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# EDITED TRANSCRIPT

WTW.OQ - Q2 2023 Willis Towers Watson PLC Earnings Call

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## OVERVIEW:

Company reported adjusted earnings per share of \$2.05, free cash flow margin of 8%, free cash flow margin of 14%, free cash flow margin of 12%, cash of \$200 million, debt of \$750 million, free cash flow of \$350 million.

## CORPORATE PARTICIPANTS

**Andrew Jay Krasner** *Willis Towers Watson Public Limited Company - CFO*

**Carl A. Hess** *Willis Towers Watson Public Limited Company - CEO & Director*

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**Charles Gregory Peters** *Raymond James & Associates, Inc., Research Division - Equity Analyst*

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## PRESENTATION

### Operator

Good morning. Welcome to the WTW Second Quarter 2023 Earnings Conference Call. Please refer to the [wtwco.com](http://wtwco.com) for the press release and supplemental information that is issued earlier today. Today's call is being recorded and will be available for the next 3 months on WTW's website.

Some of the comments in today's call may constitute forward-looking statements within the meaning of the Private Securities Reform Act of 1995. These forward-looking statements are subject to risks and uncertainties. Actual results may differ materially from those discussed today, and the company undertakes no obligation to update these statements unless required by law. For a more detailed discussion of these and other risk factors, investors should review the forward-looking statements section of the earnings press release issued this morning, as well as, other disclosures in the most recent Form 10-K and in other Willis Towers Watson SEC filings.

During the call, certain non-GAAP financial measures may be discussed. For reconciliation of the non-GAAP measures as well as other information regarding these measures, please refer to the most recent earnings release and other materials in the Investor Relations section of the company's website.

I'll now turn the call over to Carl Hess, WTW's Chief Executive Officer. Please go ahead.

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**Carl A. Hess** - *Willis Towers Watson Public Limited Company - CEO & Director*

Good morning, everyone. Thank you for joining us for WTW Second Quarter 2023 Earnings Call. Joining me today is Andrew Krasner, our Chief Financial Officer.

We continue to see our strategic initiatives resonate strongly in the marketplace as reflected in the 7% organic revenue growth we recorded in the second quarter. This solid result reflected continued strong growth across our entire portfolio of businesses despite significant challenges from outsized book of business sales in each of our segments in the prior year. Excluding book of business activity, organic revenue growth at the

enterprise level would have been 9%. We're very encouraged by the sustained top line momentum and the positive response we've seen from clients to our investments in talented technology across all our businesses.

At the same time, we faced margin headwinds from those investments as well as wage inflation in prior year book sales that limited our progress on driving margin expansion and earnings growth this quarter. The continued success of our transformation program, which exceeded our expectations yet again partially offset these headwinds. All in all, adjusted operating margin declined by 90 basis points for the quarter, which resulted in adjusted earnings per share of \$2.05. Though we had a decline in adjusted operating margin this quarter, as we've said before, our progress in margin expansion won't always be linear. However, we don't expect margin declines in any full year period.

Earlier this morning, we reset our 2024 adjusted operating margin and adjusted EPS targets. These updates reflect our margin and earnings performance to date and as we've called out in the previous quarters, the pension income headwinds that based on current market conditions, we do not expect to subside. Importantly, they also include our current assessment of the opportunities we see ahead of us with the benefit of being halfway through our 3-year plan.

We lowered our 2024 target for adjusted operating margin to 22.5% to 23.5% from 23% to 24%. While some of the change stems from the slower pace at which we generate operating leverage, it primarily reflects our opportunistic decision to further invest in talent and other key strategic initiatives, especially in our Risk & Broking segment. This incremental investment will further strengthen our long-term market position and drive continued strong organic growth beyond the 2024 forecast period.

To elaborate a bit on that decision, I want to say a few words about where our R&B segment stands today and the opportunity going forward. Our differentiated service offering, underpinned by our ability to adapt to our clients' changing needs, creates an incredibly compelling value proposition and the success of this strategy in R&B so far is evident through the strong organic growth we've been able to deliver. Our focus on specialization, innovation and top quality client service has generated substantial momentum and opportunities we did not have 18 months ago.

Earlier this month, our Aerospace team won back the Airbus account, one of the largest in the sector on the back of our strengthened value proposition. And that success is not just happening in Aerospace, our global lines of business, such as P&C, Marine and Financial solutions have continued to deliver meaningfully above market growth, including double-digit growth in the second quarter. In North America, the build-out of 12 identified industry divisions continues at pace with colleagues and infrastructure being aligned, and we expect most of this to be completed by year-end. Our traction in the marketplace has shown us there are even more opportunities here to deliver solid organic growth well into the future.

But a fixed strategy is simply not an option in today's ever-changing risk landscape. To capitalize on these opportunities and meet client-specific needs, we're continuing to advance our specialization strategy and develop innovative products and services, which will distinguish us in a way to best attract clients and talent. This requires developing differentiated offerings, increasing strategic partnerships and expanding our reach through platforms like MGAs, MGUs and affinity products. Of course, high-quality talent is essential to drive these initiatives and turn our vision into a reality. And we see our rejuvenated strategy and independent brand become a load start for that talent, which will further fuel our success.

We do appreciate the need to strike a balance between investing for incremental growth in the long term and capturing savings in the near term. While this investment in talent will partially offset the savings from our transformation program and tailwinds from higher investment income and lower pension service costs between now and 2024, we expect these efforts will drive greater operating leverage over the long term as productivity improves and we realize more efficiency from increased scale. Running a successful business is never a straight line. It's a journey filled with triumph and challenges, and we've experienced both over the last 18 months.

On one hand, the operating margin has benefited from our accelerated progress on the transformation program, interest income has been higher and our pension-related service costs have been more favorable than originally expected. At the same time, macroeconomic conditions have dampened demand for interest rate-sensitive businesses, such as M&A, and the inflationary environment has put pressure on our operating costs, driving up wages and travel and entertainment. We are also focused on implementing cost-saving measures primarily focused on eliminating nonessential travel.

