Aon Plc (AON)

Updated November 9th, 2018 by Josh Arnold

Key Metrics

Current Price:	$165	**5 Year CAGR Estimate:**	7.5%	**Volatility Percentile:**	4.4%
Fair Value Price:	$138	**5 Year Growth Estimate:**	10.0%	**Momentum Percentile:**	75.6%
% Fair Value:	120%	**5 Year Valuation Multiple Estimate:**	-3.5%	**Growth Percentile:**	88.9%
Dividend Yield:	1.0%	**5 Year Price Target**	$222	**Valuation Percentile:**	24.1%
Dividend Risk Score:	A	**Retirement Suitability Score:**	D	**Total Return Percentile:**	40.5%

Overview & Current Events

Aon is a professional services firm headquartered in London, United Kingdom. The company provides a variety of services including consulting, risk management, and health plan management. Aon has approximately 500 offices worldwide that serve about 120 countries through a workforce that numbers nearly 70,000. Domestic investors can initiate an ownership stake in Aon through American Depository Receipts that trade with a market capitalization of $40 billion on the New York Stock Exchange, under the ticker AON.

Aon reported Q3 earnings on 10/26/18 and results looked strong. Organic revenue growth was up 6% as four of its five major revenue lines were up at least 5%. Indeed, Retirement Solutions was the only segment that did not hit that level, as it rose 2% during the quarter, while both insurance segments increased their respective top lines 8%. Aon's diversified revenue streams are certainly an attractive trait for shareholders and in Q3, all of its segments posted revenue gains. Operating margins rose as well, adding 190bps as productivity improvements and a much higher top line combined to meaningfully boost Aon's profitability. These factors, along with a lower tax rate, led to 34% earnings-per-share growth against the year-ago quarter. In addition, adjusted free cash flow was up 5% year-over-year.

The company continues to focus on productivity improvements to drive operating margins higher, while it simultaneously works to improve the top line further. Organic revenue growth has come in at 4% so far this year against 3% in the same period last year. We've boosted our earnings-per-share estimate for this year to $8.10 after Q3.

Longer term, Aon says it is pushing towards mid-single digit organic revenue growth, continued operating margin expansion, and double-digit free cash flow growth. The strength seen in the Q3 report seems to be just the beginning as management is very bullish on Aon's outlook.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$2.06	$2.19	$2.46	$2.86	$2.99	$3.53	$4.66	$4.88	$5.16	$6.52	***$8.10***	***$13.05***
DPS	$0.60	$0.60	$0.60	$0.60	$0.62	$0.68	$0.92	$1.15	$1.29	$1.41	***$1.60***	***$3.20***
Shares	272	266	332	325	311	301	280	270	262	248	***245***	***200***

Between 2008 and 2017, Aon compounded its adjusted earnings-per-share at a rate of 13.7% per year. Looking ahead, we believe that company's growth is likely to continue to be quite strong, albeit a bit slower than its historical pace. More specifically, we are forecasting 10% annualized earnings growth over full economic cycles.

Management reiterated that it is "*on track to deliver our near-term target of exceeding $7.97 in adjusted earnings-per-share for the full year of 2018.*" We've boosted our estimate for this year to $8.10 as the company's results have been strong enough to warrant the increase.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	21.5	17.9	16.3	16.9	16.8	19.2	18.6	19.8	20.4	20.1	***20.3***	***17.0***
Avg. Yld.	1.4%	1.5%	1.5%	1.2%	1.2%	1.0%	1.1%	1.2%	1.2%	1.1%	***1.0%***	***1.4%***

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Aon has traded at an average price-to-earnings ratio of 18.8 over the last decade. We believe that this number is a bit higher than warranted given the expensive earnings multiple exhibited by the company between 2013 and 2017. Instead, we believe that fair value for Aon lies somewhere around 17 times earnings. The company is trading for a price-to-earnings ratio of 20.3 using our 2018 earnings-per-share estimate. If Aon's current valuation contracts to a price-to-earnings ratio of 17 over the next 5 years, this will reduce its annualized returns by 3.5% per year during this time period. In addition, we see the yield growing more quickly than the share price, rising to 1.4% from the current 1.0%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
Debt/A	76.4%	76.3%	71.3%	72.5%	74.4%	72.9%	77.7%	77.5%	79.2%	82.2%	***80.0%***	***75.0%***
Int. Cov.	31.4	10.1	7.4	7.2	7.4	8.7	8.2	6.6	6.2	3.8	***5.0***	***6.0***
Payout	29.1%	27.4%	24.4%	21.0%	20.7%	19.3%	19.7%	23.6%	25.0%	21.6%	***19.8%***	***24.5%***
Std. Dev.	30.1%	20.8%	17.8%	25.8%	14.7%	13.8%	18.6%	14.6%	13.8%	12.5%	***15.0%***	***15.0%***

