

Operator: Thank you. Our next question is from the line of Elyse Greenspan with Wells Fargo. Please proceed with your questions.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

Hi. Thanks. Good morning. My first question, Christa, I think last quarter, you had pointed to CapEx of around $200 million to $225 million for the year. It is par – I just want to confirm that that's still your kind of best estimate there. And so with the improvement in free cash flow in the back half, I guess it's going to come from a combination of lower CapEx and just growth in operating cash flow?

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

A

Hi, Elyse. We actually have increased our CapEx guidance to be $220 million to $250 million for 2023. And that's really driven by the investments we're making across Aon Business Services platforms and applications to drive future growth. And so we're really excited about that. The improvement in free cash flow and the double-digit free cash flow growth for the year is going to be driven by operating income growth and working capital. And I did note that second half free cash flow growth is always significantly stronger than first half.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

Thanks. And then my second question, going back to commercial risk, I recognize, right, that you guys do have a good market share within the M&A business, right? That that has slowed, but you will have easier comps in the back half of the year. So even recognizing that there'll be some headwinds from just still low M&A volume, wouldn't you expect sequentially commercial risk to show better growth in the back half relative to the first half of the year?

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

A

So, Elyse, I'll try and do this again because I probably didn't explain this well the first time. What we – we are lapping the comps, that's absolutely right. But what we're seeing in the external market is continued pressure into the second half of the year in the M&A environment. So we expect that trend to continue.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

Okay. And then in reinsurance solutions, Greg, I think you highlighted on just kind of robust cap on activity you guys have seen. How do you – what are you seeing on the capital side within the reinsurance market? And thoughts just for the potential opportunities over the rest of the year and then also into 2024?

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

A

Listen overall, Elyse, and Eric, should comment on this for sure, look, there's still pressure here, and there continues to be pressure on the capital side. We're incredibly vigilant about finding options, matching capital at risk in terms of what we do for our clients every day. We're navigating through it. You're seeing movement on the ILS side. You know, we talked about $5 billion we've done in 21 deals year-to-date, which has been phenomenal. So we did see an opportunity there. But it's still constrained. There's still pressure.

Eric, what else you'd add to that?

Eric J. Andersen
President, Aon Plc
A

Yeah. Look, Greg, I would say – I'll do the ILS side first is ultimately, we're seeing investors that have historically invested in cat bonds either allocate more to it, so they see opportunity. Investors that had walked away from the area have sort of returned as well as new. So you're seeing some expanded sort of market opportunity, which is why I think that market has been so dynamic in the first six months.

I think on the overall capital provision of the reinsurance market, you're starting to see an equilibrium. You're seeing the big players get more active, who see opportunities especially on the property cat side. And so – and you're seeing investors look to participate in support, either through their funds or other ways.

Not necessarily in new company creation, which is sort of what would normally happen in this cycle, but more in support of existing players who are already leaders in the industry. So we're getting to an equilibrium around pricing of property cat. Certainly as you go into the 01/01 renewals in five months, there'll be talk of inflation, there'll be talk of what happens over the hurricane season in the summer and other year events. But I do think that as the market has moved, it has found an equilibrium in property cat as well as on the casualty side of the business.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC
Q

Thank you.

Operator: The next question is coming from the line of Meyer Shields – excuse me, David Motemaden with Evercore ISI. Please go ahead with your question.

David Motemaden
Analyst, Evercore Group LLC
Q

Hi. Good morning. Just had a follow-up question on commercial risk. You guys spoke about this a couple of quarters ago. I believe it was the fourth quarter. You said the capital markets activity had a 5-point drag on the organic growth in commercial risk. Could you size how much of a drag that had on organic growth and commercial risk this quarter?

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

So we have not disclosed that detail. We did, as you mentioned, disclose it in Q4, and we haven't disclosed it going forward. What I can say is we're the leader in the space, and we're incredibly excited about our capabilities as Greg and Eric have described. And this is having a real impact on our business, but we're continuing to invest in it because we know as M&A volume comes back, this business is incredibly well-positioned to do fantastically well.

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

A

And David, we continue to reinforce literally the exact guidance we had before as we think about where we are, mid-single-digit or greater for the year overall for the business, even in the face of this challenge that Christa described.

David Motemaden
Analyst, Evercore Group LLC

Q

Got it. And also just to clarify, so tough comps in this business in the second half of – or I guess the comps are definitely easier. I think second half of 2022 was very depressed. So is it that you guys aren't expecting it to be down again off of that depressed base, but it's more just you don't see a recovery off of that depressed base? Is that the right way to put it?

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

A

It's really as simple as you almost listen to the investment bank calls. We can talk to the CEOs of those institutions. As that activity comes back, we are incredibly well-positioned not just in the core areas we've done before but also with the broader commercial applications Eric described before. So we've just gotten stronger. Literally as the transactions come back and the volume comes back, we're there. And so you can predict as well as anyone, all we're trying to do is declare.

David Motemaden
Analyst, Evercore Group LLC

Q

Got it. That's helpful. And then just on the continued investment in tech and talent, and it also sounds like even with the increased outlook on CapEx for the year, it's going to tick down in the back half of the year. And I'm just trying to just compare that with the continued investment in talent that it sounds like you guys are making. Should I take that to mean that more of the expenses are going to be coming through OpEx instead of running through CapEx and then there could be a little bit more of a headwind to margin improvement in the second half?

