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Aon Plc (AON)

Q4 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to Aon Plc's Fourth Quarter 2023 Conference Call. At this time, all parties will be in listen-only mode until the question and answer portion of today's call. I'd 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 fourth quarter and full year of 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

Good morning, everyone. Welcome to our fourth quarter conference call. I'm joined 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 start with a very sincere thank you to our Aon colleagues around the world for all they've done in 2023 to deliver for our clients and support each other. As we reflect on 2023, we observed that the client demand driving our Aon United journey. Trends around increasing volatility and interconnected risk have accelerated. Specifically, we see four broad areas of focus that increase the relevance of our core business and create opportunity to deliver more value to clients. These four megatrends revolve around trade and the consequences of sustained geopolitical uncertainty. Technology, particularly the rise of AI, whether reflecting the rate of natural catastrophes and workforce or the pandemic, has fundamentally impacted talent. These profound transitions described in our Global Risk Management Survey and Human Capital Trends Report require clients to both deliver against today's expectations and evolve to make better decisions on new risk and people challenges.

Against that backdrop, we've taken significant steps to accelerate our Aon United strategy in ways that drove performance in 2023 and set the stage to build momentum and deliver stronger performance in 2024. Most notably, we're executing our 3x3 plan to leverage our rich capital and human capital structure and capability, embed the Aon client leadership model across the firm and utilize Aon Business Services to set a new standard of innovation and client service. We then doubled down on this plan by announcing a $900 million investment into our business to accelerate Aon Business Services as a catalyst for the 3x3 plan and the complete workforce strategy efforts that reflect our simplified and more connected go to market strategy.

We closed the year with strong operating momentum and also took action to build upon our ABS-driven capability to deliver innovative and accretive new products into the middle market by announcing our intent to acquire NFP. NFP under the leadership of Doug Hammond and an exceptional team is the premier operating platform in the middle market segment with tremendous client relationships and distribution. And together we can bring stronger analytics and innovation to the space. And not just capability, but content that can serve the middle market, like Aon cyber caution evaluation or CyQu, a proprietary platform that helps clients identify, measure and manage cyber risk. NFP's operating platform will enable quick and efficient connection for Aon Business Services content, driving meaningful growth in the middle market. And we are incredibly excited about the top and bottom line growth potential for NFP, given our complementary businesses and expected synergies and the value we will create.

For Aon overall and barely one month into 2024, we already feel the momentum from these actions best demonstrated through the client benefits of our integrated risk capital and human capital capabilities. On the risk capital side, our recent Weather, Climate and Catastrophe report highlights the growing frequency and severity of events around the world as clients look to manage volatility, enhance resilience and unlock opportunity. To do this, organizations must have more actionable analytics, exactly the insight we bring with risk capital through the combined power of reinsurance and commercial risk analytics and expertise for our clients. We recently saw this in action at our annual Property Symposium with over a thousand clients and insurance markets in the room where we demonstrated a new suite of advanced analytic tools that bring together content and capability across reinsurance and commercial risk. One example is our Property Risk Analyzer, giving clients better understanding of the risk profile in real-time, which allows us to work more closely together to provide better insight into the risk mitigation options and enable them to make better decisions. From the overwhelming feedback and engagement, it's clear our clients are demanding better solutions and greater support.

And because of the steps we've taken and progress we've made with Aon Business Services on products and platforms, we can develop and roll these tools out more quickly for our largest clients and the clients of all sizes, deliver efficiently at scale. Equally compelling, for human capital, our Human Capital Trends Report highlights the rising importance to clients of having a unique and differentiated value proposition for employees. We see clients facing significant rising health care costs and lower overall population health at a time when the need to provide broad health and wellbeing offerings is greater than ever. We also saw attracting and retaining top talent as the fourth ranked risk in our Global Risk Management Survey. Our clients realize it's more important than ever to have a compelling strategy across health, wealth and talent needs that's delivered in an efficient way to maximize the benefit rewards offerings. Together, this creates significant opportunity to work with clients to design and optimize their programs, including core offerings to improve colleague health, how operations drive workers compensation costs, choosing optimal partners in their health model, and supporting top talent through a strong employee value proposition to ultimately maximize return on investment other people spend.

All these are examples of our 3x3 plan in action. It's human capital and risk capital delivered through our Aon client leadership model and enabled by Aon Business Services. These three pillars reinforce and accelerate our Aon United strategy, which has driven financial performance and gives us great confidence in our outlook.

On financial performance, we delivered strong results in the quarter that contribute to full year progress against our key financial metrics. Organic revenue growth of 7% in the quarter and 7% for the full year was highlighted by full year double-digit growth in Reinsurance Solutions and Health Solutions. And we've maintained strong overall growth throughout the year on top of 6% organic in the prior year. In the fourth quarter, commercial risk grew 4% organically, with strength in property, casualty and construction, even against the headwinds communicated in prior quarters, with ongoing pressure from trends in the M&A and IPO markets. Wealth Solutions organic growth of 5% in Q4 reflects strong growth in retirement, which includes growth from ongoing pension risk transfer projects and working off clients to address changing regulatory requirements. Reinsurance Solutions organic growth was 14%, contributing to full year organic growth of 10%, as our team closed the year strong while also helping clients prepare for and execute an early 1/1 renewal.

Health Solutions delivered 11% organic growth, reflecting strength around the world in the core, driven by net new business and retention, as well as strong growth in the U.S. Consumer Benefit Solutions. This performance gives us confidence in our ability to drive ongoing growth across the portfolio, fully reflecting the strength of Aon United. For the full year, 7% organic growth and ongoing operation improvement contributed to 80 basis points of adjusted operating margin expansion and 10% adjusted operating income growth.