While we've seen some progress in generating margin expansion from R&B, we know there is more to do, we remain confident that the right path to delivering margin expansion includes both driving organic revenue growth through our strategic investments and executing on transformation program savings and efficiency measures.

As a core part of our strategic decision to invest further in our specialization strategy and our talent base, we are excited to welcome Lucy Clarke as the global leader of Risk & Broking in the third quarter of 2024. Lucy's committed to specialization, exceptional client service and data and analytics, all directly aligned with WTW's competitive advantages and what we're doing in this space, making her the right person to accelerate the execution of our strategy. She has extraordinary market presence, a proven track record of delivering operational and financial results and an intense focus on talent.

We are delighted she is joining our team, and I look forward to welcoming Lucy to our team in the third quarter of 2024. Until then, Adam Garrard will continue to lead the segment. And after Lucy's arrival, Adam will become the Chairman of Risk and Broking.

Now let me shift gears back to our updated 2024 adjusted EPS target. The revised target of \$15.40 to \$17 reflects the sizable pension income headwinds we've discussed on previous calls, a modestly higher expected tax rate and the lower adjusted operating margin. The revised target also reflects a more narrow and precise range than our original figures given that we're halfway through our target period of 3 years.

I've already talked about the drivers behind our margins. So let me take a minute to cover the other 2 items. The most significant driver influencing our change to our EPS target is a sizable decline in expected pension income since we set our original 2024 target almost 2 years ago. We originally expected pension income to contribute \$2 to \$2.50 to adjusted EPS.

As we've communicated previously, the increase in interest rates and decline in capital market returns have created significant headwinds to pension income dynamics. As a result, we now expect pension income to contribute \$0.35 to \$0.85, less than half of our original estimate to adjusted EPS in 2024. The change in expected pension income accounts for approximately \$1.65 of the overall change in EPS target. We continue to expect pension income of \$112 million in 2023 and we'll update you on our 2024 pension expectations during our fourth quarter call after the remeasurement process.

The second driver impacting the EPS target change stems from the modest increase in tax rate due to our updated estimates of future tax rates based on legislative changes. We expect the U.K. corporate tax rate increase will have a modest impact starting in 2023. While we continue to evaluate the OECD/G20 guidance on the Pillar 2 global minimum tax released earlier this year, we expect the legislative changes may further increase the rate in 2024 and forward.

Now before I hand it over to Andrew, I want to step back for a moment and reflect on the progress of WTW since the tumult of 2021. In 2021, WTW had \$9 billion of revenue and adjusted operating margin of 19.9% and EPS of \$11.60. And the full impact of the termination of the business combination was not reflected in the company's financial results in that time. That occurred in 2022 when organic growth slowed, book of business sale activity spiked, and we need to make substantial investment in both talent and transformation-related activities to position the company for future growth.

Since that time, we've stabilized our business, we build our talent base, significantly strengthened organic revenue growth, optimize capital management return significant capital to shareholders and are transforming and simplifying our company to drive greater profitability. We are in a far better place from where we started.

We remain committed to our strategic priorities of grow, simplify and transform and we are delivering meaningful strategic progress against these initiatives. We can see their contributions to our performance, including organic growth in line with our payers and \$277 million of transformation savings. We remain committed to improving our core operating results to reach our revised 2024 goals and drive long-term earnings growth.

I want to thank our colleagues for their dedication and performance this quarter. We are truly appreciative of their continued dedication to our vision and their relentless focus on our strategic priorities to grow, simplify and transform.

And with that, I'll turn the call over to Andrew.

**Andrew Jay Krasner** - *Willis Towers Watson Public Limited Company - CFO*

Thanks, Carl. Good morning, everyone. Thanks to all of you for joining us today. Before we delve into the financials, I want to provide some additional color on our free cash flow to help paint a clearer picture of our core free cash flow performance and our outlook.

First, I want to explain why we are focused on free cash flow margin or free cash flow as a percentage of revenue rather than some of the other potential metrics. The noncash nature of our pension income can distort various free cash flow conversion calculations, whether you're calculating free cash flow conversion as a percentage of net income, adjusted net income or adjusted EBITDA. We, therefore, think free cash flow as a percentage of revenue or free cash flow margin is a clearer and more meaningful metric to track free cash flow.

Next, I'd like to remind you of the nonrecurring items that impacted our 2022 cash flow performance. In 2022, our free cash flow margin decreased to 8%, reflecting strong revenue growth and margin expansion partially offset by some significant nonrecurring items, including delayed cash tax payments for the 2021 gains recorded in connection with the sale of Willis Re and the deal termination fee, realized losses on foreign currency hedges and onetime retention and executive compensation costs. Adjusted for these onetime headwinds, our 2022 free cash flow margin would have been approximately 14%. We consider this a normalized baseline for 2022. Adding the approximately 200 basis point increase in transformation-related spend for 2023 gets us to approximately 12% free cash flow margin, which we think is a reasonable guidepost for 2023.

Looking beyond 2023, we expect to see free cash flow margin increase driven by improved cash conversion in our TRANZACT business and the abatement of transformation-related spend. Collectively, these items are expected to contribute over 400 basis points to our free cash flow margin over the long term. Starting from the 12% free cash flow margin expected for 2023, this expansion in free cash flow margin on top of our expected organic revenue growth should drive strong long-term growth in free cash flow. Additionally, we expect incremental upside driven by improved profitability and working capital improvement actions. Thus, we think 16% plus is a reasonable long-term guidepost.

I'd like to spend a few minutes expanding on how we expect each of these components to contribute to greater free cash flow and improved working capital over the long term. Let's start with improved cash conversion at TRANZACT. About 8% of our revenue comes from TRANZACT, which has tripled in size since we acquired it in Q3 2019. However, the cash conversion dynamics of this business are different than the rest of our businesses. Q4 is TRANZACT's largest revenue quarter, and that revenue consists of both fees and commissions. The commissions, which reflect both our initial placement plus estimated future renewals can take up to 5 to 6 years in total for us to collect depending on the product. Meanwhile, we incur significant upfront cash costs to place the policies, creating a working capital headwind as the business grows.

