Aon Plc (AON)

Updated May 6th, 2019 by Josh Arnold

Key Metrics

Current Price:	$179	**5 Year CAGR Estimate:**	8.2%	**Volatility Percentile:**	14.2%
Fair Value Price:	$156	**5 Year Growth Estimate:**	10.0%	**Momentum Percentile:**	81.6%
% Fair Value:	115%	**5 Year Valuation Multiple Estimate:**	-2.8%	**Growth Percentile:**	91.2%
Dividend Yield:	1.0%	**5 Year Price Target**	$251	**Valuation Percentile:**	32.8%
Dividend Risk Score:	A	**Retirement Suitability Score:**	D	**Total Return Percentile:**	48.7%

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 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 $43 billion on the New York Stock Exchange, under the ticker AON. Aon should generate more than $11 billion in revenue this year.

Aon reported Q1 earnings on 4/26/19 and results were characteristically strong. Total revenue was up 2% to $3.1 billion thanks to a 4% headwind from currency translation that was more than offset by a 6% gain in organic revenue. Aon's revenues are derived from a variety of currencies, so currency translation is typically a significant item on the income statement. In Q1, however, organic revenue growth was robust enough to fully offset it and then some. All of the company's segments posted positive organic revenue growth with Reinsurance Solutions leading the way at +9%.

Operating expenses were down 1% year-over-year to $2.3 billion primarily due to a $93 million favorable impact from currency translation, $45 million of savings from restructuring and other operational improvements, organic revenue growth, and a small savings from divestitures.

Operating margins expanded 190bps on an adjusted basis to 33.7% of revenue in Q1. This was thanks to higher revenue and lower expenses and the operating leverage that combination brings.

A flat tax rate year-over-year helped Aon keep its higher operating earnings, and the company posted earnings-per-share of $3.31 on an adjusted basis, a gain of 11%. On a GAAP basis, earnings-per-share rose 15% to $2.70.

Following a strong showing in Q1 that was largely expected, we're reiterating our forecast for $9.15 in earnings-per-share for 2019. Aon raised its dividend for the most recent payment, and the annualized payout is now $1.76, an increase of 10% from the prior $1.60.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$2.19	$2.46	$2.86	$2.99	$3.53	$4.66	$4.88	$5.16	$6.52	$8.16	***$9.15***	***$14.74***
DPS	$0.60	$0.60	$0.60	$0.62	$0.68	$0.92	$1.15	$1.29	$1.41	$1.56	***$1.76***	***$3.00***
Shares	266	332	325	311	301	280	270	262	254	245	***242***	***230***

Between 2009 and 2018, Aon compounded its adjusted earnings-per-share at a rate of 14% 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 a full economic cycle.

Management continues to be bullish, and rightfully so, as Aon's businesses are posting very strong rates of growth across the board. We see expense savings as a driver of earnings growth along with the buyback, and organic revenue growth should continue to move the top line higher as well. Given the broad assortment of professional services the company offers as well as its global footprint, we are bullish on Aon's future.

The dividend should continue to rise at roughly the rate of earnings, and we have the payout at $3.00 in 2024, up from the current $1.76. Aon is not a high-yield stock by any means, but its dividend growth potential is prodigious.

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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	17.9	16.3	16.9	16.8	19.2	18.6	19.8	20.4	20.1	17.9	***19.6***	***17.0***
Avg. Yld.	1.5%	1.5%	1.2%	1.2%	1.0%	1.1%	1.2%	1.2%	1.1%	1.1%	***1.0%***	***1.2%***

Aon has traded at an average price-to-earnings ratio of 18.4 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 19.6 using our 2019 earnings-per-share estimate. Should the stock come back to 17 times earnings, this would cause a 2.8% headwind annually for total returns. In addition, we see the yield growing slightly quicker than the share price, rising to 1.2% from the current 1.0%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	27%	24%	21%	21%	19%	20%	24%	25%	22%	19%	***19%***	***20%***

