William Blair & Company®

Equity Research

FINANCIAL
Insurance

February 08, 2008
Research Note

Ticker:	AOC
Market:	NYSE
Price:	$41.95
52-week:	($36-$51)

Stock Rating:
Market Perform

Company Profile:
Aggressive Growth

Mark Lane
(312) 364-8686
mlane@williamblair.com

Aon Corporation

Fourth-Quarter Results: Overall Respectable; Showing Some Signs of Stress

FINANCIAL SUMMARY

Fiscal Year Ends:	December	Dividend/Yield:	$0.60/1.4%
Long-term EPS Growth Rate:	12%	Market Value (mil.):	$12,549

ESTIMATES*

FYE	Q1	Q2	Q3	Q4	Annual	P/E
2007A	NA	NA	NA	$0.69	$2.37	17.7x
2008E	NA	NA	NA	NA	$2.75	15.3x
2009E	NA	NA	NA	NA	$3.55	11.8x
Cal2008					$2.75	15.3x
Cal2009					$3.55	11.8x

**** Estimates reflect the adoption of FAS 123R.***

- Aon Corporation reported reasonable fourth-quarter results, with adjusted EPS from continuing operations of $0.69, $0.01 below our estimate and $0.03 ahead of consensus. A lower tax rate added $0.03 per share and foreign currency translation added $0.04 per share.

- Organic revenue growth within insurance brokerage was 2%, compared with about 4% in the first nine months. Growth was hampered by continued competitive pressure on commercial property-casualty insurance pricing, which is affecting all of Aon's insurance brokerage peers, and this level of growth is consistent with, or even slightly better than, its peers.

- The adjusted insurance brokerage operating margin was 18.5%, compared with 17.5% in the fourth quarter, although below our estimate. The improvement was driven by cost savings from restructuring, lower pension expense, and the positive impact from foreign currency translations. These factors allowed the company to continue to invest in the future growth of its business.

- The company remains on track to recognize the final $45 million of cost savings from the 2005 restructuring program in 2008, $50 million to $70 million of cost savings from the 2007 restructuring plan in 2008, and another $175 million to $200 million in 2009. Savings from these programs is the only way Aon will be able to expand margins in the near term in the current industry environment, in our opinion.

William Blair & Company, L.L.C.
222 W. Adams St.
Chicago, IL 60606
www.williamblair.com

- The company expects the sales of Combined Insurance and Sterling Life to close in the first half 2008, with the vast majority of net proceeds to be directed at share repurchase, in our opinion.

- We are lowering our 2008 EPS estimate to $2.75 from $2.85 and 2009 EPS estimate to $3.55 from $3.60 to reflect less margin expansion within insurance brokerage.

- Our rating remains Market Perform, as we see valuation as relatively full at current levels within the context of more challenging industry fundamentals.

Discussion

Respectable Results, Showing Some Signs of Stress
Aon reported reasonable fourth-quarter results, with adjusted EPS from continuing operations of $0.69, $0.01 below our estimate and $0.03 ahead of consensus, and compared with $0.59 per share in fourth quarter 2006. The upside relative to consensus was primarily driven by a lower tax rate ($0.03 per share), and the benefit from foreign currency translation was also ahead of our expectation ($0.04 per share). GAAP EPS were $0.83 including discontinued operations (underwriting businesses pending for sale) and restructuring charges. Adjusted EPS from continuing operations were $2.37, up from $1.66 last year, given aggressive capital management, margin expansion, and a good recovery with consulting. GAAP EPS for 2008 were $3.05, compared with $2.46 in 2006.

Organic Growth Under Some Stress
Organic revenue growth within insurance brokerage was 2%, compared with about 4% in the first nine months. Insurance brokerage now represents about 85% of Aon's earnings. Growth was hampered by continued competitive pressure on commercial property-casualty insurance pricing, which is affecting all of Aon's insurance brokerage peers, and this level of growth is consistent with, or even slightly better than, its peers. Of the other publicly traded insurance brokers that have reported third-quarter results thus far, Arthur J. Gallagher (AJG $24.52) reported 1% organic revenue growth and Willis Group (WSH $32.18) reported 0% organic growth—Brown & Brown (BRO $22.48), Hilb Rogal & Hobbs (HRH $35.66), and Marsh & McLennan (MMC $26.13) have all yet to report but should report results similar to, if not worse than, its competitors, in our opinion. We expect pricing pressure to continue to adversely affect organic growth for the next several quarters and do not expect organic growth to be up more than 5% in 2008. Aon has invested a lot of the last few years to drive higher organic growth, but management does not provide much detail to assess how these investments may affect growth in the aggregate and we do not see the benefits in reported results yet.