In 2022, growth in TRANZACT created an approximately 200 basis point headwind on our free cash flow margin. Over the last few years of rapid growth in that business, we have generated a long-term contract asset, which is essentially a large long-term receivable. We expect to collect this over multiple years as policies are renewed. As our TRANZACT business continues to mature and cash collections from earlier periods outpaced the upfront cash outflows incurred in connection with the continued top line growth, we expect this working capital headwind to subside and over time become a tailwind and begin contributing positively to free cash flow margin.

Our overall individual marketplace strategy combines TRANZACT with its strong revenue growth prospects and current lower cash flow generation with a mature business of Extend Health, which has lower revenue growth, but strong cash flow. Together, the 2 businesses give us an overall Medicare operation with a strong growth profile and positive cash flow as was the case for 2022.

Moving on to the impact of our Transformation Program. We made substantial progress on the program in 2022 and have accelerated that progress in 2023. Funding the Transformation Program required approximately \$200 million in cash outflow in 2022, which translated to a roughly 230 basis point headwind to our free cash flow margin. Investment in the Transformation Program will continue to pressure our free cash flow until it is complete at the end of 2024. But beginning in 2025, the abatement of program-related spending will drive an increase in free cash flow margin.

The last point I'd like to cover is the upside from greater profitability. We continue to expect to drive margin expansion from current levels to our target range over the next 6 quarters. As our adjusted operating margin grows, so too will our free cash flow margin. In addition, we expect some

of our specific transformation program initiatives to have a positive, but more modest impact on free cash flow margin. Our finance and operational transformation initiatives include a number of tactical working capital improvement opportunities, such as centralizing and standardizing our billing and collections processes, expanding automation capabilities, and capturing long-term structural and contractual improvements to the cash aspects of how our businesses operate.

Also, the transformation of our real estate footprint should reduce our long-term CapEx needs. Together, all of these actions, along with the continued adjusted operating margin expansion beyond 2024 should drive incremental improvements in our free cash flow margin above the roughly 400 basis points we've quantified.

Turning to our results for the quarter. Our second quarter revenue was up 7% on an organic basis. Excluding book of business activity, organic revenue growth at the enterprise level would have been 9%. Our Transformation Program delivered \$53 million of incremental annualized savings during the second quarter. This brings the total to \$128 million in cumulative annualized savings this year, far exceeding our original target of \$100 million of incremental savings for 2023.

Accordingly, we're raising our guidance on cumulative run rate transformation savings actioned by the end of 2023 to \$160 million. The additional transformation savings we've identified also support an increase to the total annual cost savings we expect the program to deliver by the end of 2024 from over \$360 million to \$380 million.

I will now discuss our detailed segment results. Note that to provide comparability with prior periods, all commentary regarding the results of our segments will be on an organic basis unless specifically stated otherwise. The Health, Wealth and Career segment generated revenue growth of 5% on both an organic and constant currency basis compared to the second quarter of last year. The segment had solid organic revenue growth despite significant headwinds from book of business activity in the prior year, which negatively impacted organic revenue growth by 2 percentage points. We continue to see growth opportunities across the portfolio of businesses and expect that they will continue their growth trajectory for the rest of the year.

Revenue for health increased 4% for the quarter or 9% when excluding the impact of book of business activity in the prior year, primarily due to natural portfolio growth and new client appointments in international and Europe and higher levels of project work at brokerage income in North America. Wealth grew 5% in the second quarter. The growth was primarily attributable to higher levels of retirement work in North America and Europe. Our investments business also contributed to organic revenue growth with new client acquisitions and higher fees related to value-added services.

Career delivered 4% growth in the quarter, driven by increased demand for reward-based advisory services and higher compensation survey participation. Benefits Delivery & Outsourcing generated 7% growth in the quarter. The increase was driven by strength in individual marketplace with growth from higher volumes and placements of Medicare Advantage and Life policies as well as increased project activity in outsourcing.

HWC's operating margin decreased 40 basis points from the prior year second quarter to 18.3%. This margin decrease was primarily due to the impact of book of business activity, partially offset by transformation savings.

Risk & Broking revenue was up 6% on an organic basis and on a constant currency basis compared to the prior year second quarter. Risk & Broking had strong organic revenue growth despite significant book of business headwinds and excluding the impact from book of business settlements, Risk & Broking grew 10%. Corporate Risk & Broking had another strong quarter and continued the positive growth trajectory we have seen over the last quarters with an organic revenue increase of 7%.

Excluding book of business activity, CRB grew at 11% with double-digit growth in all geographies. This outstanding result is primarily driven by strong new business, continued improvement of our client retention and strong contributions of 13% organic growth from our specialty lines like Marine, Financial Solutions and large and complex P&C.

Our specialty lines of business are a critical area for us, and we are making meaningful investments to position us for long-term success, and we are growing at a much faster pace in these lines of business. Furthermore, while rate increases continue to have a positive impact, they had a more moderate impact compared to prior year. Interest income was up \$9 million for the quarter due to higher rates.

As noted in our earnings release and as a result of the cessation of the co-broking agreement with Gallagher, interest income directly associated with Risk & Broking fiduciary funds will be allocated to the segment beginning in third quarter of 2023. These amounts were previously allocated to the corporate segment. I would just point out that this will be done on a prospective basis only, and there is no impact to the Q2 numbers.

North America had a strong quarter due to new business and increased retention. Europe also had solid new business performance across most product lines, including P&C, Marine, Aerospace and Financial Solutions. International also contributed to organic growth led by Latin America.