These strong results demonstrate our progress and momentum, as well as the power of our Aon United Strategy and Aon Business Services platform. This performance builds on our long-term track record of results. Over the past 12 years, we've strengthened and accelerated organic revenue growth mid-single digits or greater, delivered over 1,200 basis points of adjusted operating margin expansion, and grown EPS and free cash flow at 11% compounded annual rate, ending 2023 with nearly $3.2 billion in free cash flow.

The steps we've taken to accelerate Aon United with our 3x3 plan reinforce and strengthen our long-term financial guidance for the firm, including: mid-single digit or greater organic revenue growth in 2024 and over the long-term; adjusted operating margin expansion over the long-term; and long-term double-digit free cash flow growth.

As we've communicated, initiatives like our restructuring program and expected acquisition of NFP impact this guidance in the near term. And over time, we believe these initiatives will contribute to significant ongoing shareholder value creation.

More important, we view the opportunity as higher over the next five years than at any time in our history. And in closing, we're pleased to report another strong year of progress against our Aon United strategy, which we're accelerating with our 3x3 plan, deliver risk capital and human capital at scale, fully reinforced through Aon Business Services.

Looking back on the year, we delivered accelerating growth across three of four solution lines and built momentum across the firm, including 7% full year organic revenue growth, 80 basis points of adjusted operating margin expansion, 10% adjusted operating income growth, and nearly $3.2 billion of free cash flow. Equally important, we took a series of major actions that position Aon for stronger performance in 2024 and over the coming years.

Now, I'd like to turn the call over to Christa for her thoughts on our financial results and long-term outlook. 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 delivered strong operating results in the fourth quarter to finish the year strong. In the quarter, we translated 7% organic revenue growth into 60 basis points of adjusted operating margin expansion and 10% adjusted operating income growth.

For the full year 2023, we delivered 7% organic revenue growth, 80 basis points of margin expansion, 6% EPS growth, and generated $3.2 billion of free cash flow. In the quarter, we announced our definitive agreement to acquire leading broker NFP, enabling us to unlock the fast-growing mid markets with Aon Business Services-enabled enhanced distribution and further accelerate our Aon United strategy.

The steps that we've taken around our Aon Business Services now enable us to address this attractive market in a compelling way that delivers risk capital and human capital at scale to clients of all sizes. The expected acquisition of NFP builds on our long-term, proven track record of strategically allocating capital at scale to high-return opportunities to create long-term value for clients, colleagues and shareholders. And as Greg mentioned, we see the expected acquisition and our restructuring program reinforcing our Aon United strategy and our 3x3 plan. We are extremely well-positioned to build on this momentum as we head into 2024.

As I reflect on our results, as Greg noted, organic revenue growth was 7% in Q4 and for the full year, highlighted by double-digit organic revenue growth in Reinsurance Solutions and Health Solutions. I would note that reported revenue growth of 8% in Q4 includes a favorable impact from changes in FX of 2%, and there's no net impact from changes in FX to full year reported revenue.

I'd also highlight fiduciary investment income, which is not included in organic revenue growth, was $78 million in Q4 and $274 million for the full year. If you were to include fiduciary investment income, organic revenue growth would have been 8% in both Q4 and the full year. We continue to expect mid-single digit or greater organic revenue growth for the full year 2024 and over the long term.

Moving to operating performance, we delivered strong operational improvement in Q4, with adjusted operating margins of 33.8%, an increase of 60 basis points, driven by revenue growth, efficiencies from Aon Business Services, overcoming expense growth, including investment in colleagues and technology to drive long-term growth. For the full year, adjusted operating margins of 31.6% reflect margin expansion of 80 basis points. As previously communicated, there was no impact on margin from restructuring savings.

Looking forward, we expect to deliver margin expansion in 2024 and over the long term, as we continue our track record of cost discipline and managing investments and long-term growth on an ROIC basis. We expect restructuring savings will fall to the bottom line and contribute to full year adjusted operating margin expansion. Restructuring actions completed in 2023 are expected to generate $70 million of run rate savings in 2024. At this time, we continue to expect $100 million of run rate savings in 2024 as we continue to execute against our plans for Aon Business Services and our business.

As we've previously communicated, we've conservatively modeled the expected acquisition of NFP to close midyear 2025. While the combined adjusted operating margin will initially be lower than Aon stand-alone, we expect over time to continue to improve Aon's overall margins through operational improvement and the impact from previously communicated cost synergies.

Turning to EPS, adjusted EPS was flat in Q4. Operating income grew 10%, but was offset by a headwind from a higher tax rate in the quarter and non-operating expense. For the full year, organic revenue growth and margin expansion translated into adjusted EPS growth of 6%, overcoming a headwind from non-operating expense. I'd note the change in other non-operating expense had a $0.15 per share or 4% unfavorable impact in Q4 and a $0.98 per share or 7% unfavorable impact for the full year. This reflects an unfavorable impact from balance sheet FX remeasurement in the current period, an increase in non-cash net periodic pension expense as well as a gain on sale of businesses in the prior year period. Also, as noted in our earnings materials, FX translation had a favorable impact of approximately $0.03 per share in Q4 and an unfavorable impact of $0.17 per share for the full year. If currency remained stable at today's rates, we would expect no material net translation impact to results for the full year 2024.

