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WTW.OQ - Q1 2023 Willis Towers Watson PLC Earnings Call

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## OVERVIEW:

WTW reported 1Q23 organic revenue growth of 8% and adjusted diluted EPS of \$2.84.

## CORPORATE PARTICIPANTS

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

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

## CONFERENCE CALL PARTICIPANTS

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

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

## PRESENTATION

### Operator

Good morning. Welcome to the WTW First Quarter 2023 Earnings Conference Call. Please refer to wtco.com from the press release and supplemental information that was 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 reconciliations 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's First Quarter 2023 Earnings Call. Joining me today is Andrew Krasner, our Chief Financial Officer. Our first quarter results were a great start for the year. The strong 8% organic revenue growth we delivered in the first quarter demonstrated our sustained momentum and intense focus as we continue to execute on our strategic priorities. We're particularly encouraged by the growing impact we're seeing from our recent investments in talented technology, which have strengthened the value we're able to provide our clients and yielded improved retention and new business growth.

Operating leverage on this robust growth and the continued succession of our transformation program, drove 140 basis points of adjusted operating margin expansion over the prior year, which translated into adjusted diluted earnings per share of \$2.84 for the quarter, an increase of 7% year-over-year.

Overall, I'm very pleased with our Q1 results and with the excellent progress we've made since this time last year. We saw top line growth across all our businesses, reflecting the increased value of WTW solutions in complex economic environments. Amid financial sector turmoil, high inflation and ongoing geopolitical strife, we continue to see market dynamics that provide opportunities for WTW to respond to our clients' needs to improve outcomes and reduce risk.

Now I'd like to share some additional perspective on the reset of our near and long-term expectations for free cash flow announced this morning. Our previous target for 3-year cumulative free cash flow through 2024 reflected our goal of substantially improving our free cash flow margin. This being in addition to achieving our revenue and margin targets.

We have made timely and meaningful progress toward our goals for revenue and adjusted operating margins, and we continue to believe that our long-term free cash flow improvement opportunities remain substantial and achievable. These opportunities include optimizing structural and contractual aspects of our business, enhancing our system and processes and streamlining our working capital.

However, we now believe that the best and most sustainable path to realizing those opportunities will take us beyond the end of 2024. As a result, over the near term, we expect free cash flow as a percentage of revenue to improve significantly from 2022's base of 8% free cash flow margin. Over the longer term, we still anticipate growth towards peers' free cash flow margins as the benefits from our improvement actions gain more traction and begin to drive a shorter conversion cycle.

I want to make it very, very clear that we remain committed to delivering on our core operating results. Our achievements on those fronts so far, including our very solid start to 2023, give us confidence that we will be successful in delivering on those goals.

Before turning it over to Andrew, I also want to update you on our growth, simplify and transform initiatives. Our growth initiatives take advantage of the opportunities in both core and fast-growing markets using our analytics capabilities and specialist knowledge to help create a more valuable and differentiated client experience. In Risk & Broking, our specialized approach, coupled with the strategic hires we've made over the past year have driven accelerated growth. In Health, Wealth and Career, we've had success cross-selling new solutions and products alongside our core advisory work.

Our focus on specialization has driven us to find improvements to existing solutions, new product innovation and most recently, identification and successful execution on opportunities for strategic collaboration. For example, we just announced a partnership with Zurich involving digital trading within our Broking Platform, which leverages data to structure risk to allow for a more competitive placement experience.

Another example of our strategic partnerships is our new relationship with Sapiens, a leading global provider of software for the insurance industry. We have partnered with Sapiens to create integrated solutions to help insurers underwrite policies more efficiently. These are both great examples of how our innovations are driving growth by streamlining the very complex business of risk management and modernizing traditional broking while giving our customers a quicker and more efficient experience.

A third example is our partnership with Transamerica to oversee administration and recordkeeping for our recently launched LifeSight Pooled Employer Plan in the U.S. This new product will allow employers to offer a market-leading defined contribution plan and employee experience with limited demand on their internal resources.

Shifting to our Simplify initiatives, we believe our improved sales and retention outcomes have resulted in part from our efforts to streamline the back-end shared operations of our businesses. This has enabled us to deploy a more cohesive and consistent global model that leverages our scale and provides a smoother client experience from prospect to renewal.