In the Insurance Consulting and Technology business, revenue was up 3% over the prior year period, driven by increased sales in Technology Solutions and higher project activity. R&B's operating margin was 16.1% for the second quarter compared to 19.7% in the prior year second quarter. Margin headwinds reflected the impact of the gain on sale from book of business activity in the prior year, along with the adverse timing impact from prior year incentive credits that have no impact on full year margins, but negatively impacted the quarter.

However, we saw an increase in our comp and ben run rate due to strategic investment hires. These key hires have begun to contribute to our performance in a meaningful way as exemplified by the strong organic growth for the first half of the year. We continue to expect a ramp-up in production which we anticipate will cover the increase in expenses. We are also facing expense headwinds due to the increased client activity and inflationary increases on travel, entertainment and marketing that we are actively managing with strict cost management actions, which we expect to yield a greater benefit in the second half of the year. Partially offsetting these margin headwinds were transformation savings that continue to contribute as planned as well as the impact of interest income.

Turning back to enterprise level results. Our adjusted operating margin was 14.6%, a 90 basis point decline over prior year, primarily a result of costs related to employee headcount increases and inflation as well as headwinds from the margin impact book of business sales in the prior year. The decline in margin was partially offset by transformation savings as well as the impact of interest income. The net result was adjusted diluted earnings per share of \$2.05.

Foreign exchange had a de minimis impact on EPS for the second quarter. Assuming today's rates continue for the remainder of the year, we continue to expect a foreign currency headwind on adjusted earnings per share of \$0.05 for the year. Our U.S. GAAP tax rate for the quarter was 19.8% versus 10.5% in the prior year. Our adjusted tax rate for the quarter was 23.7% compared to 20.5% in the prior year reflecting the nonrecurring nature of discrete tax benefits reflected in the prior year rate.

Our strong balance sheet gives us continued confidence in our ability to execute a disciplined capital allocation strategy that balances capital return to shareholders with internal investments and strategic M&A to deploy our capital in the highest return opportunities. During the quarter, we paid \$90 million in dividends and repurchased approximately 1.5 million shares for \$350 million. Given our confidence in achieving the plan we've laid out, we continue to view share repurchases as an attractive use of capital to create long-term shareholder value. We also actively manage our leverage profile by issuing \$750 million of new debt in May, and a portion of those proceeds will be used to pay our debt with an upcoming maturity in the third quarter.

We generated free cash flow of \$350 million for the second quarter of 2023, compared to free cash flow of \$198 million in the prior year. The improvement of \$152 million is primarily due to the non-recurrence of payments made in the prior year for certain discretionary compensation and taxes for onetime gains recorded in connection with the Willis Re sale and the income receipt related to deal termination. These tailwinds were partially offset by increased transformation program-related costs.

Overall, while we recognize we have more to do, we continue to be encouraged by the meaningful traction we are getting with clients through our strategic initiatives. Delivering strong organic revenue growth is a prerequisite for sustainably growing margins, EPS and free cash flow. We are confident in our market position and in our ability to deliver on the improvement opportunities we see today.

With that, let's open it up for Q&A.

## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Our first question comes from Elyse Greenspan of Wells Fargo.

### **Elyse Beth Greenspan** - *Wells Fargo Securities, LLC, Research Division - Director & Senior Analyst*

My first question is on the 2024 guidance. Carl, obviously, last year, you guys pulled lowered guidance for Russia, there were some changes to free cash flow. Just trying to get a sense like why is this the last cut? I mean I imagine maybe you guys went through and kind of stress tested all the components of guidance to put forth something that you won't have to revise again in January with fourth quarter earnings. But any thoughts there?

### **Carl A. Hess** - *Willis Towers Watson Public Limited Company - CEO & Director*

Yes. Good morning Elyse. Obviously, we prefer never to be revising at all. But we do try and take a measured approach. And when we finally think that look, there's, as we said before, no path that we could see towards our guidance, we want to be upfront with that. As we looked into this quarter, we saw on the pension side, we just didn't see a path to pension income to be at the levels that we had thought it might be going to '24. We thought it was the time to take a look and revise the EPS target.

On the margins, right, the new target really reflects our decision to further invest in talent and the key strategic initiatives that Andrew described, especially in R&B, because we think we are in a fabulous position to capitalize on growth opportunities. We're continuing to advance our specialization strategy and develop innovative products and services to further differentiate our offerings and position ourselves to attract the best clients and talent, that is working. We are doubling down on it.

### **Elyse Beth Greenspan** - *Wells Fargo Securities, LLC, Research Division - Director & Senior Analyst*

And then my follow-up, Carl, would be on the margin comment, right? So like you guys have had success with your savings program, but it doesn't seem like that's coming into numbers even though you provided up the target. So is that benefiting margins? Is it more coming later than expected? I just would have thought that, that could have absorbed and helped offset some of the impact of the incremental hiring, right, that you're attributing the lower margin, too.

### **Andrew Jay Krasner** - *Willis Towers Watson Public Limited Company - CFO*

Elyse, it's Andrew. No, it is absolutely helping offset or mitigate some of the continued and then the increased planned investment. And I think what you're seeing is there's some more pressure on the Risk & Broking margins. And while we're incredibly happy with the progress and the organic growth within that business, we recognize there's more to do on margin expansion, both in the short term and the long term. I want to reassure you that we know where the margin drags are and already taking action to address those.

Let me walk you through them and I'll start with the short term. So on a year-over-year basis, the most significant headwind was the book of business sales, right? And that's about 270 of the 360 basis point decline within the quarter. In the second half, we anticipate similar levels of book sales as last year. The quarterly pacing of those may vary, but second half over second half should be pretty similar. The rest is attributable to some short-term headwinds, partially offset by the savings from transformation.

The short-term headwinds are from T&E and our continued investments in talent. In T&E, we're seeing the effects of inflation as well as the increase in travel post COVID. We're working to manage this by implementing mandates around essential travel, fare caps, things of that nature. We've already seen some improvement in the T&E costs from these actions and expect that to accelerate during the second half of the year.

