Aon Corporation

Second-Quarter Results Highlight Continued Strong Execution

- Adjusted EPS from continuing operations increased 9%, to $0.76, $0.01 ahead of our estimate and $0.02 ahead of consensus (based on management's definition of adjusted EPS). The outperformance relative to our estimate was driven principally by lower corporate expenses and a lower effective tax rate, partly offset by lower brokerage revenue and lower net investment income.

- Organic revenue growth within insurance brokerage (about 85% of earnings) was 0%, compared with 1% growth last quarter and our 1% growth estimate. Growth is being hampered by continued competitive pressure on commercial property-casualty insurance pricing and the weaker global economy. We expect flattish growth in the second half of 2009 given economic headwinds and Aon's ability to take share and more stable insurance pricing.

- The adjusted insurance brokerage operating margin was 19.6%, compared with 18.3% in second quarter 2008 and our 19.8% estimate. The improvement compared with the prior year was driven by cost savings from the 2007 restructuring program, the Benfield Group acquisition (closed fourth quarter 2008), and continued good expense management away from these initiatives. We expect margins to move higher in 2009 as well, despite foreign-exchange and pension expense headwinds given the benefits from the various restructuring plans.

- The company maintained its estimated cumulative expense savings from its 2007 restructuring plan of $370 million, realized by year-end 2010, and the Benfield acquisition of $122 million, realized by year-end 2011.

- The company repurchased 3.4 million shares during the quarter for $125 million, which we expect to continue after a two-quarter breather. Outstanding share-repurchase authorization now stands at approximately $730 million.

- Management stated that it believes that the agreement between competitor Arthur J. Gallagher (AJG $22.87) and the Illinois Attorney General to once again allow the company to receive contingent commissions was a positive step toward the promotion of greater transparency and establishing a level playing field between the large national brokers and regional brokers, as opposed to simply the issue of contingent commissions, specifically.

- We are increasing our 2009 EPS estimate to $3.05 from $3.00 and maintaining our 2010 EPS estimate of $3.40. Our rating remains Market Perform.

Financial | Commercial P/C Insurance

July 30, 2009

Stock Rating:	**Market Perform**
Company Profile:	**Core Growth**
Symbol:	AOC (NYSE)
Price:	$39.89 (52-Wk.: $33-$50)
Market Value (mil.):	$10,543
Fiscal Year End:	December
Long-Term EPS Growth Rate:	12%
Dividend/Yield:	$0.62/1.6%

	2008A	2009E	2010E
Estimates			
EPS Q1	$0.71	A$0.76	NA
Q2	$0.71	A$0.76	NA
Q3	$0.69	$0.66	NA
Q4	$0.81	$0.86	NA
FY	$2.90	$3.05	$3.40
CY		$3.05	$3.40
Valuation			
FY P/E	13.8x	13.1x	11.7x
CY P/E		13.1x	11.7x

Trading Data (Thomson Financial)

Shares Outstanding (mil.)	277
Float (mil.)	257
Average Daily Volume	3,604,862

Financial Data (Thomson Financial)

Long-Term Debt/Total Capital (MRQ)	25.0
Book Value Per Share (MRQ)	21.2
Enterprise Value (mil.)	12,492.7
EBITDA (TTM)	1,362.0
Enterprise Value/EBITDA (TTM)	9.2x
Return on Equity (TTM)	25.8

Two-Year Price Performance Chart

Source: Thomson Financial, William Blair & Company estimates

Mark Lane
312.364.8686
mlane@williamblair.com

Rachel Carter
312.364.8962
rcarter@williamblair.com

Discussion

Solid Results Given Challenging Environment

Aon reported solid second-quarter results given the challenging environment, with management's definition of adjusted EPS from continuing operations increasing 9%, to $0.76, $0.01 ahead of our estimate and $0.02 ahead of consensus. The outperformance relative to our estimate was driven principally by lower expenses and a lower effective tax rate, partly offset by lower brokerage revenue and lower net investment income. The impact from foreign-currency translations decreased EPS by $0.04, although this was largely included in our estimate. EPS from continuing operations including restructuring charges were $0.51, compared with $0.54 in the year-ago period. GAAP EPS were $0.52, compared with $3.71 in second quarter 2008 that included a $3.28 per share gain from the sales of Combined Insurance Holdings of America and Sterling Life Insurance.