Additionally, in 2024 we expect non-cash pension expense and OIE to be $43 million spread evenly across quarters compared to $71 million in 2023. And as we've previously communicated, based on a mid-2025 close, the expected acquisition of NFP is expected to be dilutive in 2025, breakeven to adjusted 2026 EPS, and accretive in 2027 and beyond. At this time, there are no further updates on the regulatory process or deal timeline for NFP.

Turning to free cash flow, we generated $3.2 billion of free cash flow in 2023. For the full year, cash from operations increased $216 million year-over-year or 7%, reflecting double-digit operating income growth and overall working capital optimization, partially offset by higher cash tax payments. I'd note the negative impact to working capital caused by temporary invoicing delays associated with the new system implementation, which we communicated last quarter, persisted in Q4 and impacted our overall continued progress on working capital.

Free cash flow increased 5% as cash flow from operations was offset in part by a $56 million or 29% increase in CapEx. CapEx was $252 million in 2023 as we executed technology projects to drive long-term growth. Going forward, we expect CapEx to grow in line with the business, managed on a disciplined ROIC basis. Looking forward, free cash flow will be impacted in the near term by restructuring, higher interest expense, and the expected NFP deal and integration costs. We expect to return to our trajectory of double-digit free cash flow growth over the long term, driven by operating income growth and a $500 million opportunity in working capital. As we contemplate the expected acquisition of NFP, the transaction strengthens our long-term free cash flow outlook. We expect the transaction to add over $300 million of free cash flow in 2026 and $600 million of free cash flow in 2027.

Now let me provide an update on our accelerated Aon United program, which is enabling Aon Business Services and our 3x3 plan. As Greg highlighted, the 3x3 plan is accelerating our Aon United strategy. We see particular opportunity around Aon Business Services as the catalyst. We are investing to standardize platforms and operations, drive data analytics-based product innovation and deliver at scale to create better tools, better experiences and greater relevance to clients and colleagues.

In the fourth quarter, we incurred $129 million of restructuring-related charges with a cash outflow of $13 million. We're pleased with the progress we made in the quarter, and we've incurred 12% of total expected cash restructuring charges. The actions we've taken in 2023 are expected to generate $70 million of run rate savings in 2024, contributing to the $100 million of cumulative savings we expect for the full year 2024. As mentioned, program savings were not material in 2023.

As we said previously, we look at the opportunity in Aon Business Services and across our client-facing capabilities. We know delivering our strategy will result in long-term progress against our key financial metrics and will drive more value for clients, colleagues and shareholders.

Turning now to capital allocation, we allocate capital based on return on capital and long-term value creation. I'd note over time we've driven value creation through core business results, share buyback and acquisitions. As we look historically, we have a successful track record balancing acquisitions and dispositions of all sizes and share buyback. Given our strong outlook for free cash flow over the long term, we expect share repurchase to continue to remain our highest return on capital opportunity for meaningful ongoing capital allocation. We believe we are significantly undervalued in the market today, highlighted by the $2.7 billion of share repurchase in 2023. We expect to continue to invest organically in content and capabilities we can scale across the firm, and we'll continue to assess priority areas for inorganic investment, noting our M&A pipeline continues to be focused on our global priority of scalable solutions to our clients' growing and evolving challenges.

We will continue to assess all capital allocation decisions on an ROIC basis, noting we ended 2023 with an ROIC of 33.1%, an increase of nearly 2,100 basis points over the last 12 years, reflecting our track record of balancing growth and returns to create long-term value. I'd note ROIC will initially be negatively impacted after the expected acquisition of NFP. We expect it to improve over time as we execute our Aon United strategy to drive long-term value creation. Our expected acquisition of NFP is consistent with our proven capital allocation framework. It enables us to put capital to work at scale and strengthen our free cash flow profile in the long term, which we'll continue to allocate to drive shareholder value creation. Between now and the expected close of the deal we expect discretionary capital allocation will continue to be much more weighted towards share buyback given the commitments we've made around NFP.

Following the expected close of NFP, free cash flow will be impacted in the near term by deal and integration costs and higher interest expense for a transaction-related debt and as we take steps to de-lever our balance sheet and return metrics to levels consistent with our current credit ratings profile.

Turning now 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. We remain committed to maintaining our current investment grade credit ratings. We expect to continue adding debt supported by EBITDA growth until we complete the expected acquisition of NFP and expect to maintain our current ratings.

As we've previously communicated, we expect to fund the cash portion of the purchase with approximately $7 billion of new debt, with $2 billion borrowed at close and $5 billion raised in 2024 across a range of maturities subject to market conditions. Following the transaction-related debt issuance in 2024, we expect to incur approximately $12.5 million of negative interest carry expense per quarter until deal close. As we previously communicated, the financing and capital management plan contemplated in this transaction is consistent with maintaining our current investment-grade credit profile. We expect our credit ratios to be elevated over the 12 to 18 months post close and we expect to bring our leverage ratios back in line with levels consistent with our credit profile driven by substantial free cash flow generation and incremental debt capacity from EBITDA growth, noting our track record of effectively managing leverage within current ratings.

In summary, in 2023, we delivered strong operational performance, contributing to continued progress against our Aon United strategy. Our strong financial results and disciplined capital management enable us to return $3.2 billion to shareholders through share repurchase and dividends. The steps we've taken around our 3x3 plan are accelerating our Aon United strategy catalyzed by Aon Business Services and reinforced by the restructuring program and our expected acquisition of NFP. We remain incredibly excited about the opportunity to continue to drive top and bottom line results to drive value for clients, colleagues and shareholders, and look forward to building on this momentum in 2024.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. We'll now be conducting the question and answer session. [Operator Instructions] Thank you. And our first question today will be coming from the line of Andrew Kligerman with TD Cowen. Please proceed with your question.

