Aon Plc (AON)

Updated February 10th, 2020 by Josh Arnold

Key Metrics

Current Price:	$230	**5 Year CAGR Estimate:**	7.5%	**Market Cap:**	$53.9B
Fair Value Price:	$198	**5 Year Growth Estimate:**	10.0%	**Ex-Dividend Date:**	04/30/20[1]
% Fair Value:	116%	**5 Year Valuation Multiple Estimate:**	-3.0%	**Dividend Payment Date:**	05/15/20[2]
Dividend Yield:	0.8%	**5 Year Price Target**	$318	**Years Of Dividend Growth:**	8
Dividend Risk Score:	B	**Retirement Suitability Score:**	D	**Last Dividend Increase:**	10.0%

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 $54 billion on the New York Stock Exchange, under the ticker AON. Aon should generate more than $11 billion in revenue this year.

Aon reported Q4 and full-year earnings on January 31st and revenue and earnings both beat estimates. Adjusted earnings-per-share for the quarter came to $2.53, up from $2.16 in the year-ago period. Q4 organic revenue growth was up 7%, including growth of at least 5% in four of its five segments. Total revenue was up from $2.77 billion in Q4 of 2018 to $2.89 billion. Commercial Risk Solutions revenue rose 5%, Reinsurance Solutions revenue was up 15%, Retirement Solutions revenue declined -3%, Health Solutions revenue rose 5%, and Data & Analytics Services revenue increased 7%.

Adjusted operating margin was 27.9% of revenue, up from 25.8% in the year-ago period. Aon continues to benefit from significant operating leverage as the top line grows, but expenses increase less quickly.

For the year, total revenue was up 2%, but organic revenue grew 6%. Operating margin increased 19.7%, up 250bps as a percentage of revenue to 27.5%. Earnings-per-share increased 12% to $9.17 on an adjusted basis. Operating cash flow increased 9% to $1.8 billion and free cash flow was up 11% to $1.6 billion. The company expects to see $580 million of annualized cost savings in 2020.

Our initial estimate for 2020 earnings-per-share is $10.40 as we forecast yet another strong year of growth.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$2.46	$2.86	$2.99	$3.53	$4.66	$4.88	$5.16	$6.52	$8.16	$9.17	***$10.40***	***$16.75***
DPS	$0.60	$0.60	$0.62	$0.68	$0.92	$1.15	$1.29	$1.41	$1.56	$1.72	***$1.76***	***$3.10***
Shares[3]	332	325	311	301	280	270	262	254	245	237	***230***	***200***

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, for the most part. 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. We note forex translation has been a sizable headwind in the past, but Aon has thus far been able to overcome that, and then some.

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[1] Estimated date
[2] Estimated date
[3] Share count in millions

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The dividend should continue to rise at roughly the rate of earnings, and we have the payout at $3.10 in 2025, up from the current $1.76. Aon is not a high-yield stock by any means, but its dividend growth potential is prodigious.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	16.3	16.9	16.8	19.2	18.6	19.8	20.4	20.1	17.9	17.7	***22.1***	***19.0***
Avg. Yld.	1.5%	1.2%	1.2%	1.0%	1.1%	1.2%	1.2%	1.1%	1.1%	0.9%	***0.8%***	***1.0%***

Aon has traded at an average price-to-earnings ratio of 18.4 over the last decade. We believe that fair value for Aon lies somewhere around 19 times earnings. The company is trading for a price-to-earnings ratio of 22.1 using our 2020 earnings-per-share estimate. Should the stock come back to 19 times earnings, this would cause a ~3% headwind annually for total returns. In addition, we see the yield growing slightly quicker than the share price, rising to 1% from the current 0.8%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	24%	21%	21%	19%	20%	24%	25%	22%	19%	19%	***17%***	***19%***