Organic Growth Feeling Impact From Economy, Although Still Strong Compared With Peers

Organic revenue growth within insurance brokerage (about 85% of earnings) was 0%—the first quarter in four years that the company did not achieve positive organic growth and the 16th consecutive quarter avoiding negative organic growth—compared with 1% quarter and our 1% estimate, outperforming peers Brown & Brown (BRO $19.57) with a 4.7% organic contraction and Arthur J. Gallagher & Company with a 1.2% organic contraction, but underperforming competitor Willis Group Holdings (WSH $26.85) 1.0% organic growth reported this week. Marsh & McLennan (MMC $20.63) is scheduled to report its second-quarter results before the markets open on Wednesday, August 5, 2009. Given the environment, we are particularly pleased with Aon's organic growth, as four of the five businesses were flat to positive compared with the first quarter, with only EMEA declining relative to the first quarter, reflective of the weak economic conditions in continental Europe.

Growth in the aggregate is being hampered by continued competitive pressure on commercial property-casualty insurance pricing (about two-thirds of revenue is commissions) and the weaker global economy that is limiting exposure growth in a material way and increasing clients' resistance to price increases. Pricing for the quarter on average was flat to down in the low single digits, according to management—retail was flat to down low single digits, and reinsurance was flat to up low single digits. These levels were consistent with first-quarter prices and represent a very modest improvement from fourth quarter 2008 when prices overall were down low single digits.

Management's view on the prospects for commercial property-casualty insurance pricing was essentially unchanged from the first quarter. The market remains soft, according to management, and the global economic crisis is having a material adverse impact on volume. Exposure growth concerns appear to trump pricing woes at this stage in the cycle, in our view. We expect flattish growth in the second half of 2009 given economic headwinds and Aon's ability to take share and more stable insurance pricing. Our basic view since mid-September 2008 has been that underlying underwriting margins were still too high for the commercial property-casualty insurance industry to push for price increases aggressively despite capital pressures; we believe this view has been generally accurate. Therefore, we believe the primary catalyst toward a further push in pricing is further deterioration in underlying margins and profitability after more than four consecutive years of price declines.

Regionally, the Americas experienced 3% organic growth, compared with negative 1% in the year-ago period. Production was driven by double-digit new business growth within U.S. retail and Latin America from wins within the company's financial institutions book and success with the company's operating efficiencies initiatives to drive consistent rate levels globally. The United Kingdom once again saw the greatest decline, with a 5% organic contraction, compared with positive 1% a year ago, highlighting the U.K. economy's dependence on financial, construction, and energy sectors—all significantly impaired during the current recession, coupled with soft pricing amplified by a 20% decline in exposure growth in the region. Similarly, EMEA organic revenue contracted 3%, compared with positive 7% in the year-ago period, reflective of widespread weakness within continental Europe, as mentioned above. While Australia and select emerging markets performed well in the quarter, Asia's organic growth was adversely affected by the exit from certain businesses in Japan, resulting in a 1% organic contraction overall, compared with positive 1% in the year-ago period.

Reinsurance brokerage achieved strong organic growth of 4% in the quarter, evidence of the progress Aon is achieving within the Benfield franchise. Management stated that it is seeing strength within both its treaty and facultative books, and has been able to retain 95% of the top 150 producers at Benfield. In addition, management was pleased with the client reception of Aon Benfield, having retained all 30 of the top relationships identified before the integration.