On talent, the short-term margin headwinds are just from the gradual and lumpy ramp in productivity for new hires. We continue to expect a ramp in that production, which we do anticipate is going to cover the investments and yield a greater benefit going forward. So as a result of all that, we see the current margin headwinds as temporary and do continue to expect margin expansion within the Risk & Broking and the enterprise on an annual basis.

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**Carl A. Hess** - *Willis Towers Watson Public Limited Company - CEO & Director*

Yes. Let me just sort of leverage a little bit on that, Andrew. I mean, first of all, our investments in the talent have actually been paying off in excess of what we had projected, to date, not that we're fully there yet, but the pace is actually in excess of kind of our original expectations. So that does encourage us. But as I look sort of a bit further than the rest of this year, right? I mean -- what we're doing is saying we think we actually have a great opportunity to deepen and broaden what we do. We see the talent we're able to attract and that encourages us, actually, as I said before, to double on what we're trying to go here.

Most of the investment is in talent, but there's also investment in things like MGAs and MGUs deepening our affinity platform and building out the next level of technology within our ICT business to support the insurance industry where we see strong demand. With respect to that talent investment, right, it is about high reproductive talent that can best leverage our platform. It is highly aligned to our specialization strategy. We do recognize that comes with the usual margin drag. This is a typical 12- to 18-month time until we get full productivity out of these people.

But I look forward and say, look, a year ago, we were all about filling gaps rebuilding teams after a period where we had been suffering heightened attrition due to business disruption. Looking forward, right, it is far more opportunistic and looking for talent that's going to drive the most profitable and fastest growing parts of our business, especially the global lines that Andrew referred to earlier.

I want to be crystal clear, right? This is about going on the defensive -- going on the offensive, we are not about backfilling gaps in the bench anymore. This is about offense, not defense.

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**Operator**

Our next question comes from Gregory Peters. One moment as we bring him to stage.

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**Charles Gregory Peters** - *Raymond James & Associates, Inc., Research Division - Equity Analyst*

Thank you for the increased disclosure around the free cash flow. And I wanted -- my first question, I wanted to focus on that, I guess, it's Slide 15, where you talk about your longer-term free cash flow target of 16%. It feels like the transformation program spend, that's going to be a layup, because that's going to come to an end. The improved profitability seems realistic, I guess. I guess when I look at the 3 buckets, the one I'm concerned about would be the TRANZACT cash conversion. That business for others has been problematic in terms of translating into free cash flow. And also in this free cash flow slide, you didn't mention DSOs and that used to be a lever for the company for improving free cash flow. So maybe you could give us some additional comments around this slide?

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**Andrew Jay Krasner** - *Willis Towers Watson Public Limited Company - CFO*

Yes, sure. Greg, it's Andrew. I'll start with the DSO component there. So we do expect incremental benefit from tactical working capital actions focused on opportunities that we see. And that sort of gets reflected in the long-term view on Page 15 in the plus symbol there, if you will. Some

of the other actions, of course, do lead to improved working capital management as well. So that is absolutely factored into our plans over the longer term for improved free cash flow margin.

Specifically, with regard to TRANZACT, when we bought that business, we did expect it to be a high-growth business, and we have far exceeded our initial expectations in that regard. And I think that's a testament to the compelling offering that the company provides to its customers and the dedication of its team members in that business. As mentioned in the prepared remarks, the business creates a working capital headwind as it grows. And since we're required to incur significant upfront cash costs, it takes about 5 to 6 years depending on the product to eventually collect all the cash for a sale or a substantial portion of the cash for a sale.

But we were fully aware of the cash flow dynamics, right, at the time we acquired it, and it has evolved as expected. We continue to see improvement in that area as the business grows and matures. We do have that long-term receivable, which we can continue to focus on and will collect over time. We expect the business to become cash positive sometime in the next few years. And in the meantime, we do expect that drag to decline.

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**Charles Gregory Peters** - *Raymond James & Associates, Inc., Research Division - Equity Analyst*

Okay. Fair enough. I guess my follow-up question will pivot back to the margin piece and I know you've talked about it in your prepared remarks, you just answered Elyse's questions regarding it. You spoke about book sales and recruiting. I guess -- from a margin improvement standpoint, I guess I was a little disappointed with the second quarter results. I would have expected some for you guys to report some benefits. So when you said in your answer, book sales, is there going to be more drag from book sales in the second half of this year? And on recruiting, is there more margin drag on recruiting in the second half of this year versus where we were in the first half?

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**Andrew Jay Krasner** - *Willis Towers Watson Public Limited Company - CFO*

Yes, sure. Let me start with the book sale question. So we do expect some level of book sale activity in the second half of the year. However, we do expect it to be roughly on par with the book sale activity in the second half of last year. The quarterly pacing of that may vary, but in aggregate over the second half should be pretty comparable.

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**Carl A. Hess** - *Willis Towers Watson Public Limited Company - CEO & Director*

Okay. With regard to recruiting, Greg, I guess one thing I'd note is sort of open positions of the company are at half the level they were a year ago. And so that should give you an idea of sort of overall where we're trying to do with recruitment. However, I want to point out that I think we're at a point in time, and yes, Lucy Clarke's arrival, I think, is a testament to this where the choice we've made very deliberately to specialize within R&B is it's the foundation of our growth, and it is significantly attractive to people who can actually help us generate revenue. We think that this is the time to capitalize on that.

And so we do think that targeted investments in our global lines and our industry strategy, this is exactly the right time for those to be paying off. So we're going to be looking to actively find that talent.

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**Operator**

Our next question comes from Paul Newsome of Piper Sandler.

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**Jon Paul Newsome** - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

I had another sort of book of sale question. If we're looking at the profit margin of the businesses, you're looking -- you're using through book sales versus the rest of the business, are those book sales businesses have similar margins? Or is that another sort of source of margin compression for the company as these businesses are sold away?