Finally, our Transformation Program delivered \$75 million of incremental annualized savings during the first quarter, consistent with the expected pacing of the \$100 million in incremental run rate savings we expect to generate from the program this year. This brings the total to \$224 million in cumulative annualized savings since the program's inception. We continue to search for additional opportunities for savings.

Overall, we believe we're making progress toward our long-term organic growth, margin expansion and EPS targets. Continued execution of our strategic initiatives this quarter delivered healthy organic revenue growth, strong adjusted operating margin expansion and further savings from our Transformation Program.

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

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

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

Thanks, Carl. Good morning, everyone. Thanks to all of you for joining us today. Our clients continue to face a host of economic challenges, including rising commercial insurance rates. However, pricing increases appear to be moderating as our fourth quarter 2022 commercial lines insurance pricing survey showed an aggregate increase of just below 5%.

Data for nearly all lines continue to indicate price increases with the exception of workers' compensation and directors and officers liability. The largest price increases came in commercial auto, followed by commercial property. We continue to focus on helping our clients with our specialized knowledge in Risk & Broking capabilities so they can make more informed decisions about how to best manage their risk in the current environment.

As Carl mentioned, we had a strong start to the year with first quarter revenue up 8% on an organic basis and solid growth across our portfolio of businesses. Our adjusted operating margin was 18.6%, a 140 basis point improvement over prior year, reflecting our growth and expense discipline, along with the benefits of our Transformation Program. The net result was adjusted diluted earnings per share of \$2.84, a 7% increase over the prior year.

Let's turn to 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 6% on both an organic and constant currency basis compared to the first quarter of last year.

Revenue for health increased 8% for the quarter primarily due to increased project work in North America related to helping clients implement legislative changes and managed plan costs as well as from strong growth in international with new client appointments supplemented by healthcare inflation and increases in client covered populations.

Wealth, grew 4% in the first quarter. The growth was primarily attributable to higher levels of retirement work in Europe and North America, including compliance and derisking projects along with new client acquisitions. This growth was partially offset by a nominal decrease in our Investments business, which continued to be pressured by the decline in capital markets that occurred in the second half of 2022.

Career experienced 4% growth in the quarter, driven by increased demand for advisory services and increases in data and software license sales. Benefits Delivery & Outsourcing generated 7% growth in the quarter. The increase was driven by new outsourcing clients and compliance projects plus strength in our individual marketplace with growth from higher volumes and placements of Medicare Advantage and Life policies.

HWC's operating margin was 24% this quarter compared to 20.7% in the same prior year period. This strong margin growth was primarily due to higher operating leverage. Risk & Broking revenue was up 10% on an organic basis and 5% on a constant currency basis compared to the prior year first quarter.

Corporate Risk & Broking had an outstanding quarter with an organic revenue increase of 10%, driven by growth across all regions and most lines of business, primarily from new business and improved retention. As we've indicated, book-of-business settlement activity has slowed after the uptick over the last 2 years with only a 1 percentage point impact on organic growth for the quarter.

Investment income was \$12 million for the quarter due to higher rates and impacted organic growth for the quarter by 1 percentage point.

North America had a strong quarter due to new and renewal business and increased retention, a result of the strategic investments and initiatives that Carl highlighted earlier.

Europe also had solid new business performance across a number of product lines including Aerospace, Financial Solutions and Natural Resources as our focus on building and strengthening our industry and product specializations continues to deliver robust growth. International also contributed to organic growth with double-digit growth in all regions.

In the Insurance Consulting and Technology business, revenue was up 7% over the prior year period, primarily driven by increased sales and retention in Technology Solutions. R&B's operating margin was 19.9% for the first quarter compared to 21.6% in the prior year first quarter. Margin headwinds reflect the inclusion of profits up until the date of deconsolidation from our now divested Russia business in the comparable period.

Absent this headwind, margins improved as a result of organic revenue growth in CRB and transformation savings, gain on sale and interest income, partially offset by the run rate impact of 2022 strategic investment hires. As we expected, last year's key hires have begun to contribute to our performance in a meaningful way as exemplified by the solid organic growth this quarter, and we continue to expect a ramp-up in production this year.

