

# Aon Corporation

## Quick Look at Fourth-Quarter Outperformance, Better Margin Expansion Resulting From Restructuring Programs

### Highlights

**Strong fourth-quarter results; management's tone continues to be cautionary.** Adjusted EPS from continuing operations increased 20%, to \$0.96, \$0.11 above our estimate and \$0.15 above consensus (based on management's definition of adjusted EPS). The outperformance relative to our estimate was driven by higher margins within insurance brokerage and consulting—benefiting from restructuring programs and positive foreign currency translations. The impact from foreign-currency translation increased EPS by \$0.05—modestly ahead of our estimate. GAAP EPS including restructuring charges were \$0.69 and GAAP EPS from continuing operations including restructuring charges were \$0.49. Management's tone for 2010 continues to be more cautionary, with key concerns surrounding the timing of an authentic improvement in the global economy.

### Organic revenue growth still reflective of economic headwinds.

Organic revenue growth within insurance brokerage (about 85% of earnings) was negative 1%, compared with negative 3% growth last quarter and our 1.4% growth estimate. Aon outperformed peer Arthur J. Gallagher & Company (AJG \$23.10), which had negative 2.0% organic growth, but once again underperformed competitor Willis Group Holdings (WSH \$28.11), which had 2.0% organic growth. Peers Brown & Brown (BRO \$17.76) and Marsh and McLennan (MMC \$22.20; Market Perform) have yet to report fourth-quarter results. Growth in the aggregate is being hampered by the weaker global economy that is limiting exposure growth in a material way and a persistently soft pricing environment for commercial property-casualty insurance pricing. Pricing for the quarter on average was effectively unchanged from the third quarter, flat to down in the low single digits—retail was flat to down low single digits, and reinsurance was flat to up low single digits. Organic growth within consulting was negative 4%. Organic growth in the core business was also negative 4%, after negative 5% last quarter, negative 1% in second quarter 2009, and positive 2% organic growth in first quarter 2009. Adjusted consulting margin increased 230 basis points from the year-ago period to 21.4%, well ahead of our 15.5% estimate, driven principally by cost savings from the 2007 restructuring program.

**Adjusted insurance brokerage operating margin exceeds 20% target; management increases long-term target to 25%.** The adjusted insurance brokerage operating margin was 20.7%, compared with 19.9% in fourth quarter 2008 and our 20.1% estimate—the fourth quarter is the seasonally strongest margin quarter. The improvement compared with the prior year was driven by cost savings from the 2007 restructuring program (\$108 million), the Benfield Group acquisition savings of \$17 million (closed fourth quarter 2008), and continued good expense management away from these initiatives. These benefits were offset by three significant headwinds: investment income—which declined 62% in the quarter, or \$23 million—pension expense, and intangible amortization and depreciation expenses

### Financial | Commercial P/C Insurance

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Stock Rating: **Market Perform**  
Company Profile: **Core Growth**

Symbol: AON (NYSE)  
Price: \$39.97 (52-Wk.: \$35-\$43)  
Market Value (mil.): \$10,631  
Fiscal Year End: December  
Long-Term EPS Growth Rate: 12%  
Dividend/Yield: \$0.61/1.5%

	2009A	2010E	2011E
<b>Estimates</b>			
EPS Q1	\$0.76	NA	NA
Q2	\$0.76	NA	NA
Q3	\$0.65	NA	NA
Q4	\$0.96	NA	NA
FY	\$3.13	\$3.35	\$3.65
CY		\$3.35	\$3.65

<b>Valuation</b>			
FY P/E	12.8x	11.9x	11.0x
CY P/E		11.9x	11.0x

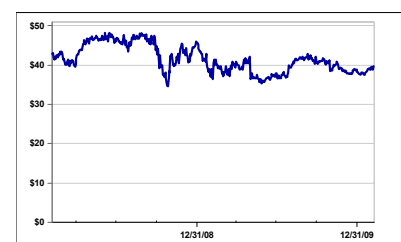
### Trading Data (Thomson Financial)