Andrew Kligerman
Analyst, TD Cowen

Q

Thank you. Thank you and good morning. I'm kind of interested in the robust growth in both the reinsurance business and the Health Solutions business and the sustainability there. On reinsurance with 14% organic growth, was it largely driven by the capital markets and advisory? And how sustainable do you think that can be? And then on the consumer benefits solutions side of health, what actually drove the consumer benefits solutions strength?

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

A

Well, Andrew let me start and Eric, chime in here as well. Start overall, we're really pleased with how we closed the year on the growth story overall. When you think about the 7% across the firm, really strong momentum as we go into 2024. But you're right, reinsurance and health, absolutely phenomenal. Teams were absolutely terrific. And I would highlight the quarter but also highlight the year when you think about reinsurance across the year at 10% and Health Solutions at 10%, double-digit, it really is a story amplified by Q4 but really across the year and it has been highly consistent when you think about the description around the 3x3 plan and risk capital and human capital. Both of these approaches contributed to growth sort of in the context of health and reinsurance and give us great momentum as we go into 2024. But maybe, Eric, a little texture on both pieces for the year and the quarter.

Eric J. Andersen
President, Aon Plc

A

Sure, Greg. It's a great question. And just to reaffirm, just a fantastic team operating really on fire. I would say on Q4, to go to your question, there was record cat bond issuance for the quarter, but we also had very strong growth in treaty and fac. So across the board, good. And I would say the trends that we have been seeing over last couple of years, I think have an opportunity to continue. Certainly whether it's climate change, whether it's casualty uptick in terms of loss costs, whether it's opportunities from a profitability standpoint that our insurers are dealing with from their own books of business. The need for data analytics, the need for capital support as they position their primary businesses are all still there, and it's a global answer. So we're seeing it in Europe and Asia-Pacific, as well as strength in North America and the UK. So we're really optimistic about the business and feel like it's really well-positioned.

And then maybe on the health side, just to comment on the health side is I think same thing, right? We had great wins in the core health and benefit business. And as you mentioned, the consumer business across the globe, whether led by EMEA, UK, US, and it really was new logos for us on core health and benefits. I think on the consumer side, the ability to offer unique products to the consumer part of our corporate clients is really a strength of the firm. And those products evolve, and I think they're meeting the needs of the individual consumer. And we also see that as an opportunity to continue to grow.

Andrew Kligerman
Analyst, TD Cowen

Q

Excellent. And then, just lastly on M&A. I guess, in the slides you talked about potentially growing organically and inorganically there. Do you think M&As are a real possibility in the next year or two as you kind of await a conclusion on the NFP acquisition? And if you are interested in M&As, what would be some of those targeted businesses where you'd like to be?

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

A

So Andrew, to start overall, as Christa described, we continue to look as we think about deployment of capital. Obviously, buyback, it's top of the list given how undervalued we are. But we're looking across the board even as we think about sort of the closure on the NFP front and, again, return on invested capital base, content base in every way, shape or form. But we see opportunities around the world, and our pipeline continues to be very strong.

But what else, Christa, you'd add from a capital allocation standpoint?

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

A

I mean, reinforcing exactly what you said, Greg. We allocate capital based on return on capital. We definitely – based on the free cash flow outlook in 2024 in the long term – see we are significantly undervalued. And we will disproportionately allocate that free cash flow to buyback in 2024. But we do have a great M&A pipeline – Andrew, to your question – in areas like data analytics, if you think about the acquisition of Tyche, a fantastic acquisition in the data analytics space; in areas like health, as Eric highlighted. And so, there are a number of areas that are front and center for clients in terms of meeting their emerging challenges.

Andrew Kligerman
Analyst, TD Cowen

Q

And if you see the right opportunity, you wouldn't hesitate to go after it, correct?

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

A

And Andrew, the thing I would say is it's all about return on capital. And so, given how undervalued we are, buyback is the top of the list. And for us to invest in M&A, it's got to be buyback. And so, we'll continue to look at everything. And there's certainly some terrific opportunities out there, but we'll continue to be very disciplined on return on capital.

Andrew Kligerman
Analyst, TD Cowen

Q

Very helpful. Thank you.

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

Q

Hi. Good morning. This is [ph] Jack (00:29:41) on for Mike. A question on organic growth. In your footnotes, it says that organic growth benefited by 1% from a held-for-sale business. And which segment did that impact, and will that have a similar impact until the business is sold?

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

A

So thanks so much for the question, [ph] Jack (00:30:00). We do continue to manage the portfolio actively. These are businesses that we are divesting. And so, we think about this as just a better representation of our revenue and business going forward. It is in commercial risk, and we communicated the 1% impact in Q4 and for the full year.

Q

Got it. Thank you. And then, second question, you called out again this quarter decline in global M&A activity as being a source of organic growth deceleration from prior periods. Would you be able to offer any color on what percentage of Aon's revenues touched M&A spend? Is it a big enough driver to continue negatively impacting growth, given that M&A volumes are still falling by double-digit levels?

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

A

So Mike (sic) [Jack], if you step back, it's been the continuation of what we talked about throughout the overall year in terms of sort of where we are. And we would observe – by the way, we help serve, if you think about Q4 2023 versus Q4 2022, stayed on 4% and 4%. So it's sort of same year-over-year even against this headwind. And we haven't disclosed sort of the detail on sort of the impact, but it's substantial.