Now let's turn to the enterprise level results. We generated profitable growth this quarter with our adjusted operating margin increasing 140 basis points to 18.6% from 17.2% in the prior year. This improvement reflects the benefits of higher operating leverage from the increased top line growth and transformation-related savings, which we expect to continue to be a key contributor to our ongoing margin expansion and the attainment of our 2024 margin goals.

Please note that the margin tailwind created by interest income and book-of-business settlement activity was offset by the margin headwind from the divestiture of our highly-profitable Russia business, whose results were included in the prior year up until the date of deconsolidation.

Foreign currency was a headwind on adjusted EPS of \$0.06 for the first quarter, largely due to the strength of the U.S. dollar. Assuming today's rates continue for the remainder of the year, we expect a foreign currency headwind on adjusted earnings per share of \$0.05. Our U.S. GAAP tax rate for the quarter was 19.5% versus 27.5% in the prior year.

Our adjusted tax rate for the quarter was 20.5% compared to 21.1% in the prior year. The current quarter adjusted tax rate is lower primarily due to the favorable impact of discrete items in the current year. The adjusted tax rate for the full year may increase moderately as a result of the U.K. corporate tax rate increase which became effective on April 1.

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 in strategic M&A to deploy our capital in the highest return opportunities.

During the quarter, we paid \$87 million in dividends and repurchased approximately 432,000 shares for \$104 million. We continue to view share repurchases as an attractive use of capital. We generated free cash flow of \$92 million for the first quarter of 2023 compared to free cash flow of negative \$10 million in the prior year.

The \$102 million year-over-year improvement in free cash flow was primarily driven by more favorable working capital improvements resulting mostly from higher cash collections and lower discretionary compensation payments made in the current year quarter as compared to the prior year quarter.

Our Q1 results are reflective of the progress we've made since the beginning of 2022. We've come a long way stabilizing the business, rebuilding our talent base, strengthening our organic revenue growth and accelerating the Transformation Program to drive greater profitability in the future. We're committed to delivering the same success with free cash flow generation.

Though our actions on free cash flow have not yet yielded results within the time frame we expected, we remain focused in the near term on driving meaningful improvement in our free cash flow margin for 2022's base of 8% free cash flow margin, and in the longer term, making continual progress and moving more towards peer levels.

As free cash flow generation remains a high priority, we've made enhancements to our original improvement plans to strengthen our organizational focus on cash flow. As you may have seen in our proxy statement, we have added free cash flow as a KPI for annual incentives in the executive compensation program and are working on implementing cash flow-linked KPIs for others in the organization to drive broader accountability across the company.

In addition, we are focused on pursuing long-term structural and contractual improvements to the cash aspects of how our businesses operate. As you might expect, this is the area where we have the largest class of opportunity to improve, but those opportunities are the most time consuming to realize.

As a reminder, full year 2023 pension income is expected to be about \$112 million. If this level of pension income remains consistent in 2024, it would pose a significant headwind to our 2024 adjusted EPS target. Pension income, which is sensitive to macroeconomic conditions, is remeasured at year-end. Accordingly, we will provide additional guidance on our 2024 pension income expectations and the resulting impact to the adjusted EPS target when we release Q4 2023 earnings results.

Overall, we are excited by the strong start to 2023 with business performance ramping up as expected, and the benefits of our investments in talent and technology starting to meaningfully contribute to results. In addition, our successful transformation efforts and operating leverage have allowed us to continue to drive margin expansion. We have made consistent progress in our commitments for organic revenue growth and increased operating margins and EPS.

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

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions)

Our first question today comes from C. Gregory Peters of Raymond James.

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

Carl and Andrew, I guess let's kick off the Q&A with the organic in Risk & Broking seems to be accelerating. And looking over your comments in the slide deck, at the same time, we're seeing some compression on operating margin. So I guess as I think about that, maybe comment on where we are in the hiring cycle or reinvestment cycle of talent and how you think about organic. I know you don't really like to guide quarterly, but it seems like there's quarterly sequential improvement. How are you thinking about it for the balance of the year?

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

Sure, Greg. So I mean, we're actually very pleased, right, with the progress we've made in terms of the revenue acceleration in Risk & Broking, and that's -- while there is some rate pressure, specifically in financial lines and in our M&A business, where just simply economic activity in terms of merchant acquisition has declined and that has an effect.