Shares Outstanding (mil.)	274
Float (mil.)	NA
Average Daily Volume	2,099,017

### Financial Data (Thomson Financial)

Long-Term Debt/Total Capital (MRQ)	25.0
Book Value Per Share (MRQ)	21.2
Enterprise Value (mil.)	12,307.5
EBITDA (TTM)	1,309.0
Enterprise Value/EBITDA (TTM)	9.4x
Return on Equity (TTM)	7.5

### 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

**Katherine McCauley**  
312.364.8488  
kmccauley@williamblair.com

associated with the Benfield merger that, in the aggregate, resulted in 200 basis points of adverse impact in the quarter, according to management. The adjusted operating margin for the year was 20.3% compared with 18.7% in 2008. We expect modest margin expansion in 2010, 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 expense savings from the past few years. Management has increased its long-term adjusted insurance brokerage operating margin target to 25%, which it believes will be achievable through the combination of the benefit from restructuring, disciplined expense management, improved commissions through operating efficiency initiatives, and the benefit from an improving interest rate environment. We view the 25% operating margin target as a two- to three-year goal without a more noticeable improvement in the global economy or the commercial property-casualty insurance pricing environment that would drive organic growth appreciably higher in the near term.

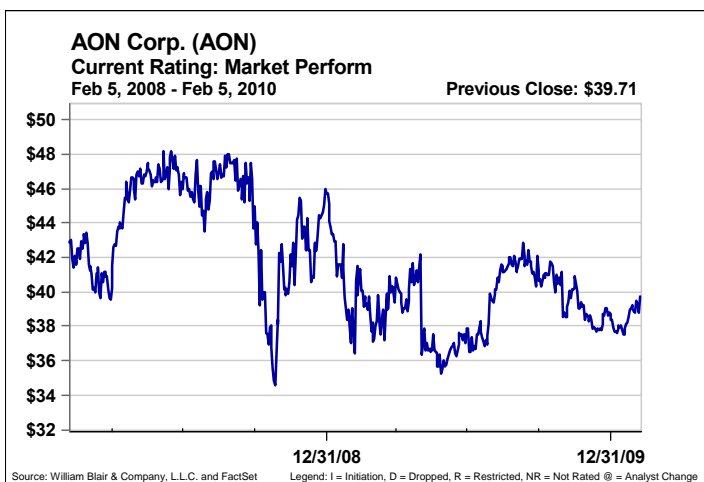
**Restructuring programs continue to deliver strong results—new share repurchase program in place.** The company increased its estimated cumulative expense savings from its 2007 restructuring plan to \$536 million from \$467 million, realized by year-end 2010, and maintained the Benfield acquisition total estimated savings of \$122 million, realized by year-end 2011. To date, roughly \$314 million (\$269 million 2007 program; \$45 million Benfield program), or 48%, of total restructuring savings from both programs have been achieved. The company repurchased 8.6 million shares during the quarter for \$340 million, roughly \$265 million capacity remains under the existing repurchase program, and management announced the authorization of a new \$2 billion repurchase program subsequent to year-end 2009. Management halted its share repurchase activity in late 2008 and early 2009 amid extreme market volatility, and the fourth quarter marks an acceleration in activity compared with \$125 million last quarter. We expect future activity to be below the current quarter's level given we expect Aon to generate about \$1 billion of operating cash flow in 2010.

**Maintaining rating, 2010 EPS estimate, and establishing 2011 EPS estimate.** We are maintaining our 2010 EPS estimate of \$3.35, and establishing a 2011 estimate of \$3.65. We have cut our organic growth rate estimates, but offset the drag with higher cost savings excluding additional restructuring charges. Aon trades at nearly 12.0 times our 2010 EPS estimate, and we view 10 to 12 times as a more attractive entry point. We favor Aon over competitor Marsh & McLennan in the near term at the same valuation level (Marsh & McLennan trades at 11.7 times our 2010 estimate of \$1.90), 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 a valuation level closer to 15 times 12-month P/E could be justified at some point with rising commercial insurance prices and a return to a more normalized exposure growth environment.

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Additional information is available upon request.



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Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	66	Outperform (Buy)	5
Market Perform (Hold)	34	Market Perform (Hold)	1
Underperform (Sell)	0	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](http://www.williamblair.com)

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