Brokerage Operating Margin—Restructuring Benefits Continue to Counter Significant Headwinds

The adjusted insurance brokerage operating margin was 19.6%, compared with 18.3% in second quarter 2008 and our 19.8% estimate. The improvement compared with the prior year was driven by cost savings from the 2007 restructuring program ($52 million), Benfield Group acquisition savings of $10 million (closed fourth quarter 2008), and continued good expense management away from these initiatives. These benefits were offset by three significant headwinds: investment income, pension expense, and intangible amortization and depreciation expenses associated with the Benfield merger that, in the aggregate, resulted in 250 basis points of adverse impact in the quarter. Investment income declined 61%, or $30 million, with a 150-basis-point adverse impact, with increased intangible amortization and depreciation expenses associated with the Benfield merger (roughly 70-basis-point adverse impact) and pension expense (roughly 30-basis-point adverse impact) accounting for the balance of the impact. We expect margins to move higher in 2009 despite foreign exchange, investment income, and pension expense headwinds given the ongoing benefit from the company's restructuring plans, which management has done an excellent job of realizing expenses savings from the past few years. In general, management expects to invest about 20% of the savings into growth initiatives.

Regarding the 2007 restructuring program, Aon incurred $74 million of charges in the quarter and achieved roughly $52 million of savings—principally in the brokerage segment through a reduction in headcount. The company maintains its expectations for the cumulative expense savings from its 2007 restructuring plan of $370 million to be achieved by the end of 2010. The Aon Benfield restructuring program incurred $21 million of charges in the quarter and achieved roughly $10 million of savings, and is still expected to result in ultimate cumulative savings of $122 million achieved by the end of 2011. To date, roughly $184 million ($170 million 2007 program; $14 million Benfield program), or 37%, of total restructuring savings from both programs have been achieved.

Consulting Remains Under Pressure

Consulting experienced an organic contraction of 1%. The core business experienced an organic contraction of 1% after positive 2% last quarter and positive 4% in fourth quarter 2008. Adjusted consulting margin increased to 15.0%, from 14.0% in the year-ago period. Overall, consulting in general has greater economic sensitivity than the insurance brokerage business, given it is more dependent on headcount growth and certain specialty practices include higher discretionary spending, in our opinion. Management characterizes this as a midteens business, and continues to expect margins to decline in 2009, given headwinds that the company faces from a weakening economy.

Increasing 2009 Estimates; Maintaining 2010 Estimates – Rating Remains Market Perform

We are increasing our 2009 EPS estimate to $3.05 from $3.00 given the outperformance this quarter, the recent weakness in the U.S. dollar, and a lower tax rate per management's guidance. We are maintaining our 2010 EPS estimate of $3.40. The company repurchased 3.4 million shares during the quarter for $125 million. Outstanding share-repurchase authorization now stands at approximately $730 million. This was the first quarter since third quarter 2008 that the company has repurchased shares, reflective of the conservative stance management has taken regarding its cash flow given the uncertain economic environment.

Aon trades at roughly 12 times our 2010 EPS estimate and we view 10 to 12 times as an attractive entry point. We favor Aon over competitor Marsh & McLennan in the near term at the same valuation level (Marsh & McLennan trades at 11.5 times our 2010 EPS estimate of $1.80) given higher visibility, better execution the past few years, and less economic sensitivity in Aon's business—more stable insurance brokerage contributes about 50% to Marsh & McLennan's earnings, compared with 85% at Aon. In addition, Aon has built real leverage into its business through its dominant market position and efficiencies in its business, and we believe closer to a 15-times 12-month P/E valuation level could be justified at some point with rising prices and a return to a more normalized exposure growth environment.

Aon Corporation
Condensed Income Statement Comparison
($ in millions, except per share data)