We're actually really pleased with the momentum across the portfolio. We're growing particularly in our global lines, and we continue to grow across all geographies. We do see the momentum building up the hires we've made since the last part of '21 going into '22.

These people continue to contribute, and we're seeing momentum build up in what they're bringing to revenue and the bottom line, and we anticipate that to be a helpful accelerate during the rest of the year. In addition, the results in Insurance Consulting and Technology, driven by software sales are encouraging. This is sort of recurring revenue helps build a base that continues to be a strong performer for us.

The environment for our services remains one where we have a lot of optimism regarding that. These are -- we are able to help clients with their risk management and risk mitigation strategies across a variety of macroeconomic conditions. So I think we're pretty well poised for the year ahead. We continue to look for good talent in the business.

As I've said before, right, we'll never stop that. But I think we've actually largely reloaded across the portfolio in terms of not having significant major gaps in what we're able to deliver to the marketplace. And that's been one of the reasons that the results are what they are.

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

Greg, it's Andrew. I think just one other thing to think about as it relates to organic growth in Risk & Broking and across the enterprise as well as that in Q2 of last year, there were \$45 million of book sales. So we just want to be thoughtful about that going forward as it relates to organic growth. And I think, you also had a question around margin as well within the segment for the quarter.

So Risk & Broking had a margin decrease of 170 basis points. And excluding interest income of \$12 million and bookings of \$7 million, the margin decrease was about 310 basis points. However, interest income and book gains were more than offset by a \$37 million operating income headwind from the deconsolidation of the Russia business, which happened in the first quarter of last year, and that component equated to a 340 basis point margin headwind. So absent that, some growth there in margin.

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

I just want to follow up on the margin headwinds. It feels like that we shouldn't be seeing these type of headwinds as we move through the year. Is there any point in time where you think you'll hit that inflection where the hiring will -- the normalized hiring will reflect in the margin results. Clearly, Russia is now over with after first quarter. But just trying to see how you guys are thinking about the cadence of margins this year.

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

Yes. As you know, we don't give margin guidance by segment. But with regard to the full year, we're excited about the trajectory for margin growth within Risk & Broking. As you know, we ensure -- to ensure we maximize our future growth potential, and as Carl mentioned, right, started making some meaningful investments in the revenue-producing talent and we're now beginning to see those results from those investments to come through, and we expect that momentum to continue.

So that combined with the efficiencies created for transformation, we have confidence in the continued acceleration of margin improvement in that business over time.

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

It makes sense. I guess the other question, I'll pivot to the free cash flow revision. And as part of your 2024 guidance, and I know you slipped in a comment about EPS in Russia and the other headwinds there, but -- or pension excuse me. But on free cash flow, can you talk about how the free cash flow update might affect your ability to buy stock back in the future? And maybe just give us an updated view on that.

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

Yes, sure. We think about share repurchases as one of the investment opportunities that we have, utilizing free cash flow. So of course, we balance the share repurchase activity across other organic and inorganic investments. And we monitor that continuously along with the rest of the capital structure. So we feel pretty good about our ability to continue to reinvest in share repurchases, if that's the right reinvestment decision from the free cash flow.

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

And just a point on the free cash flow guidance. Is there any unusual headwinds outside of restructuring that might hit '23 that weren't in '22?

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

Outside of transformation, nothing that we're currently anticipating or aware of.

**Operator**

(Operator Instructions)

Our next question comes from Paul Newsome from Piper Sandler.

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

I'm sorry, I want to beat on the free cash flow change. Could you really just kind of hone in a little bit more on what changed in the last 3 months that changed the -- your thoughts? It just wasn't clear to me. I apologize if it's just me, exactly what changed in the environment that changed your view on it?

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

Yes. Paul, it's Andrew. So we previously believed that there were headwinds in risk to overcome. There were also multiple potential paths open to us to meet our free cash flow target by the end of 2024. As you know, different circumstances in paths can produce very different cash flow results. And since February, we've updated our assessment of the various circumstances around free cash flow, including the progress of free cash flow improvement efforts, updated economic and financial market conditions, currency movements, business-specific dynamics and the expected level of transformation spend.

And based on those recent assessments, we believe the potential path to achieving the prior target by the end of 2024 have narrowed. And therefore, we updated our target for future free cash flow to reflect our view that while we believe we'll make continual progress in improving free cash flow conversion. It's just likely to take us beyond the end of 2024 to realize the full opportunities that we see.