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**Andrew Jay Krasner** - *Willis Towers Watson Public Limited Company - CFO*

Yes. The books that we're selling generally have the same economic profile and margin profile as the broader business. So there's nothing specific about the margins of the businesses or books that we're selling.

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**Jon Paul Newsome** - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

That makes more modeling easier. Second question, a lot of what your peers have done with respect to margin improvement over time came to some very careful divestitures of businesses that you'll see every quarter from them. How does that fit into your strategy as well, if at all? Looking at sort of divesting? Are you looking at divesting some of these businesses that might have lower margins as well?

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**Andrew Jay Krasner** - *Willis Towers Watson Public Limited Company - CFO*

Yes. We won't comment on any specific M&A actions. But as you can imagine, portfolio management is always front and center for us. And of course, we do look across the broad base of our businesses to make strategic decisions about that portfolio.

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**Carl A. Hess** - *Willis Towers Watson Public Limited Company - CEO & Director*

And I'd add, we use that for our acquisition strategy as well. We're looking for businesses where we can be a better owner than the current owner.

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**Operator**

Our next question comes from David Motemaden from Evercore.

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**David Kenneth Motemaden** - *Evercore ISI Institutional Equities, Research Division - MD & Fundamental Research Analyst*

I just had a question just on the new margin range for next year, the 22.5% to 23.5%. Could you just help me understand and think through some of the pluses and minuses that would help you be at the high end versus the low end of that outlook?

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**Andrew Jay Krasner** - *Willis Towers Watson Public Limited Company - CFO*

Yes, sure. I think part of it will be -- Carl mentioned some continued investment in talent as well as some platforms. So I think it will be the payback period from those investments. Another determining factor would be the pace at which some of the operating leverage becomes visible through the Transformation Program and some incremental savings from the Transformation Program as well. So the timing of that sort of is what feeds into the bounds of that range.

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**Carl A. Hess** - *Willis Towers Watson Public Limited Company - CEO & Director*

And then I'll just add demand across various parts of our business, right? So while I think we've got a very diversified portfolio and that has enabled us to what storms, we do try to take advantage of conditions as we find them, like sort of demand across the portfolio, as you can see from the segment numbers, the growth remains strong there, and we're looking to make sure we stay focused on the areas where we see the strongest demand in the marketplace, whether that's in the specialty lines within R&B, our Health and Benefits Business, and focus within our Career business in a place where we see demand, which is sort of coping with new ways of working in the new normal.

I'd also add, there's upside in our wealth business, especially in the -- if capital markets stay up and in fact that we're collecting percent of asset fees across a large chunk of our investments business.

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**David Kenneth Motemaden** - *Evercore ISI Institutional Equities, Research Division - MD & Fundamental Research Analyst*

Yes. Got it. That makes sense. And then I guess I was just on some of the hiring that you've made up to this point. Maybe you can help me understand just how far along you are in the ramp of production of those hires? And are we sort of hitting like a peak in terms of how those hires you've made in the past can contribute? And is that partially why you're sort of making additional strategic investments or maybe you could just help me understand where we are in terms of the ramp-up of the hires you've made up to this point?

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**Carl A. Hess** - *Willis Towers Watson Public Limited Company - CEO & Director*

Sure, sure, sure. So as I alluded to a little while ago, we're actually very happy with the progress for our '22 (inaudible) cohort of hires, right? They've actually performed in excess of where we think they thought we would be at this point in time. But no, they're not up to full productivity yet. As we've said, that's 12 to 18 months and sort of on average, we're about 12 months on that. The 2023 hires, which is a smaller number. It's only been half a year, right, are performing in line with expectations, but that's, of course, early days.

I think what I'm saying with respect to sort of looking forward, right, is we actually see significant strong demand for our specialty approach, and we think that there is talent we can attract under the way we have focused this company, which is different than the way others approach it to able to actually double down on that strategy and push that ahead. So it's -- yes, I think what we've seen from the '22 and '23 hires is encouraging, but that's not necessarily just saying, okay, more of the same. We think that it's actually a confirmation of our strategy and how it's resonating with clients that want us to move ahead.

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**Operator**

Our question comes from the line of Meyer Shields from Keefe, Bruyette, & Woods.

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**Unidentified Analyst**

This is [Jane] on for Meyer. I just have a question on (inaudible) length. So given how well the organic growth has been playing out, do you guys see any changes in your investment?

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**Andrew Jay Krasner** - *Willis Towers Watson Public Limited Company - CFO*

Any changes -- I'm sorry, any changes in the investment given the organic growth?

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**Unidentified Analyst**

Yes, yes, yes.

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**Andrew Jay Krasner** - *Willis Towers Watson Public Limited Company - CFO*

No. I think as Carl just alluded to, we do see continued opportunity for talent in the market. So we're not sort of filling gaps at this point as we had been historically. This is more about leaning forward and being on the offensive with regard to our talent investment strategy where we continue to see really strong opportunity for talent that aligns with our specialization strategy.

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**Unidentified Analyst**

Got it. My second question is on the free cash flow guidance. I know you guys gave the long-term guidance of 16%, just wonder improved 12% guidance of this year through to 2024 linearly? Or how does -- can you add some details on that?

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**Andrew Jay Krasner** - *Willis Towers Watson Public Limited Company - CFO*

I'm sorry, can you repeat the question, please?

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**Unidentified Analyst**

So for the free cash flow guidance, just wondering can you add some details on 2024? Or do you see it just improve linearly to the 15%?

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**Andrew Jay Krasner** - *Willis Towers Watson Public Limited Company - CFO*

Yes. I mean, yes, we do expect continuous improvement, but we haven't given any specific free cash flow margin guidance for 2024.

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**Operator**

Our next question comes from the line of Mark Marcon from Baird.

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**Mark Steven Marcon** - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

With regards to the margin change, basically, at the midpoint, you've reduced the margin guide by about 50 bps, is that sufficient in terms of -- is that enough of a cushion to really improve the talent pipeline? And then thinking about the morale and retention with regards to your long-term associates, do you think that's going to be fairly meaningful in terms of driving further engagement and driving further productivity?