	1Q08	2Q08	3Q08	4Q08	2008 Actual	1Q09	2Q09E	3Q09E	4Q09E	2009 Estimate	2010 Estimate
Revenue:											
Insurance brokerage	**$1,566**	**$1,610**	**$1,473**	**$1,581**	**$6,230**	**$1,550**	**$1,578**	**$1,490**	**$1,678**	**$6,296**	**$6,590**
% change	*10%*	*8%*	*4%*	*-3%*	*5%*	*-1%*	*-2%*	*1%*	*6%*	*1%*	*5%*
% organic growth	*2%*	*2%*	*2%*	*2%*	*2%*	*1%*	*0%*	*2%*	*2%*	*1%*	*4%*
Americas	$493	$588	$557	$642	$2,280	$477	$574	$546	$648	$2,245	$2,335
% change	*3%*	*1%*	*2%*	*-1%*	*1%*	*-3%*	*-2%*	*-2%*	*1%*	*-2%*	*4%*
% organic growth	*1%*	*-1%*	*1%*	*3%*	*0%*	*2%*	*3%*	*2%*	*2%*	*2%*	*4%*
International	$766	$725	$616	$648	$2,755	$648	$613	$554	$661	$2,476	$2,569
% change	*15%*	*14%*	*7%*	*-9%*	*6%*	*-15%*	*-15%*	*-10%*	*2%*	*-10%*	*4%*
% organic growth	*2%*	*2%*	*2%*	*2%*	*2%*	*1%*	*0%*	*2%*	*2%*	*1%*	*4%*
Reinsurance brokerage	$256	$248	$252	$247	$1,003	$395	$372	$378	$358	$1,503	$1,608
% change	*7%*	*13%*	*9%*	*18%*	*11%*	*54%*	*50%*	*50%*	*45%*	*50%*	*7%*
% organic growth	*1%*	*2%*	*1%*	*2%*	*1%*	*1%*	*4%*	*3%*	*3%*	*3%*	*6%*
Net investment income	$51	$49	$48	$44	$192	$30	$19	$12	$10	$71	$78
% change	*13%*	*-8%*	*-14%*	*-14%*	*-6%*	*-41%*	*-61%*	*-75%*	*-77%*	*-63%*	*9%*
Consulting services	**$342**	**$335**	**$335**	**$341**	**$1,353**	**$308**	**$300**	**$307**	**$336**	**$1,251**	**$1,294**
% change	*4%*	*5%*	*3%*	*-8%*	*1%*	*-10%*	*-10%*	*-8%*	*-2%*	*-8%*	*3%*
% organic growth	*0%*	*2%*	*6%*	*3%*	*3%*	*2%*	*-1%*	*2%*	*2%*	*1%*	*4%*
Total operating segment revenue	$1,908	$1,945	$1,808	$1,922	$7,583	$1,858	$1,878	$1,798	$2,013	$7,547	$7,884
% change	*9%*	*8%*	*4%*	*-4%*	*4%*	*-3%*	*-3%*	*-1%*	*5%*	*0%*	*4%*
Corporate and other	$5	$17	$41	$6	$69	$1	$13	$5	$5	$24	$26
Intersegment revenue	($9)	($7)	($4)	($5)	($25)	($6)	($6)	($7)	($7)	($25)	($28)
Total revenue	**$1,904**	**$1,955**	**$1,845**	**$1,923**	**$7,627**	**$1,853**	**$1,885**	**$1,796**	**$2,012**	**$7,546**	**$7,882**
% change	*8%*	*7%*	*6%*	*-4%*	*4%*	*-3%*	*-4%*	*-3%*	*5%*	*-1%*	*4%*
Pretax income from continuing operations[1]											
Insurance brokerage	**$309**	**$294**	**$247**	**$314**	**$1,164**	**$321**	**$309**	**$276**	**$347**	**$1,253**	**$1,373**
% change	*17%*	*12%*	*1%*	*5%*	*9%*	*4%*	*5%*	*12%*	*11%*	*8%*	*10%*
% total revenue	*19.7%*	*18.3%*	*16.8%*	*19.9%*	*18.7%*	*20.7%*	*19.6%*	*18.5%*	*20.7%*	*20.1%*	*21.1%*
Consulting services	**$66**	**$47**	**$53**	**$65**	**$231**	**$52**	**$45**	**$45**	**$52**	**$194**	**$207**
% change	*35%*	*-2%*	*36%*	*2%*	*16%*	*-21%*	*-4%*	*-16%*	*-20%*	*-16%*	*7%*
% total revenue	*19.3%*	*14.0%*	*15.8%*	*19.1%*	*17.1%*	*16.9%*	*15.0%*	*14.5%*	*15.5%*	*15.5%*	*16.0%*
Total operating segment revenue	$375	$341	$300	$379	$1,395	$373	$354	$320	$399	$1,447	$1,580
% change	*20%*	*10%*	*6%*	*4%*	*10%*	*-1%*	*4%*	*7%*	*5%*	*4%*	*9%*
% total revenue	*19.7%*	*17.4%*	*16.3%*	*19.7%*	*18.3%*	*20.1%*	*18.8%*	*17.8%*	*19.8%*	*19.2%*	*20.0%*
Corporate and other	**($48)**	**($51)**	**($22)**	**($54)**	**($175)**	**($59)**	**($41)**	**($55)**	**($53)**	**($208)**	**($208)**
Total pretax income	**$327**	**$290**	**$278**	**$325**	**$1,220**	**$314**	**$313**	**$265**	**$347**	**$1,239**	**$1,372**
% change	*24%*	*7%*	*16%*	*5%*	*13%*	*-4%*	*8%*	*-5%*	*7%*	*2%*	*11%*
% total revenue	*21.6%*	*18.6%*	*19.5%*	*21.1%*	*20.2%*	*20.7%*	*20.1%*	*17.9%*	*20.8%*	*19.9%*	*21.1%*
Provision for income taxes	**$102**	**$76**	**$78**	**$93**	**$346**	**$108**	**$57**	**$74**	**$97**	**$336**	**$398**
Effective tax rate	*31.2%*	*26.2%*	*28.1%*	*28.6%*	*28.4%*	*31.5%*	*27.1%*	*28.0%*	*28.0%*	*28.9%*	*29.0%*
Adjusted operating earnings	**$225**	**$214**	**$200**	**$232**	**$874**	**$230**	**$147**	**$191**	**$250**	**$818**	**$974**
% change	*22%*	*17%*	*19%*	*4%*	*15%*	*-3%*	*3%*	*-4%*	*8%*	*1%*	*11%*
Operating earnings per share[1]	**$0.70**	**$0.70**	**$0.69**	**$0.81**	**$2.90**	**$0.76**	**$0.76**	**$0.66**	**$0.86**	**$3.05**	**$3.40**
% change	*23%*	*23%*	*32%*	*19%*	*24%*	*8%*	*9%*	*-4%*	*7%*	*5%*	*12%*
Average diluted shares	**319.8**	**305.3**	**290.3**	**288.1**	**300.9**	**288.8**	**289.1**	**289.0**	**289.0**	**289.0**	**286.5**
% change	*-1%*	*-5%*	*-10%*	*-11%*	*-7%*	*-10%*	*-5%*	*0%*	*0%*	*-4%*	*-1%*