We've come a long way in stabilizing the business, rebuilding our talent base, strengthening organic revenue growth and accelerating the Transformation Program to drive greater profitability. And we're still committed to delivering the same success with free cash flow generation. And while we would have liked to have made more progress on it to date, it's just taking longer to achieve than some of the other financial goals.

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

Similarly to the EPS goal, I mean, I would have thought that the best estimate of 2024's pension revenue would be this year's revenue. And I think, consensus is reflecting some view that, that goal is going to be difficult to achieve. Why not just sort of rip the Band-Aid off and lower that expectations (inaudible) the EPS?

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

Yes. So we'll not know our expectations for pension income for 2024 until the end of 2023 when we perform our valuation and expect to provide relevant updates at that time. We're calling out the challenge presented by the pension income dynamics, something we've talked about before and which has continued its pension income remains pressured through 2023.

And if that dynamic continues in 2024, it will be meaningfully harder to reach our existing target and if pension income rebounded to where it had been in the past. And having said that, we remain focused on driving the organic growth, operating leverage and cost savings to achieve our long-term EPS target to help offset that headwind.

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**Operator**

Our next question comes from Elyse Greenspan from Wells Fargo.

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

My first question since you guys are calling out the pension income and then obviously, we have the free cash flow update. Does that mean that you took another look, I guess, at the '24 guidance? And that you have confidence in the other components of the financial plan, your revenue target and margin goals? And so the only, I guess, component that there's concern about is pension income?

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

Elyse, I think we're making great progress on our revenue goals and our margin goals. And things that we can control, we are driving through the organization and driving hard, and we're very happy with the progress we've made to date. The reason we call out the pensions is that's driven by external interest rates and capital market returns. And despite having a market-leading investment business, those aren't things we can control.

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

And then my second question goes back to the R&B margin. And I know you did call out some book-of-business gains last Q2, but you also get the benefit, right, that the investment income -- higher investment income that can come through this Q2. But I just want to understand the comments.

So it sounds like if we neutralize for Russia, fiduciary investment income and book gains, right? Maybe you would have got a little bit of margin improvement within R&B. So if that's the case, I think it's around 30 basis points, would you expect to at least see that 30 basis points of improvement from here? I'm just particularly concerned with the leverage within R&B, especially if you're able to continue to report high single-digit organic revenue growth in the segment?

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

Yes, Elyse, and your math there is spot on. As I said earlier, we don't guide on segment margins. but we do expect that the margin trajectory to continue on a path, but it will be -- could be choppy quarter-to-quarter, and we do have the potential headwind from the book sales from last year, weighing on margin in Q2, for example. But over the long term, we're still very confident about the margin acceleration in that business.

**Operator**

Our next question comes from Andrew Kligerman of Credit Suisse.

**Andrew Scott Kligerman** - *Crédit Suisse AG, Research Division - MD & Senior Life Insurance Analyst*

Maybe thinking about the organic revenue growth. You target mid-single digit following 8% this quarter. And hence it strikes me that there could be materially more upside. I mean I think your net hiring in risk and brokerage just by our calculation was up 7% year-over-year, maybe even more Health, Wealth and Career is 4.5%.

And I guess that, you have a book-of-business headwind of \$45 million in the second quarter. But you also had 1.5 point benefit this quarter from interest income and that should persist through the year. You've got inflation, which is helping drive up organic revenues, we saw a big number from a competitor of yours. So the question is, is that mid-single-digit guidance around organic revenue growth? Is the bias for potential on the upside to that? Or what should we be thinking about?

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

Yes. Andrew, I mean, we're obviously pretty pleased with our progress this quarter, and we do expect healthy growth for the rest of the year. There is a lot of economic uncertainty out there. But despite the uncertainty, there's continued strong demand for our services across the portfolio.

Yes, it is early in the year, right? So we are not adjusting our mid-single-digit organic expectations at this time. But you're right, the momentum in the business does look favorable. So -- and we -- that's one of the reasons we remain confident in our longer-term goals, closing the revenue gap with peers and continue to get to our long target, right? The strategic hiring we've made, the initiatives we talked about at the beginning of the call, all that's playing into the revenue momentum in the portfolio.