We've got an amazing group of colleagues who serve this marketplace. And as Eric has mentioned before on prior calls, we have doubled down on this capability. We fully anticipate this is going to come back in absolute full force. The amount of dry powder out there, as you know well, is extensive. I would remind you it shows up in our organic when the deal is complete, and we see lots of things in the pipeline as sort of things are coming to pass. And we fully expect over the course of 2024 to see a return. But this is meaningful for us and we've been able to work it very, very strongly and maintain growth across the board, even in the face of this headwind.

But Eric, what else would you add to that?

Eric J. Andersen
President, Aon Plc

A

Greg, I think you described it perfectly. Just maybe one little bit of color. This week, for example, we held a conference where we had 400 members of the private equity community, the corporate M&A, corp dev teams, the insurance markets, the reps and warranties, tax indemnity, tech. And we essentially were going through the marketplace just from a growth standpoint, but also from a product innovation standpoint, recognizing that as the deals return, and they will, we want to make sure we're well-situated with the clients, with the markets, making sure the products are fit for purpose and are evolving to meet the needs, not just here in the US, but in Europe and other places where, when it returns, we have made that commitment. We want to hold the team so that we're ready and front and center when the deals start to happen.

Q

Thank you.

Operator: Our next questions are from the line of Jimmy Bhullar with JPMorgan. Please proceed with your questions.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

Hey, good morning. The first just following up on the whole M&A discussion. It seems like capital markets activity is beginning to pick up and the investment banks are seeing that across the board. So wondering if you're seeing any signs of that in your business as well? Or is it more your hope that things will pick up in 2024, but you haven't seen any of it?

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

A

Jimmy, we're seeing exactly the same thing you're seeing and you're hearing about. And listen, you can imagine, this is a market we're highly connected to with clients and with all the banks and everyone else involved in the process. And I would say there's high expectations everywhere. You'd only listen to the investment bank – or quarterly calls to sort of understand that. And so, we certainly see lots of potential. And as Eric described, the amount of capital on the sidelines ready to return is high, and we're incredibly well-positioned to do that. But I would say, as I mentioned before, it shows up in organic for us as the deals are completed. And so, as you see that move, you can expect that's going to be fully reflected in our performance.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

Okay. And then, on commercial brokerage, the organic growth of 4%, I think you mentioned double-digit growth in Asia-Pacific, which is obviously good. But it also suggests that the US is very weak and maybe close to flat, which seems a little odd, given GDP growth, pricing and also just trends that other brokers have reported. So what's really going on in the US that's pressuring the growth to being flat despite some of the tailwinds in the economy overall?

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

A

Yeah, I would start overall. Your overall assertion, I can see where you're getting to, but really doesn't reflect what's going on in reality. Obviously, the businesses are very, very different sizes, so one doesn't really offset the other in any way, shape or form. We would come back to the overall commercial risk story is exactly what we described before, which is, listen, we are exactly where we were in Q4 of last year. It was an emerging headwind and became a substantial headwind. We overcame that and a lot of this is not just commercial risk, but the connection of commercial risk and reinsurance and risk capital. And we closed the year, we had observed some others in the market seem to be retreating. We're not retreating at all. It's 4% versus 4% of last year and we're going into 2024 with a lot of momentum. So we're very excited about the overall prospect as we move into 2024 and maybe, Eric, talk a little bit about the risk capital implications as all of this coming is together and the potential around it.

Eric J. Andersen
President, Aon Plc

A

Yeah, sure, Greg. I think certainly strong retention, strong new business both in North America and around the world and our commercial risk business is important, but maybe I'll use it as an opportunity to show the connectivity between sort of the risk capital framework. And maybe I'll talk about the cat bonds that I know we wanted to get some airtime on. We did the first ever cyber cat bond in the quarter, which was a great opportunity for our team working with one of our insurance company clients to take the systemic cyber risk and get it into the capital markets, which does two things. It actually allows the insurer to open up the amount of limit they provide to clients, which was something that our clients were looking for. And it also appropriately values and places that type of systemic risk into the right capital source.

But the point of it is we were then able to take that ILS structure using the data and analytics that we did to build it and used it to do an ILS structure for one of the largest corporates in Europe who was looking for a traditional sort of cyber program but wasn't able to get the limit they wanted. So taking something that we did for an insurer, using the data analytics and structure and bringing it to a large corporate and maybe finishing it.

Because Greg, I know you mentioned NFP in your opening comments and just to tie it through, able to take the same data and analytics that we use to build the cat bond and then the corporate structure to actually power the CyQu product that is built for the middle market, which then attaches a risk transfer product to it. So again using data analytics on one topic, just cyber actually, to drive growth in reinsurance and commercial risk and ultimately in the middle market part of the commercial risk segment. So that's what's driving the retention, that's what's driving the strong renew business. And I think those opportunities exist for us across multiple areas.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

Thank you.

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

Bob Huang
Analyst, Morgan Stanley & Co. LLC

Q

Hi. Good morning. First question is about the Vesttoo legal settlement. Can you talk about how much of the $197 million is likely to be the full extent of the impact? In other words, in the press release, you obviously mentioned there is a potential of some of that being sent back to you. What's the progress of that? Can you maybe give a little bit more detail of how confident you are that some of the $197 million will be paid back to Aon?

Eric J. Andersen
President, Aon Plc

A

Listen, I would just open by saying that we strategically wanted to draw a line under this issue for our market partners and for ourselves so that we were able to move forward together as partners. And so the effort was made to come to an agreement with each of the affected parties so that we could then continue to both, one, trade forward, but then also begin to work on recoveries together. And so we see an opportunity for recoveries that will happen over time as the bankruptcy process runs its way through. And we're confident that we'll be able to recover a meaningful amount.