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**Carl A. Hess** - *Willis Towers Watson Public Limited Company - CEO & Director*

So I think with regard to the 50 basis points that we do think that, that gives us the flexibility we're looking for. We can structure compensation, which, for us, of course, is highly variable, especially in client engaging to be able to manage the impact of recruitment.

With respect to morale, one of the biggest screens we use is -- are they going to fit well with the team, right? And that's been our approach historically. We anticipate that will very much be part of our approach going forward. It fits beautifully with a specialization strategy, because you're not looking for a lone wolf selling, right? It's about insights-based approach to helping clients manage risk fueled by data and analytics. And that ends up with someone who's quite committed to that and that by its very nature, makes it more of a team-based approach. So I think there's a sort of a virtuous cycle, we guess, with respect to our approach that actually makes team building easier and minimizes morale disruption that might take.

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**Mark Steven Marcon** - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

That's great. And then what's the tax rate that you're assuming for the '24 EPS targets?

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**Andrew Jay Krasner** - *Willis Towers Watson Public Limited Company - CFO*

Yes. We haven't specifically given that information but if you think about the current year adjusted tax rate it is modestly higher, as of now, year-to-date, and we expect something modestly higher on a full year basis year-over-year.

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**Operator**

Our next question comes from the line of Michael Zaremski from BMO.

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**Michael David Zaremski** - *BMO Capital Markets Equity Research - MD & Senior Equity Research Analyst*

Okay. Great. And on the free cash flow, thanks for the added color. I just want to confirm that the pension income levels or the pension changes in terms of the impacting your EPS that doesn't flow through to cash flow, right?

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**Andrew Jay Krasner** - *Willis Towers Watson Public Limited Company - CFO*

Correct. The pension income is noncash.

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**Michael David Zaremski** - *BMO Capital Markets Equity Research - MD & Senior Equity Research Analyst*

Okay. Got it. Okay. Switching gears to the segments. You've talked a lot about and you have been for a number of quarters by investing in talent opportunistically, is this also happening in the Health, Wealth and Career segment a bit? I just asked because margins were a little light there as well versus expectations.

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**Carl A. Hess** - *Willis Towers Watson Public Limited Company - CEO & Director*

So we do see talent as flocking to the flag, right, in HWC as well. Although I think it's a bit different positionally than it is with -- as opposed to R&B. In that we've got a very, very successful leading wealth business. And with already, I think, a very good market position. So we don't -- you wouldn't typically see large-scale recruiting going on in that business. The recruiting is more focused on health and benefits where we do see the opportunity to gain market share. And we're just -- we think our position in broking globally is one where we can continue to capitalize.

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**Operator**

Our next question comes from Yaron Kinar from Jefferies.

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**Yaron Joseph Kinar** - *Jefferies LLC, Research Division - Equity Analyst*

I guess my first question, Carl, just listening to the explanations behind the lowering of guidance for '24. It almost sounded to me like excluding the pension element that interest and inflationary trends were a net negative. I guess that's -- if I heard that correctly, it's a little counterintuitive to what I would have thought the net impact that broker would be? So I would love to hear a little more on that.

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**Carl A. Hess** - *Willis Towers Watson Public Limited Company - CEO & Director*

So when I was talking about interest rates being negative, it with respect to the pension, right? It wasn't in respect of the fact that we do receive more interest income.

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**Yaron Joseph Kinar** - Jefferies LLC, Research Division - Equity Analyst

I thought you'd also talked about the pressure from higher interest rate environments on M&A activity and on operating costs, right?

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**Carl A. Hess** - Willis Towers Watson Public Limited Company - CEO & Director

No. I mean, we -- I think the puts and takes are a little hard to work out, right? But we do have a large scale as do others, right, M&A-focused brokering business and the freeze in that marketplace is obviously quite unhelpful on that side. So it's as I said, it's a bit more complex.

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**Yaron Joseph Kinar** - Jefferies LLC, Research Division - Equity Analyst

Yes. But I guess if we take a step back, and again, excluding the pension element, wouldn't the higher interest rate and higher inflation environment be a net positive holistically?

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**Andrew Jay Krasner** - Willis Towers Watson Public Limited Company - CFO

Not necessarily. I think it depends on the impact of inflation on different components of the income statement. So obviously, there's been a lot of wage inflation over the last 2 years, and that's not just related to new hirers, right, that does impact our existing wage base. There is inflation. We talked about the cost of travel has gone up meaningfully, things of that nature, that is mitigated, right, by the impact of fiduciary income. But as Carl mentioned, we do have some interest rate sensitive businesses, right, that get impacted by that as well like M&A-related products.

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**Carl A. Hess** - Willis Towers Watson Public Limited Company - CEO & Director

Yes. So I guess I would not call it a huge negative, but it's not nearly the positive you might take it on looking at some components alone.

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**Yaron Joseph Kinar** - Jefferies LLC, Research Division - Equity Analyst

Okay. I appreciate that. And then if we flip to the pension component specifically, if I'm doing the math correctly. The midpoint of the new guidance, you're talking about roughly \$80 million worth of pension income in '24. And I understand we'll get another update at year-end. But if that math is roughly correct, can you maybe explain why we'd see another, call it, 30% reduction in pension income year-over-year when capital markets are actually up year-to-date and I think the level of interest rate increases has moderated a bit?

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**Carl A. Hess** - Willis Towers Watson Public Limited Company - CEO & Director

Yes. So if you look at our pension plans, right, the asset mixes will have a heavy effect here. Our biggest plan is the U.K. plan, which actually doesn't have a lot of equity exposure at all in it as it has a fairly tight asset liability match. It's quite sensitive to both interest rates and inflation levels, because of the indexation of U.K. pension liabilities.