**Andrew Scott Kligerman** - *Crédit Suisse AG, Research Division - MD & Senior Life Insurance Analyst*

Got it. And then second question, just moving back to the free cash flow in the quarter of \$92 million. But by our expectation, we were thinking maybe it will come in somewhere between \$300 million and \$400 million. And just kind of hoping you could unpack what those pieces were that kind of came off course? Because last quarter, despite a pressured free cash flow number, you seemed optimistic that you could still get into that 3-year figure of \$4.3 billion to \$5.3 billion.

You figured there were ways to kind of maneuver to that. And now we're looking at \$92 million this quarter. And I'm wondering, a, how did it get this low? What were the key pieces? And two, how do you get -- now that you've kind of tossed the \$4.3 billion to \$5.3 billion. And what seemed like a good -- forget the margins, it seems like you could just get to \$1.6 billion, \$1.7 billion a year. Is that something we could think about in 2025? Is that a real goal? And I'll stop there.

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

Yes, sure. So let me take that in 2 parts. So I think, first, just on the quarter free cash flow, I think, this is the first time in a number of years where the free cash flow in the first quarter has been a positive number. It is typically a negative number just given it is when discretionary compensation payments are made. So we feel very good about the free cash flow number for the first quarter of \$92 million.

For the sort of long-term sort of view, which I think is what you were getting at around free cash flow generation, we think we've provided sort of a balanced view, right? A very short and longer-term guidance, we recognize that we have work to do in pursuit of our long-term free cash flow margin goal. And we're confident that the areas we identified will help us make sustainable improvements. And over that long term, we do expect to see continual improvement in free cash flow margin towards peer levels.

**Andrew Scott Kligerman** - *Crédit Suisse AG, Research Division - MD & Senior Life Insurance Analyst*

Okay. So that kind of \$4.3 billion to \$5.3 billion, if you kind of annualize it by '25, do you think you can be in that kind of peer zone with that kind of annualized experience? Or is it still too early?

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

I think it's a bit early, but where we're focused on is continual improvement from where we are today and making sure that we work our way towards peer averages over the long term.

**Operator**

Our next question comes from Michael Zaremski from BMO.

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

So pension income, any thoughts about the potential to close out some of the pension plans if that's a possibility to take advantage of higher rates. Some of your peers have taken some structural actions and charges over the last many years to kind of minimize that volatility? Or does that just not make sense from an economic perspective?

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

Our pension design is actually pretty immune. The open plan of the U.S., right, is the one where you design changes might do anything. And that's one where we've actually made design changes over prior years to reduce a lot of the volatility associated with a traditional defined benefit design.

Our big plan in the U.K. is basically doesn't have accruals for people anymore. So design changes wouldn't do anything there. And the investment strategy we run against these plans is designed to largely preserve the funded status of the plan despite capital market interest rate fluctuations.

And actually, if you look at the pension footnote, you'll see that those strategies did exactly what they were supposed to do during last year. So we're pretty happy with how we manage the plans for stability.

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

Okay. That's clear. Okay. Last question, just very good results in Health, Wealth and Career. Just curious, with a 1% GDP backdrop in 1Q, were results surprising to you? One of your peers recently said on their earnings call that they feel that some of the services they provide are currently deemed to be a little less discretionary than they've been in prior decades in kind of as the company sort out this post-pandemic world. Any thoughts there?

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

Yes. We'll speak to the peers, but I think the team has done a great job over the years of positioning us for growth under all sorts of different conditions. And I do think that the relevance of the services we offer is as high as it's ever been, right? I mean there is demand in our wealth business for pension risk management solutions that are indeed a bit more feasible under current economic conditions for pension plan sponsors.

There has been strong demand for our health business, project activity due to legislative changes in North America and our continued expansion of our client base and helping our clients deal with healthcare inflation and the effect on their costs.

And in our career business, where over the years, we've taken strong steps to make sure that there's less of an emphasis on discretionary project work and more on software recurring revenue continues to grow and our -- the software licensing that we're doing in that business has been a substantial part of that.

So yes, we're quite happy. And I guess, I'd point out, generally, employers are still struggling with the new ways of working and what the advice we can help to help them cope with sort of the new normal in terms and sort of the fact that despite any potential recessionary cause, employment levels still remain very high. I do remain optimistic about the demand for our services in that area.