Bob Huang
Analyst, Morgan Stanley & Co. LLC

Q

Okay, thank you. Second question is on cash flow. I understand that you've kind of mentioned this a little bit. On your slide you removed double-digit growth for the near term, but reiterated a long-term guidance for free cash flow. I'm assuming that it's fair to say this is mainly due to the NFP acquisition over the next two years. Is it safe to assume that like is that the reason? And can you maybe give a little bit more context in terms of how you're thinking about free cash flow guidance going forward?

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

A

Yes, thanks so much for the question. So firstly, I'd reiterate your point, which is we are incredibly confident in the long-term free cash flow growth of double digits and extremely excited about how NFP accelerates the long-term free cash flow growth of Aon, adding $300 million in free cash flow in 2026 and $600 million of free cash flow in 2027. And look, as we think about free cash flow in 2024, we haven't given specific guidance. But here's how I think about it. We expect to grow free cash flow driven by operating income growth and improvements in working capital. We do expect ongoing cash tax headwinds. We've communicated the restructuring program, but we haven't given specific guidance around the timing of the cash impacts. And we've talked about the impacts of NFP.

We don't expect to incur material costs before close, and we've said we expect to incur $12.5 million of negative interest carry expense per quarter until deal close following the transaction-related debt issuance. We've said CapEx will grow in line with the business from $252 million in 2023. We've communicated legal settlements, as Eric just said, expect those to flow through over the next several years, knowing there will be meaningful recoveries. Ultimately, we expect to deliver underlying free cash flow growth and we're targeting double digits as we move past the negative impacts of restructuring and NFP. Very excited about the long-term double digit free cash flow trajectory of Aon.

Lastly, in 2024, we do expect a disproportionate majority of the free cash flow to be allocated to buyback given we're operating on a return on capital basis and we are substantially undervalued today.

Bob Huang
Analyst, Morgan Stanley & Co. LLC

Q

Got it. I really appreciate the color. Thank you for reiterating that. Thank you.

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

Robert Cox
Analyst, Goldman Sachs & Co. LLC

Q

Hey, thanks for taking my question. Maybe just the first question on one of the higher growth areas of insurance. And thinking about the higher growth areas, one of those is currently the E&S space. And I was just curious on how Aon thinks internally about the feasibility of owning a wholesale broker. Is there any reason to think that could potentially be a good fit?

Eric J. Andersen
President, Aon Plc

A

Maybe I'll take a stab at that one. Thanks for the question. Listen, there's been explosive growth in the E&S market over the last 5 to 7 years on a magnitude of tenfold. And there's a lot that's driving it. Right, whether it's the lawsuits that you see in the property market, whether it's regulatory pressure on pricing and forms, and there's a lot to it. We have consolidated our wholesale relationships so that we're actually working in partnership to get access to that capital when we need it for our clients. Some of our competitors do own wholesalers, and that's the way they chose to enter into the marketplace. So it's something we always look at. But we like where we are today and we like the relationships that we have with our major partners today.

As we need it, that marketplace tends to flex up and down with different market cycles. And so I would say right now it is based on the challenging market conditions, especially in the property area. It's significant growth. But it will ebb and flow over time.

Robert Cox
Analyst, Goldman Sachs & Co. LLC

Q

Got it. Appreciate that. And maybe just a follow-up on pricing. I think some of the other brokers have talked about expectations for fairly stable P&C pricing in 2024. And I'm curious if Aon shares that view, if there's any other color you would want to add on the pricing trajectory.

Eric J. Andersen
President, Aon Plc

A

So I think a number of people have commented on it during this earning season. I would say that we're probably heading towards a market where it's more of a series of markets where you see price competitiveness in certain areas where new capital has drawn in. D&O, for example, would be one that's been called out. You also see challenges still in certain parts of property and people are a little worried about casualty has social inflation. Some nuclear verdicts have kind of hit the wires and they're worried about prior year reserve. So I think rather than just a rising market for all, what we're going to see over 2024 and 2025, it is going to be very product specific and very risk specific, which is something that I think plays well to us because it allows us to use our teams and our analytics to be able to help them think through how they either want to trade or manage the risk. But I think that's where we see the market going at 2024 and 2025.

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

A

I maybe just add, Rob, as well, as you think about impact as it relates to our overall performance, bringing it back to Aon, we've talked about mid-single-digit or greater. We don't see anything changing that view. Again, pricing is one aspect. We've talked about market impact, which includes insured values and a number of other pieces that fit into the equation. Our ability to work with clients in any type of marketplace and our advantage in doing so. And so our view is market will be what it will be, a series of markets, as Eric has just described. But our ability to deliver mid-single-digit or greater, we feel like we're going into 2024 with a lot of momentum behind.

Robert Cox
Analyst, Goldman Sachs & Co. LLC

Q

Appreciate that. Thanks.

Operator: 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. I wanted to come back to commercial risk. You guys said I guess there was a 1% impact of business that you put out in dispositions in the quarter overall, right. So that would imply if it impacted commercial risk, that was 2% of the segment, which would bring your organic to 2% before that adjustment. And I know you've highlighted the M&A and the SPAC and the IPO slowdown. And I think, Greg, in response to an earlier question, you pointed that the US probably would not have been flat, right? That there's – we couldn't really back into that. But what is actually impacting commercial risk away from the M&A and SPAC business that aside from this disposition, the growth would have been 2%?

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

A

Christa, you might be on mute.