The U.S. plan is more -- is invested to work into a U.S. plan would be invested with a mix of both bonds and other assets. But even within the return-seeking assets pool, there's a large part of alternative assets and other diversifying strategies, which won't necessarily move in line with the public equity markets. That protects us on the downside, but it does give up some upside in strong equity markets.

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**Operator**

Our next question comes from Mike Ward from Citi.

**Michael Augustus Ward** - Citigroup Inc. Exchange Research - Research Analyst

Andrew mentioned, I think, strong commercial pricing was less of a tailwind this quarter. We've kind of been hearing strength out there from peers and primaries. Just wondering, is it -- are you altering commissions? Is it just the comps? Any commentary would be helpful.

**Carl A. Hess** - Willis Towers Watson Public Limited Company - CEO & Director

So I mean if you look at the rate on the commercial risk side, I mean, overall, we're seeing flatter single-digit increases or even small decreases depending on local market conditions. Rate increases across many lines are moderating, but there are definitely some lines that aren't seeing any abatement at present U.S. property, probably being the most predominant one. Remember, we are a very global firm with respect to our mix. And that -- so you can't necessarily take our book as typical for others. But it's certainly in cat-exposed property rate increases are still coming through.

Casualty is a bit of a different story. There's more stability in the global portfolio with relatively small rating increases being written.

**Michael Augustus Ward** - Citigroup Inc. Exchange Research - Research Analyst

Got it. And then I think Carl mentioned potential upside in the wealth business. Any update on the outlook for that one in the second half with markets being where they are?

**Carl A. Hess** - Willis Towers Watson Public Limited Company - CEO & Director

Yes. Well, I mean, with sort of pension funding levels being at a pretty hefty rate -- sorry, compared historically, right, the pension funds are pretty well funded. So the opportunity for pension risk transfer activity remains elevated, and we have a market-leading position that in the major markets. And then the other phenomenon just referring to is we've got an investment business that is a substantial part of that is compensated basis points. And with asset levels up, that's helpful for that business.

**Operator**

Our next question comes from the line of Brian Meredith of UBS.

**Brian Robert Meredith** - UBS Investment Bank, Research Division - MD, Financials Research Sector Head & Global Insurance Strategist

Two questions here. Carl, I'm just curious, in the 2024 guidance, what is embedded with respect to the economic outlook? What would happen if nominal GDP goes, let's call it, 2%, 3%, would it be challenging to make your kind of guidance targets? And then what else are you embedded in that with respect to the commercial lines pricing environment?

**Carl A. Hess** - Willis Towers Watson Public Limited Company - CEO & Director

So with respect to rate, I mean, we and brokerage aren't necessarily as sensitive to rate. It is the carriers in that, and I think I've made this point in prior calls, right, when rates skyrocket, our clients will just simply retain more risk to try and manage their budgets. So we don't see rate is having a major effect on our prospects for '24.

I think with respect to sort of general economic conditions, as long as they're generally manageable, we've got a portfolio of businesses that has shown resilience and sort of good times and bad. And so providing clients are so paralyzed by volatility that they aren't willing to make decisions. We tend to do okay.

**Brian Robert Meredith** - *UBS Investment Bank, Research Division - MD, Financials Research Sector Head & Global Insurance Strategist*

Got you. So a recession or something should matter?

**Carl A. Hess** - *Willis Towers Watson Public Limited Company - CEO & Director*

Maybe sharp and sudden recession where clients sort of have to swerve in their plans, right, is -- unexpectedly, right, is not necessarily helpful. Although even then, right, that may drive demand for consulting projects that help to manage the changing conditions.

**Brian Robert Meredith** - *UBS Investment Bank, Research Division - MD, Financials Research Sector Head & Global Insurance Strategist*

Makes sense. And then my second question, I'm just curious, Carl, can you talk a little bit about just employee retention and efforts and what you're doing to keep people. I mean I look at your stock down 12% and all the other brokers are up mid-teens. And I can tell you just from any company work out, you're always looking at that stock price. What are you doing to kind of help keep people? And what does retention look like right now?

**Carl A. Hess** - *Willis Towers Watson Public Limited Company - CEO & Director*

So I mean, the most retention has been actually quite good, and attrition this year has been lower than our expectations and in line with industry -- our industry in general. So we're quite happy with how that's been playing out. Engagement is a huge part of employee retention, right? And that's often we do research on this, right, within our career business, right? And engagement goes far beyond compensation, right?

It's actually -- there's a number of factors that drive it. And we do eat our own cooking and try and take the advice of our career consultants to create a workplace that people actually want to be participate in, because they think they're making a difference for their own career, for their colleagues, for their clients and for society at large. That's not to say, compensation doesn't play in it, but it's by no means the determinative matter. And I think we're doing well enough that the attrition numbers are reflecting our efforts in that regard.

**Operator**

Our next question comes from the line of Mark Hughes from Truist Securities.

**Mark Douglas Hughes** - *Truist Securities, Inc., Research Division - MD*

How are you approaching TRANZACT this year? It seems like the environment was a little more productive last year. Do you think this will be another strong growth year for TRANZACT?

**Andrew Jay Krasner** - *Willis Towers Watson Public Limited Company - CFO*

Yes. We continue to expect healthy growth from that business. There's more to that business than just the Medicare Advantage market where we do sell other products and those products have different financial profiles and cash collection profiles with them as well. So we do make sure that we look to create a balanced portfolio across that business.

**Carl A. Hess** - *Willis Towers Watson Public Limited Company - CEO & Director*

And as we've said in prior calls, right, we do think the CMS regs that came out are manageable for us, and we've taken steps to adapt the business to them. So we don't view them as impacting TRANZACT's potential to thrive.

**Operator**

Our last question comes from the line of Rob Cox from Goldman Sachs.

It appears that we do not have Mr. Cox, so we will go on that as our last question. I'll give one moment to see if anyone else would like to ask questions.

As I am showing no further questions at this time, and we have no closing remarks, that concludes our session. Thank you for participating in today's meeting.

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