**Operator**

Our next call comes from Robert Cox with Goldman Sachs.

Mr. Cox? All right, we seem to have lost Mr. Cox.

We'll move on to our next question comes from David Motemaden from Evercore ISI.

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

So I wanted to just ask on the free cash flow and I just wanted to get a better sense of some milestones that we can track from the 8% margin in 2022. In the disclosure, you said that or you mentioned the absence of onetime headwinds that will help you improve free cash flow meaningfully this year and that's obviously offset by the cost to achieve for the Transformation Program. But these onetime headwinds that you're saying should help you improve or the absence of these onetime headwinds that should help you improve free cash flow. Could you size those for us?

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

Yes. And I think, this is some of the detail, it's Andrew, that we had shared previously, so we can definitely go through that again and provide some additional insight there. So if you recall there were about \$200 million of headwinds from FX-related derivative payments, there was about \$200 million of headwinds from tax-related timing payments and also about \$100 million of incremental onetime discretionary compensation payments that we had discussed.

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

Got it. That's helpful. Thanks for laying those out for me. I somehow missed that. So -- and I guess, and then the timing of the Transformation Program, I think there's still overall \$536 million of cost to achieve that will happen over the next couple of years. Is it safe to assume that pretty equal spreading that out over the next couple of years?

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

Yes. I think that's fair. It does move around a bit quarter-by-quarter and year-by-year when it hits the cash flow statement. But yes, I think that's a safe assumption for now.

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**Operator**

Our next question comes from Yaron Kinar with Jefferies.

Mr. Kinar?

All right, well, we can move on to our next question, which comes from Mark Marcon. Mr. Marcon is with Baird.

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

So on Health, Wealth and Careers, good -- really good margin improvement. Can you elaborate a little bit on some of the key drivers there? And then I know careers, the discretionary element has been reduced. But we're starting to see some signs of cyclical slowing in some components of the economy. Are you seeing any evidence of you're still remaining discretionary elements being pressured at all? And how should we think about that with regards to the margins going forward?

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

Yes, it's Andrew. Thanks for the questions. On the first part, regarding HWC's margin progress, I think there's really 2 components that you see there. One is the operating leverage just inherent in the business and, two, the impact of transformation savings more visible in the bottom line.

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

With respect to career, right? I mean you start peeling back the hood and look at the mix of services we have there, right? I mean, the demand for executive compensation services remains strong, and we believe that it will remain strong, pretty much regardless of economic conditions. For work in rewards, in general, as I sort of talked about in the prior question, right, we do see continued demand for people to sort of deal with how the new ways of working affect compensation programs and benchmarking.

And we've taken steps over the years, right, to be able to offer more of this as a software basis than discretionary consulting projects, which helps with the stability. And then we've taken quite an initiative over the last few years to embed employee experience into all aspects of how we deliver services across the health, wealth and career and that's actually led to some substantial revenue momentum and demand for our employee portal software offering. So we think that the business is far more resilient than it had been in times past.

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

That's great. And then obviously, there's been all sorts of questions about the free cash flow target moving a little bit. And you mentioned specifically changing the KPIs to emphasize from a behavioral perspective, addressing some of the things that could accelerate free cash flow conversion. How long do you think it would take to get there?

Like -- everybody's been asking, does this mean '25 or '26 when we get to peer levels. While we've got the public call going, is there a way to just say here are the specific things that we're doing and here's when we think would be a reasonable time period to accomplish that or a conservative time period to accomplish it?

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

Yes. And I can go through some of the buckets of initiatives that we are focused on but don't want to sort of get into specific timing because we are much focused on continual improvement in that area. So first is strengthening the organizational focus on free cash flow. You had mentioned the KPI for annual incentives, things of that nature.

The second category is around working capital improvement opportunities across all of our businesses. So we do currently see substantial opportunities across receivables, payables and some of the other key working capital accounts.

And the third area is around optimizing the cash generation profile of our business portfolio. And that is, as you might expect, one of the largest classes of opportunities, but also the most time consuming to realize.

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**Operator**

Our next question comes from Yaron Kinar with Jefferies.

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

So I'll just start with continuing, I guess, I have the line of questions on free cash flow. So I think, you mentioned that you expect the near-term meaningful improvement from 2022's margin of 8%. Do you also expect near-term improvement to 2022's free cash flow margin if we were to adjust back the onetime drags?