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

A

Oh, sorry. So, Elyse, one of the things I wanted to clarify was on the held for sale item. It is across a couple of solution lines and we didn't disclose specifics, but we are divesting this business. And so we think it's a much better representation of our organic revenue growth and the go forward business. And then as we continue to describe the major impact on commercial risk is the M&A and IPO environment, and that has remained depressed. And Eric and Greg have outlined how they see that recovering in 2024. But Eric, would you like to add anything here?

Eric J. Andersen
President, Aon Plc

A

Christa, the only thing I would add, I mentioned it before, is stronger business growth, strong retention and rollover for our clients in North America and around the world. So the underpinnings of the business continue to be very strong.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

Okay, that's helpful. And then as we – one question I had on reinsurance, right. Obviously, it's a lower volume quarter and we went through kind of what drove the growth in the fourth quarter. As we think about the Q1 in 2024, right, we've heard about the renewals, January 1 being good. But right, obviously price increases came down because they were so strong last year. How do we think about reinsurance organic growth in a still strong, but decelerating price increase environment?

Eric J. Andersen
President, Aon Plc

A

Maybe I'll take that one, Greg. Listen, I think there was certainly adequate capital to get the client's needs done for the 1/1 renewals. Then, that's predominantly Europe and parts of North America. Recognizing that Florida and Asia-Pacific tend to be April and June of the year.

I would also say part of the risk capital strategy is how do we actually deploy reinsurance capability into either commercial risk or new sectors. And so, just to give you an example, it's kind of early days, but I spent some time in Dubai at the COP conference and we spent a lot of time working with various government entities around how you bring reinsurance structuring capability to help mitigate the effects of a changing climate. And so, that is core reinsurance, data and analytics, structuring, global access to capital, to a whole new sector of potential clients.

And so, I do think, certainly, the main of the business continues to be served by the insurance companies, but there is opportunity outside of that space to drive new growth for us in what you would consider core reinsurance capability. So that, and if you think about fac, you think about investment banking, ILS markets and being able to use that capital for corporates. And so, it's a very accretive group that is well coordinated with our commercial risk clients in the risk capital framework. And so, we do see opportunities for continued growth in that space over the coming period.

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

I would add, Elyse, though, the momentum of this team in the core space of reinsurance, but more broadly across risk capital has been tremendous. And obviously, the quarter by quarter view is helpful. But we look at the annual view. If you think about kind of 10% for the year, that's what's really unique. Not saying where we're going to be next year other than mid-single digit or greater across the solution lines, which we aspire to.

And so, I think you can take away, you've just heard on commercial risk momentum into 2024. And clearly, as you look at reinsurance momentum into 2024, for all the reasons that Eric's described in the core solution line, but also in risk capital. Don't lose this. This risk capital orientation is a big deal. It is meaningful in terms of sort of what we're doing. Same on the human capital side. The connectivity across reinsurance or commercial risk creates better solutions. Eric's described a couple of them already. And so, for us, we feel good about the momentum going into 2024 based on the work we did, the groundwork we laid in 2023 on risk capital and human capital.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC
Q

Thanks. And then, one more. The savings, I know, Christa, you reaffirmed the $100 million for 2024. It doesn't sound like there were any that came through in the fourth quarter, so I guess we'll start seeing the savings flow through in the first quarter. Is that correct?

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

That's correct, Elyse.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC
Q

Thank you.

Operator: Our next question is from the line of Meyer Shields with KBW. Please proceed with your question.

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

Thanks. So Greg and Christa, you've been very consistent about the impact of the slow M&A and IPO market on organic growth. I want to take a step back and say how do you think about the fact that organic growth is so dependent on one segment of the marketplace that you ended up with such differentiated results relative to peers? Is that a concern?

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

A

Well, if you step back, Meyer – I just would step back and say, look at the overall performance of the firm year-over-year. In essence, we are up for the year: 6% last year, 7% this year across the firm. If you think about commercial risk, again, we were 4% in Q4 last year, we're 4% in Q4 this year, even against a substantial headwind we've described. And what we want you to understand in the context of that is imagine all of the things that sort of went behind that that created that momentum in Q4 and into now 2024 in the commercial risk piece. We've overcome that and maintained where we were last year. So we're very optimistic about the momentum into 2024.

This category is substantial in M&A. And we love it, and we are disproportionately good at it. We are unbelievably good at it from a client leadership standpoint. And so, we don't feel bad about that in the least. We love it and we're going to double down in it. But we also continue to build out other platforms. This year has given us the opportunity to really think that through and really leverage the risk capital orientation.

I would highlight, I mentioned it in my comments, the Property Symposium. We got 1,000 clients and markets in the room, and we bring up the Property Risk Analyzer. And this is really a function of reinsurance and commercial risk analytics. And the power of that in the minds of a client were substantial. And so, now, we've got a suite of capabilities that are going to contribute to the commercial risk and to reinsurance as we head into 2024.

So from our standpoint, what we'd really like you to take away and certainly our feeling and commitment is mid-single digit or greater, the translation into OI margin improvement and, as Christa described, the translation into double-digit free cash flow growth. We have never had more conviction about each of those three categories and are delivering those, and we'll continue to deliver those. And the addition of NFP is only going to strengthen our free cash flow profile over time. So for us, we're always going to be cautious in our approach, but resolute. And we feel very good about the momentum going into 2024.

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

Q

Okay. That's very helpful. Thank you. Second question, when we look at the strong organic growth in reinsurance, looking at the breakdown, I think you talked about treaty, facultative and investment banking. Is that component of revenues positive or negative to overall market?