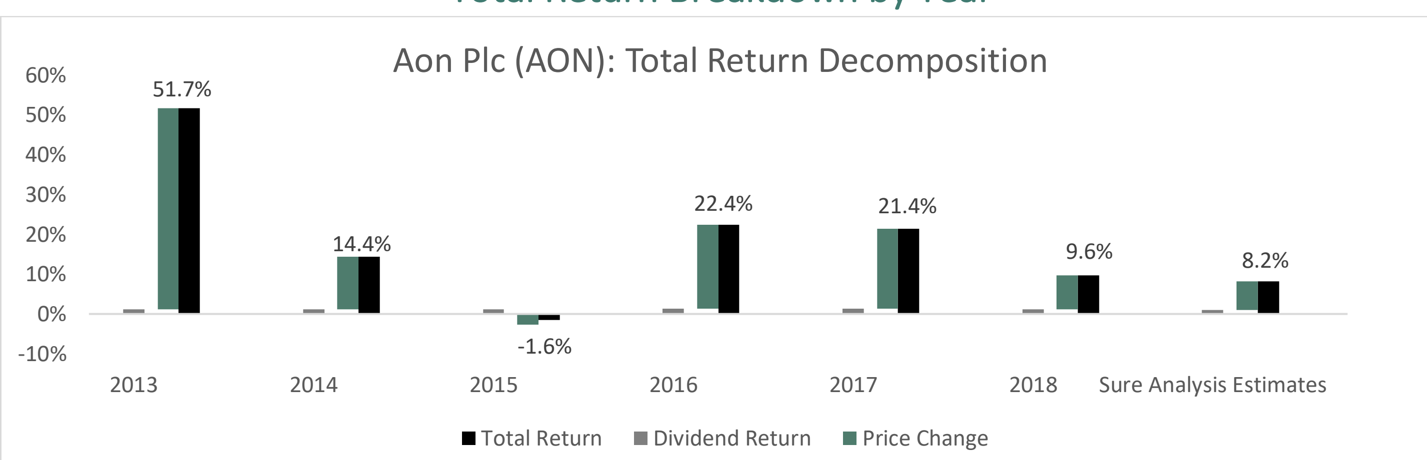
Aon's payout ratio is still very low, consistent with the company's historical practices, and we do not believe that will change. We see the dividend remaining around one-fifth of total earnings so the payout is extremely safe. However, this means Aon is highly unlikely to have a meaningful yield anytime soon.

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, along with its world-class client list and reputation.

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. The recent rally in the stock, however, has caused the valuation to move much higher. We are now forecasting 8.5% total annual returns, consisting of the 1% yield, 10% earnings-per-share growth, and a 2.8% headwind from the valuation. Given this, we are downgraded Aon to hold from buy as we see the fair value of the stock below the current price. Aon offers dividend growth potential but also a long runway for earnings-per-share growth. However, the current valuation has us more cautious on the stock than we have been in the past.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	7595	8512	11287	11514	11815	12045	9480	9409	9998	10770
SG&A Exp.	6574	7268	9691	9918	10144	10079	7556	7452	8128	8457
D&A Exp.	242	305	582	655	635	594	338	319	891	769
Operating Profit	1021	1244	1596	1596	1671	1966	1587	1638	979	1544
Operating Margin	13.4%	14.6%	14.1%	13.9%	14.1%	16.3%	16.7%	17.4%	9.8%	14.3%
Net Profit	747	706	979	993	1113	1397	1385	1396	1226	1134
Net Margin	9.8%	8.3%	8.7%	8.6%	9.4%	11.6%	14.6%	14.8%	12.3%	10.5%
Free Cash Flow	267	603	777	1150	1524	1556	1809	2170	551	1446
Income Tax	268	300	378	N/A	N/A	N/A	175	148	250	146

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	22958	28982	29552	30486	30251	29772	26883	26615	26088	26422
Cash & Equivalents	217	346	272	291	477	374	384	426	756	656
Acc. Receivable	N/A	N/A	3183	3101	2896	2815	2564	2106	2478	2760
Goodwill & Int.	6869	12258	12046	11918	11575	11380	10628	9300	10091	9320
Total Liabilities	17527	20676	21432	22681	22056	23141	20824	21083	21440	22203
Accounts Payable	N/A	N/A	1832	1853	1931	1805	1772	1604	1961	1943
Long-Term Debt	2008	4506	4492	4165	4389	5582	5700	6205	5966	6244
Total Equity	5379	8251	8078	7762	8145	6571	6002	5475	4583	4151
D/E Ratio	0.37	0.55	0.56	0.54	0.54	0.85	0.95	1.13	1.30	1.50

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	3.3%	2.7%	3.3%	3.3%	3.7%	4.7%	4.9%	5.2%	4.7%	4.3%
Return on Equity	14.0%	10.4%	12.0%	12.5%	14.0%	19.0%	22.0%	24.3%	24.4%	26.0%
ROIC	10.1%	7.0%	7.7%	8.1%	9.1%	11.3%	11.6%	11.9%	11.0%	10.8%
Shares Out.	266	332	325	311	301	280	270	262	254	245
Revenue/Share	26.09	28.55	33.11	34.62	37.46	40.20	33.40	34.81	38.35	43.60
FCF/Share	0.92	2.02	2.28	3.46	4.83	5.19	6.37	8.03	2.11	5.85

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