Brokerage Operating Margin Up; A Lot Tougher to Drive Improvement in 2008
The adjusted insurance brokerage operating margin was 18.5%, compared with 17.5% in the fourth quarter, although below our estimate. The fourth quarter is Aon's seasonally strongest. The adjusted insurance brokerage operating margin in 2007 was 18.2%, compared with 17.2% in 2006. Management's goal is to drive the operating margin well above 20% over time. The improvement was driven by cost savings from restructuring, lower pension expense, and the positive impact from foreign-currency translations. We estimate that the cost savings from restructuring and lower pension aided the margin by more than 500 basis points. The impact from foreign-currency translations is not quantifiable, but it is not immaterial, in our opinion. However, these factors allowed the company to continue to invest in the future growth of the business. Management suggests margins will go in 2008, but will not quantify how this will be accomplished. We believe the company will be challenged to expand margins much within insurance brokerage in 2008 given that we expect continued pressure on commercial property-casualty insurance pricing and organic revenue growth for insurance brokers and management continued to invest for future growth.

Aon Corporation
Insurance Brokerage (about 85% of earnings)
Adjusted Operating Margin Analysis

Adjusted operating margin - 2006	16.1%	Adjusted operating margin - 2007	18.1%
Pension expense	2.1%	Pension	0.0%
Cost savings from restructuring	3.1%	Cost savings from restructuring	1.6%
Investments/net expense inflation/other	**-3.1%**	**Investments/net expense inflation/other**	**-1.2%**
Adjusted operating margin - 2007	18.1%	Adjusted operating margin - 2008 estimate	18.5%
Foreign exchange translation	very positive	Foreign exchange translation	modestly positive
Organic growth	3%-4%	Organic growth estimate	3%-5%

Source: William Blair & Company research

Consulting Fine; Outsourcing Remains a Drag

Organic growth within consulting services was down 5% given the continued drag from the outsourcing business, which has lost some large clients. Growth in the core business was only 3% after 8% last quarter. Adjusted consulting margin increased to 17.2% from 15.4%—the fourth quarter is also consulting's strongest seasonal quarter given timing of health care enrollments. Management believes a midteens operating margin within consulting is sustainable. We believe this business 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. Results within consulting have been volatile the past several quarters, but we are encouraged by the underlying trend and we do not see a need for Aon to remain in the HR outsourcing business. The drag from the outsourcing business ends in the second quarter. We also believe that consulting is the segment that can benefit the most from a more substantial acquisition.

Continued Restructuring Driving Any Opportunity for Margin Expansion

Last quarter management announced a second restructuring plan that is designed to realize annualized savings of approximately $240 million by 2010, including $50 million to $70 million in 2008 and $175 million to $200 million in 2009. The 2005 restructuring plan remains on track to deliver $280 million of cost savings by 2008, compared with the original plan of $150 million and the remaining $45 million of direct, incremental cost savings in 2008. Management continues to see the opportunity to manage the business more efficiently and the new plan is necessary to push margin expansion further given that organic growth is not high enough currently to drive any real operating leverage in the business.

Capital Management Should Remain Aggressive

On December 17, 2007, Aon announced agreements to sell Combined Insurance Co. (CICA) for $2.4 billion to ACE Limited (ACE $57.55) and Sterling Life Insurance for $352 million to Munich Re Group. Aon expects to receive about $2.6 billion in after-tax proceeds and dividends with the primary use of funds directed at share repurchase. A total of $2.6 billion of after-tax proceeds and dividends ($325 million prior to close) was at least 25% greater than we had expected in a sale of these businesses. The Sterling transaction is expected to be completed by the end of first quarter 2008 and CICA is expected to be completed by the end of second quarter 2008. After these transactions close, Aon will have no ongoing underwriting operations. We expect the vast majority amount of net proceeds to be directed at share repurchase. Aon repurchased about 19.1 million shares in 2007 after repurchasing more than 28.0 million shares in 2006.