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

A

So, what we really said was we've given guidance on CapEx, $220 million to $250 million. Yes, you're absolutely right, CapEx is a little front loaded with how the projects worked out this year. But we do think about it over the course of a full year, CapEx $220 million to $250 million for 2023. In terms of margin expansion, we expect full year margin expansion, and we are on track for mid-single-digit or greater organic revenue growth, margin expansion for the full year, and double-digit free cash flow growth. And so yes, things are happening slightly more in the first half in terms of some expense growth and CapEx growth. But really, you should think about these things over the course of a full year.

David Motemaden
Analyst, Evercore Group LLC

Q

Okay, great. Thank you.

Operator: Thank you. The next question is from the line of Meyer Shields with KBW. Please proceed with your questions.

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

Q

Great. Thanks so much and good morning. I guess we're all digesting just how significant the M&A practice is in terms of revenues. Just wondering if you could give us some guidance in terms of how to think about the margin impact, whether it's what you've seen in recent quarters or what that implies for margin expansion when this business line recovers.

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

A

Yeah. So thank you so much, Meyer. What I would tell you is we are on track for full year margin expansion. And the margin in this business, we continue to manage the business as an overall portfolio. And I would say they're not particularly different to the rest of the business.

We are focused on continuing to invest our entire portfolio in higher revenue growth, higher margin areas supported by Aon Business Services with the analytical impact. And what I would say is as you think about margin expansion long term, it's really just another way to measure the value we create for clients, which is why our data, analytics and insight matter so much, because that's increasingly what drives value as our clients look to understand forward-looking risk. And so it's those areas of the business that generate more value for clients.

And then obviously with Aon Business Services, we're driving to create that value more efficiently, which is why we're really investing in Aon Business Services to get it to the next level around driving operational excellence, better customer service, and increased innovation at scale. And so we're really confident about driving sustainable margin expansion in 2023 and each year beyond that.

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

Q

Okay, understood. Second question, I know you typically don't disclose expected tax rates and unless you want to change the approach now. I was just hoping you could let us know, given OECD minimum tax reform, internally, so do you – are you expecting the tax rate to go up?

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

A

So, Meyer, as you exactly predicted, we are not giving guidance on the tax rate going forward. As I look back historically, exclusive of the impact of discrete items which can be positive or negative, our historic underlying rate over the last five years was 18%. So we feel really good about our overall global capital structure, our global cash structure, and our ability to navigate regulation and legislative changes going forward.

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

Q

Okay. Fair enough. Thank you.

Operator: Thank you. Our last question is from the line of Jimmy Bhullar with JPMorgan. Please proceed with your questions.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

Hey, good morning. So first, just had a question for Christa on how you think about the impact of inflation on your results. Obviously, it helps on the revenue side, but to the extent there's competition for talent or higher IT expenses, then it hurts on margins. But assuming inflation stays high, is that a positive for you overall or is it a negative or a push?

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

A

Thank you very much, Jimmy. So what we would say is inflation overall is good for our business. And what we've seen so far is the inflationary impact on our expense base. You saw compensation impacted in 2021, 2022 and again in the first half of 2023. We've seen that come through on the expense base.

What we're starting to see come through is inflation impacts on the revenue side, whether that's increased asset values or whether that's medical and healthcare inflation. So it's impacting commercial risk and health, insurance prices, and therefore our revenue lines. And we expect that impact on inflation to come through in our revenue over the next 12 to 24 months. And so we would expect that positive side of inflation to start coming through.

But Eric, anything else you'd add here on inflation?

Eric J. Andersen
President, Aon Plc

A

Yeah, listen, I think how asset values are repriced, I think that is something that's been sort of reput into the business in a more consistent way, especially on the property side. I think inflation around [ph] verdicts (00:56:01) on the liability side. So I think it is, as you're saying, impacting pricing from an insurer standpoint.

I would say it also creates sort of decision-making that the client will make. So the clients may take higher retention, they may use captives that requires different support. It may – they may take things on their own balance sheet versus transferring it. So, it's not a straight line. And often, it will turn into other capabilities that we can provide clients service for rather than just straight up insurance pricing. So, the clients are reacting to inflation the way any business would. And so that gives us an opportunity to provide a broader suite of capabilities to them as they're managing it.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

Okay. And then on share buybacks, the last few years, they've been heavier in the second half than in the first half. Should we assume a similar pattern this time, and especially considering that your free cash flow is going to be higher as well? Or does the buyback activity thus far this year already incorporate the higher free cash flow in the second half?

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

A

Yeah. So Jimmy, what we would tell you is we think about allocating cash based on return on capital, cash on cash return, and our highest return on capital opportunity remains share repurchase. And so as we generate cash, you can think about us allocating it disproportionately to buyback because it sets the bar for all other uses of cash. And look, what we would say is we don't actually forecast buyback by quarter, but you can see in any calendar year, it's the highest use of cash across the firm. And so whether that cash is coming from debt or operating cash flow, as we generate that cash, we'll utilize it to buyback or M&A or organic investment depending on the ROIC return. And we definitely see a huge opportunity to invest in buyback given we are substantially undervalued today based on the way we value our business on a DCF basis.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

Okay. 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

Just want to say that thank you, everyone, for joining and we look forward to the discussion next quarter. Have a great day.

Operator: This will conclude today's conference. Thank you for your participation. You may now disconnect your lines at this time.