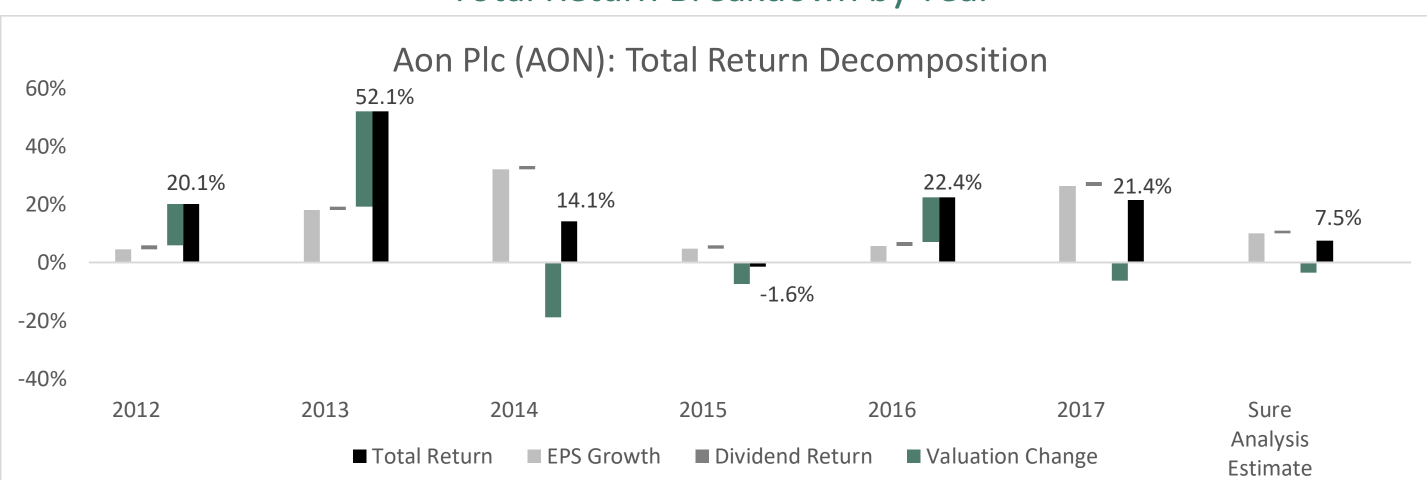
Aon's quality metrics has remained remarkably consistent over time. The company does not report gross profits (which explains the omission of our typical gross profits-to-assets ratio), but its debt-to-assets, interest coverage, and payout ratio have exhibited little volatility over the last decade. At the security level, we note that Aon's stock price volatility is much lower than one might expect from a company whose revenue is derived almost entirely from financial businesses. In 2008 – the depth of the 2007-2009 financial crisis – Aon's stock price standard deviation barely exceeded the 30% level. The payout ratio is still very low, consistent with the company's historical practices, and we do not believe that will change. Interest coverage is more than sufficient and that should only improve in the years to come.

Aon was very resilient during the Great Recession and we expect that will be the case once more, the product of its very diversified revenue streams; this is also a competitive advantage for the firm.

Final Thoughts & Recommendation

Aon's historical growth has been very impressive and points to a well-managed business that operates at the edge of the financial services industry. With that said, its valuation is meaningfully above our perception of fair value. We are forecasting 7.5% total annual returns, consisting of the 1% yield, 10% earnings-per-share growth, and a 3.5% headwind from a lower valuation. Due to a share price that trades in excess of fair value, Aon earns a hold recommendation from Sure Dividend at current prices.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	7528	7595	8512	11287	11514	11815	12045	9480	9409	9998
SG&A Exp.	6588	6574	7268	9691	9918	10144	10079	7556	7452	8128
D&A Exp.	222	242	305	582	655	635	594	338	319	891
Operating Profit	940	1021	1244	1596	1596	1671	1966	1587	1638	979
Operating Margin	12.5%	13.4%	14.6%	14.1%	13.9%	14.1%	16.3%	16.7%	17.4%	9.8%
Net Profit	1462	747	706	979	993	1113	1397	1385	1396	1226
Net Margin	19.4%	9.8%	8.3%	8.7%	8.6%	9.4%	11.6%	14.6%	14.8%	12.3%
Free Cash Flow	856	267	603	777	1150	1524	1556	1809	2170	551
Income Tax	242	268	300	N/A	N/A	N/A	N/A	175	148	250

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	22940	22958	28982	29552	30486	30251	29772	26883	26615	26088
Cash & Equivalents	582	217	346	272	291	477	374	384	426	756
Acc. Receivable	N/A	N/A	N/A	3183	3101	2896	2815	2564	2106	2478
Goodwill & Int.	6416	6869	12258	12046	11918	11575	11380	10628	9300	10091
Total Liabilities	17525	17527	20676	21432	22681	22056	23141	20824	21083	21440
Accounts Payable	N/A	N/A	N/A	1832	1853	1931	1805	1772	1604	1961
Long-Term Debt	1977	2008	4506	4492	4165	4389	5582	5700	6205	5966
Total Equity	5310	5379	8251	8078	7762	8145	6571	6002	5475	4583
D/E Ratio	0.3723	0.3733	0.5461	0.5561	0.5366	0.5389	0.8495	0.9497	1.1333	1.3018

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	6.1%	3.3%	2.7%	3.3%	3.3%	3.7%	4.7%	4.9%	5.2%	4.7%
Return on Equity	25.4%	14.0%	10.4%	12.0%	12.5%	14.0%	19.0%	22.0%	24.3%	24.4%
ROIC	18.6%	10.1%	7.0%	7.7%	8.1%	9.1%	11.3%	11.6%	11.9%	11.0%
Shares Out.	272	266	332	325	311	301	280	270	262	248
Revenue/Share	24.72	26.09	28.55	33.11	34.62	37.46	40.20	33.40	34.81	38.35
FCF/Share	2.81	0.92	2.02	2.28	3.46	4.83	5.19	6.37	8.03	2.11

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.