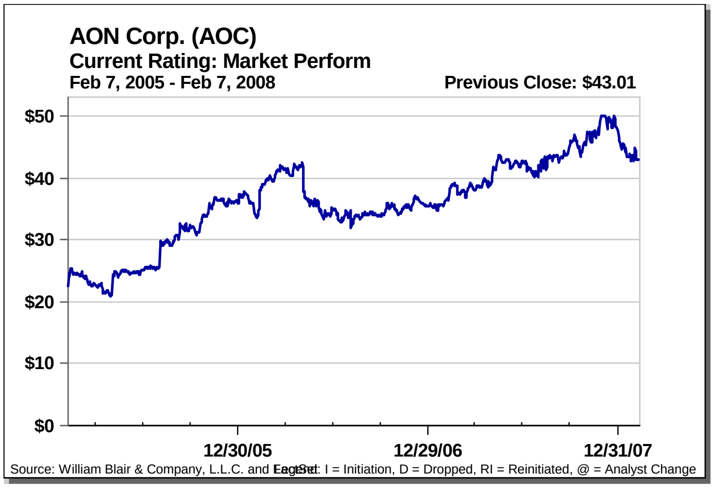
Taking Estimates Down a Bit; Rating Remains Market Perform

We are lowering our 2008 EPS estimate to $2.75 from $2.85 and 2009 EPS estimate to $3.55 from $3.60 to reflect less margin expansion within insurance brokerage. All our estimates are on a continuing operating basis and exclude the earnings contribution from the underwriting business. We estimate the company will direct the vast majority of net proceeds from the sale of the underwriting businesses at a generally regular pace, although the company also has enough capacity to execute a tender offer.

Aon continues to accomplish a lot, the sale of the underwriting businesses establishes Aon as a pure professional services firm, the company continues to manage capital very aggressively, it is working to manage expenses aggressively, and it continues to make substantial investments for future growth. That said, organic growth will continue to be under pressure for the next several quarters, in our opinion, and we see valuation as relatively full at current levels with the stock trading at a modest discount to market off of 2009 estimates. Our primary concerns have been the adverse impact on organic growth from the cyclical pressure on commercial property-casualty insurance pricing coupled with valuation. Execution has clearly been much better and the stock could continue to benefit from its mostly defensive characteristics in the near term, in our opinion. Our view on valuation could be wrong if Aon can drive higher organic revenue growth, which would result in greater-than-expected margin expansion, or recognize additional expense savings from the most recent announced restructuring plan.

A principal or employee of William Blair & Company, L.L.C. is a member of the board of directors or advisory board of Aon Corporation.

Additional information is available upon request.



Current Rating Distribution (as of 2/1/2008)

Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	59	Outperform (Buy)	13
Market Perform (Hold)	40	Market Perform (Hold)	6
Underperform (Sell)	1	Underperform (Sell)	1

*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.

Mark Lane attests that 1) all of the views expressed in this research report accurately reflect his/her personal views about any and all of the securities and companies covered by this report, and 2) no part of his/her compensation was, is, or will be related, directly or indirectly, to the specific recommendations or views expressed by him/her in this report.

Stock Rating: William Blair & Company, L.L.C. uses a three-point system to rate stocks. Individual ratings reflect the expected performance of the stock relative to the broader market over the next 12 months. The assessment of expected performance is a function of near-term company fundamentals, industry outlook, confidence in earnings estimates, valuation, and other factors. Outperform (O) – stock expected to outperform the broader market over the next 12 months; Market Perform (M) – stock expected to perform approximately in line with the broader market over the next 12 months; Underperform (U) – stock expected to underperform the broader market over the next 12 months; Not Rated (NR) – the stock is currently not rated.

Company Profile: The William Blair research philosophy is focused on quality growth companies. Growth companies by their nature tend to be more volatile than the overall stock market. Company profile is a fundamental assessment, over a longer-term horizon, of the business risk of the company relative to the broader William Blair universe. Factors assessed include: 1) durability and strength of franchise (management strength and track record, market leadership, distinctive capabilities); 2) financial profile (earnings growth rate/consistency, cash flow generation, return on investment, balance sheet, accounting); 3) other factors such as sector or industry conditions, economic environment, confidence in long-term growth prospects, etc. Established Growth (E) – Fundamental risk is lower relative to the broader William Blair universe; Core Growth (C) – Fundamental risk is approximately in line with the broader William Blair universe; Aggressive Growth (A) – Fundamental risk is higher relative to the broader William Blair universe.

The ratings and company profile assessments reflect the opinion of the individual analyst and are subject to change at any time.

The compensation of the research analyst is based on a variety of factors, including performance of his or her stock recommendations; contributions to all of the firm's departments, including asset management, corporate finance, institutional sales, and retail brokerage; firm profitability; and competitive factors.

Please contact us at 1-800-621-0687 or consult http://www.williamblair.com/pages/eqresearch_coverage.asp for all disclosures.

William Blair & Company®

Investment Banking ▪ Asset Management ▪ Equity Research ▪ Institutional & Private Brokerage ▪ Private Capital

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

CHICAGO BOSTON LONDON NEW YORK SAN FRANCISCO SHANGHAI TOKYO ZURICH