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

You do have to think about the transformation spend as part of that. But we do expect to continue to make progress on that metric over time. There may be some volatility inherent in that. But over the longer term, we do expect continual progress on that metric.

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

Okay. And then with regards to the pension income and the potential drag to 2024 EPS guidance. Can you maybe tell us what pension income levels or range were contemplated when the initial guidance was offered?

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

The initial guidance looked at a variety of different economic scenarios. So I don't think it was any one particular scenario for what was going on with...

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

And I think, what's changed was just the rapid, right, the pace of the movement in rates and capital returns that factored into that. But it was originally set back in 2021. And if you go back over the average of 7 years or so of investment of pension income, it was well north of \$250 million. So I think, just the macro environment changed which drove sort of the big change in the pension income.

**Operator**

Our next question comes from Charlie Lederer of Citi.

**Charles Lederer**

Just looking at some of the drivers of strength in global lines over the last year or so, can you pack if there are -- or unpack if there are any particular lines that you're more excited about going forward? And I guess in aerospace, specifically, can you talk about whether you're gaining share or more benefiting from a favorable environment?

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

We're very happy with the progress across all global lines. I did call out Phoenix where we've got particular challenges, not particular to us. But I think looking at anyone who's got a similar footprint, you're going to find the same thing as the combination of rate and sector activity in M&A. But the results are actually quite strong across the portfolio. I'm not going to dive into particular concentrated areas, right, such as Aerospace, but we're very happy with the performance of our teams, and I think, we have great momentum going forward.

**Charles Lederer**

Okay. And then I guess, can you provide any color on TRANZACT performance in the quarter? And then wondering if you have a view on CMS' new Medicare marketing rules and whether that could have an impact going forward.

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

So we're quite happy with TRANZACT performance for the quarter, and we see -- we expect continued growth for TRANZACT this year. We do view the issuance of the recent CMS regulations as a manageable event.

**Operator**

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

**Meyer Shields - Keefe, Bruyette, & Woods, Inc., Research Division - MD**

I was hoping -- pardon me, to get some color on where you see the needs for hiring now? Is it maintenance? Are there still some of the gaps that we saw in the aftermath of elevated attrition, I was hoping you could talk us through that.

**Operator**

I'm sorry, we seem to have an issue with the line, you'll hold for just one moment.

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

I think we're back now, operator. So the -- we have -- I think I'd put it this way, right? We don't have major gaps anymore, Meyer, the way we did in late '21, '22. The teams have done a great job of bringing in talent across the organization. And that shows up an improved retention rates in the portfolio and some of the revenue acceleration we've seen in new business. So we're quite happy with where we are. As I said earlier, right, we'll

always be on the lookout for good talent. So this is a people business and good talent is how you continue to grow this business. But we're happy with our human capital situation right now.

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**Meyer Shields** - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Okay. Perfect. That's helpful. Second question, does the revised free cash flow outlook impact your M&A potential strategy?

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

It's Andrew. I think we're very comfortable with our capital position and the capital structure and the embedded financial flexibility that we have there to be able to take advantage of opportunities that come our way. So no concern from our perspective there whatsoever.

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**Operator**

And our next question comes from Mark Hughes with Truist Securities.

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

On the wealth business, if we do see interest rates decline in coming quarters, how does that impact the pension project work? Maybe refresh me on that?

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

So the wealth business has 2 components, right? We've got our retirement consulting business which is largely recurring work, right, valuations are pension plans, et cetera. And then we have project work various sorts, including pension risk transfer. The market right now for pension risk transfer with funded status approved in pension plans across most major economies is a good one.

And should rates decline, depending what sort of -- if equity markets rise in response to a rate decline, you probably wouldn't see deterioration in funded positions, which leaves pension risk transfer opportunities just as attractive for plan sponsors. But a lot of what we do is not just the actual transaction itself, but helping people monitor these conditions and determine whether other activities such as bulk lump sums might be attractive.

So we do anticipate continued demand in this particular area. I would point out that if you saw less demand for pension risk transfer, that's less assets leaving our investments business. So we've got a bit of a hedge in the portfolio there.

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**Operator**

And thank you, everyone, for your participation in today's conference. This does conclude our program, and you may now disconnect. Have a wonderful day.

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