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

A

So reinsurance is a similar margin business to all of our businesses, which is why we operate Aon as one segment, Meyer. And one of the things we would say, part of our Aon United strategy, is we are bringing together a lot of the back office technology operations and shared service functions into Aon Business Services, which is enabling our focus on common and shared operations, technology platforms at scale, and then product innovation at scale. And so, we're really operating more and more the firm in one segment with risk capital, human capital, enterprise client, and Aon Business Services.

Gregory C. Case

Chief Executive Officer & Executive Director, Aon Plc

A

And Meyer, this is worth a – look, it's really a great question and really worth a point of high emphasis. This connectivity that Christa is describing, risk capital, human capital, connected through enterprise client, delivered and amplified by Aon Business Services, a big deal. Our ability to continue to drive margin improvement as we did this year with lots of investments into the business is high. And the exciting piece is this connectivity on Aon Business Services, 15,000 colleagues working this interconnected end of the business is not just continued margin improvement, which you saw, but also the capability to really create outcomes that really drive client innovation options that they didn't have before, as well as service enhancements they didn't have before. And so these pieces all come together to sort of create this integrated view, which really give us great confidence around not only top line growth, but also margin improvement and the implications on free cash flow.

Meyer Shields

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay, fantastic. Thank you so much.

Operator: Our next question is 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. I guess first question, as we've seen some reserving issues in casualty and financial lines across the industry, I'm wondering if this were to become a more widespread issue for the industry, could that impact Aon's profit commissions? And is that material enough that it would impact your margins or organic growth near term?

Eric J. Andersen

President, Aon Plc

A

So I'll say we don't do the profit commission, so that's not true for us. So that's not in our portfolio. But I would say in terms of what's happening in that marketplace, I do think it does reflect some pressure that the insurers are seeing, especially on the casualty side. I would say on the financial line side, it's probably more a question of just supply and demand, where a lot of the new [indiscernible] (00:55:40) into the market [Technical Difficulty] (00:55:43) you're just seeing price competition versus any prior loss problems. But I think the casualty piece with medical inflation, they call it social inflation, is affecting their prior reserves. But it will not have an impact on us from that perspective.

Charlie Lederer

Analyst, Citigroup Global Markets, Inc.

Q

Got it. Thanks. And then on the commercial risk segment, just wondering, as you know, deal volumes come back eventually, does that carry a higher margin or that would help your margins as that becomes a larger proportion of the mix again?

Gregory C. Case

Chief Executive Officer & Executive Director, Aon Plc

A

Again, I would just reinforce the point, Charlie, around sort of as Christa described, overall margin. Ability to sort of drive margin across the firm. We've got a very long track record of being able to do that over the last decade plus. And we have enhanced our ability to do that with Aon Business Services. And so we are excited about adding growth as it also helps us deliver our margin. You don't see us really make that trade off. We really do both and the profile is ahead of us to do exactly that. And we would absolutely see as you know our 3x3 plan fits together that M&A is going to be and IPO is going to be a fundamental part of that. And we're excited to have that growth come back.

Charlie Lederer
Analyst, Citigroup Global Markets, Inc.

Q

Got it. Thank you, guys.

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

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

Hey, thanks. I just wanted to follow up on your comments around the expected timing of the close of the NFP deal. Is mid-2025 what you realistically think the deal will close or is it just more a given the uncertainty you don't want to overpromise because it seems like it's a long lead time for a deal that really in my view doesn't entail a lot of antitrust or other issues given the market focus of NFP, but.

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

A

Thanks so much for the question. And we agree we operate in very different segments with very limited overlap and we fully expect to close in mid-2024. We have modeled the deal very conservatively with a mid-2025 close and that is us being conservative financially.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

Okay. And then in terms of sort of processes, are there areas where there is some overlap and we can't see it from the outside? Or do you not think there's going to be anything related to potential dispositions in order to get the deal approved?

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

A

So Aon and NFP operate in highly competitive markets and most importantly, the purpose of this transaction is to grow Aon's presence in the fast-growing middle market segment. And so we do not see overlap and we again expect the deal to close mid-2024.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

Okay. Thank you.

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

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

Thanks very much. I would like to add a couple of thoughts as we close today, just picking up Eric and Christa on some of the comments that have been made throughout the call, which have been very, very helpful. Just reiterate a couple of things. First, reflect on the long track record we've had delivering on the strategic initiatives and external commitments. And think about it's included a number of significant acquisitions and divestitures and a history of successfully executing around the restructuring programs. And that brings us to where we are today, which you can tell from our enthusiasm we're very excited about. If you think about the 3x3 plan, each component of our strategy and the execution plan here are fully aligned, totally connected. You think about Eric described today risk capital and human capital and the capability that comes together with that. The client response of this has been exceptional.

As we continue to build that, it's now connected completely through our ability to deliver that into the field, enterprise clients and the Aon client leadership model, fully connected. And then this amplification on Aon Business Services came up a few times today. We would encourage you to really dig in and understand the power of what this really means. 15,000 colleagues in this group, well beyond the efficiency that Christa described, which you saw on the 2023 OI margin and 316. It's really the ability to deliver better content and a better service experience. That combination really is extremely, it's exciting for us in terms of what it means for Aon and for our client. And as Eric described it really, you think about sort of NFP, the opportunity in NFP is there because of their great capability and awesome operating platform and our Aon Business Services capability.

And again, we bring all that together with a $900 million investment to accelerate that, do that over three years across the 3x3 plan with what we're taking more time. So I just want to highlight as the questions come together, they are really connected in our mind and really put us in a unique position to execute against our overall plan and deliver great momentum in 2024, 2025 and 2026. So just want to end with that summary and say thanks to everyone for being part of the call today and look forward to our discussion next time.

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