

Aon Corporation

Third-Quarter Earnings Quick Take: HR Solutions Segment Disappoints

Summary:

Solid progress on the brokerage margin and better-than-peer organic growth for the quarter were masked by weakness in the HR solutions segment. Adjusted operating EPS of \$0.69 was below our estimate of \$0.72 and consensus of \$0.73. However, excluding \$0.03 of currency gains, the quarter ended up coming in about \$0.06 below our expectations.

Key Points:

- Weakness in HR Solutions Segment:** The consulting segment had a tough quarter, although it has been traditionally seasonally weak during the third quarter. The operating margin was 11% for the quarter, versus our estimate of 15% (excluding cost savings). Third quarter is seasonally weak but the margins are even weaker than expected. On a sequential basis expense were up by almost 8% in third quarter 2011 versus second quarter 2011. Cost savings also came in materially below our expectations. The level of cost growth will be a key factor going forward.
- Brokerage Organic Growth:** Brokerage organic growth during the quarter was 4% in both the United States and internationally. Overall organic growth was 2.9%, above our estimate of 2.5%. The only weak spot was reinsurance brokerage, which continued to have negative organic growth for the sixth out of the last seven quarters.
- Brokerage Margin:** The margin got a nice boost above expectations for the quarter. The margin came in at 19%, above our expectations of 17.9%, and a 160 basis point improvement year-over-year.

Bottom Line:

Progress with the Hewitt merger hit a speed bump this quarter as expense growth far exceeded revenue growth, and margins took a big hit. Given a strong recent run in the stock, this will likely pressure the stock in the near term. Long term, the stock remains a reasonably good value and should have good momentum in 2012.

Aon Corporation is a leading global insurance broker, providing risk management services, insurance and reinsurance brokerage, and human capital consulting.

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October 28, 2011

Stock Rating: **Outperform**
Company Profile: **Established Growth**

Symbol: AON (NYSE)
Price: \$50.27 (52-Wk.: \$39-\$55)
Market Value (mil.): \$16,243
Fiscal Year End: December
Long-Term EPS Growth Rate: 12%
Dividend/Yield: \$0.60/1.2%

	2010A	2011E	2012E
Estimates			
EPS Q1	\$0.83	A\$0.80	\$0.91
Q2	\$0.81	A\$0.83	\$0.91
Q3	\$0.61	A\$0.69	\$0.81
Q4	\$0.84	\$1.03	\$1.15
FY	\$3.07	\$3.34	\$3.77
CY		\$3.37	\$3.77

Valuation

FY P/E	16.4x	15.1x	13.3x
CY P/E		14.9x	13.3x

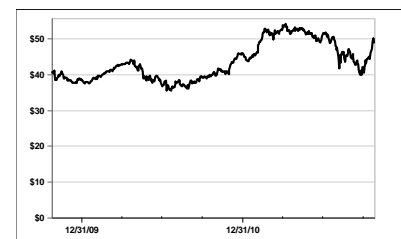
Trading Data (Thomson Financial)

Shares Outstanding (mil.)	327
Float (mil.)	323
Average Daily Volume	2,981,444

Financial Data (Thomson Financial)

Long-Term Debt/Total Capital (MRQ)	25.0
Book Value Per Share (MRQ)	21.2
Enterprise Value (mil.)	20,872.7
EBITDA (TTM)	2,127.0
Enterprise Value/EBITDA (TTM)	9.8x
Return on Equity (TTM)	10.5

Two-Year Price Performance Chart



Sources: Thomson Financial, William Blair & Company estimates

AON Corporation (AON)
Variance Analysis
(\$ in millions, except per share data)

	3Q10 Actual	2Q11 Actual	3Q11 Actual	% Change Y/Y Q/Q		3Q11 WB est	Variance % \$	
RISK AND INSURANCE SEGMENT								
Total Revenue	\$1,484.0	\$1,728.0	\$1,617.0	9%	-6%	\$1,539.0	5%	\$78.0
<i>Organic Growth</i>	-0.5%	2.0%	2.9%			2.5%		
Total Expenses	\$1,226.0	\$1,373.0	\$1,309.0	7%	-5%	\$1,263.5	4%	\$45.5
Operating Income	\$258.0	\$355.0	\$308.0	19%	-13%	\$275.5	12%	\$32.5
<i>Pre Tax Margin</i>	17.4%	20.5%	19.0%			17.9%		
CONSULTING SEGMENT								
Total Revenue	\$321.0	\$1,090.0	\$1,112.0	246%	2%	\$1,070.0	4%	\$42.0
Total Expenses	\$267.0	\$880.0	\$998.0	274%	13%	\$904.2	10%	\$93.8
Operating Income	\$54.0	\$210.0	\$114.0	111%	-46%	\$165.8	-31%	(\$51.8)
<i>Margin with cost savings</i>	16.8%	19.3%	10.3%			22.0%		
<i>Margin after amortization</i>	-	13.9%	4.8%			16.3%		
CONSOLIDATED								
Adjusted Operating Income Per Share	\$0.81	\$0.83	\$0.69			\$0.72		(\$0.03)
Average diluted shares	282.6	342.7	336.9			337.9		

Source: Company reports and William Blair & Company, L.L.C. estimates

William Blair & Company, L.L.C.

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Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	59	Outperform (Buy)	8
Market Perform (Hold)	31	Market Perform (Hold)	2
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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