[1]Excludes restructuring charges, other nonrecurring gains/losses, and discontinued operations

Source: Company reports and William Blair & Company estimates

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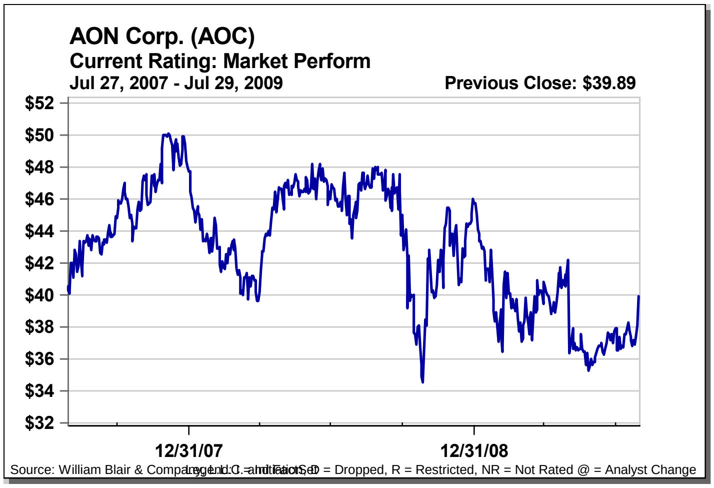

Current Rating Distribution (as of 06/30/09)

Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	59	Outperform (Buy)	3
Market Perform (Hold)	40	Market Perform (Hold)	1
Underperform (Sell)	1	Underperform (Sell)	0

*Percentage of companies in each rating category that are investment banking clients, defined as companies for which William Blair has received compensation for investment banking services within the past 12 months.

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William Blair & Company, L.L.C.   222 West Adams Street   Chicago, Illinois 60606   312.236.1600   www.williamblair.com

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