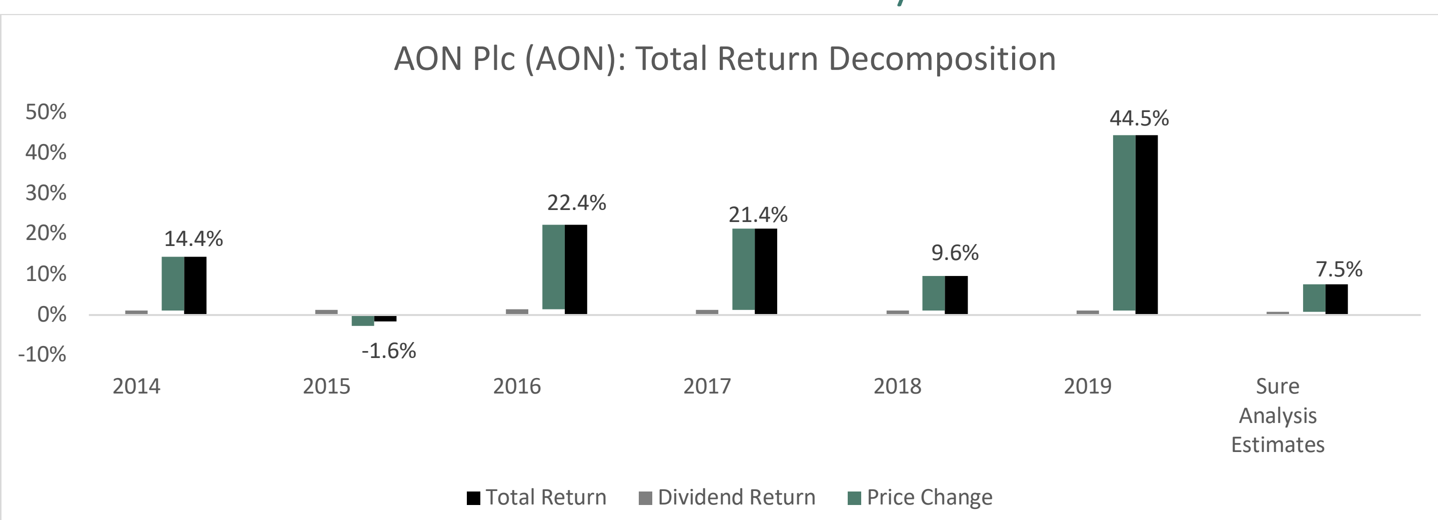
Aon's payout ratio is still very low, consistent with the company's historical practices, and we do not believe that will change. We see the dividend remaining around one-fifth of total earnings, so the payout is extremely safe. However, this means Aon is highly unlikely to have a meaningful yield anytime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

Aon was resilient during the Great Recession and we expect that will be the case again; 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. We are forecasting 7.5% total annual returns, consisting of the 0.8% yield, 10% earnings-per-share growth, and a modest headwind from the valuation. We are thus reiterating Aon as a hold. 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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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	8512	11287	11514	11815	12045	9480	9409	9998	10770	11013
SG&A Exp.	2,171	3,124	3,209	3,199	3,065	1,951	1,765	2,039	2,354	2,226
D&A Exp.	305	582	655	635	594	338	319	891	769	564
Operating Profit	1,244	1,596	1,596	1,671	1,966	1,587	1,811	1,065	1,544	2,169
Operating Margin	14.6%	14.1%	13.9%	14.1%	16.3%	16.7%	19.2%	10.7%	14.3%	19.7%
Net Profit	706	979	993	1,113	1,397	1,385	1,396	1,226	1,134	1,532
Net Margin	8.3%	8.7%	8.6%	9.4%	11.6%	14.6%	14.8%	12.3%	10.5%	13.9%
Free Cash Flow	603	777	1,150	1,524	1,556	1,809	2,170	551	1,446	1,610
Income Tax	300	378	360	390	334	175	148	250	146	297

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	28,982	29,552	30,486	30,251	29,772	26,883	26,615	26,088	26,422	29,405
Cash & Equivalents	346	272	291	477	374	384	426	756	656	790
Acc. Receivable		3,183	3,101	2,896	2,815	2,564	2,106	2,478	2,760	3,112
Goodwill & Int.	12,258	12,046	11,918	11,575	11,380	10,628	9,300	10,091	9,320	8,948
Total Liabilities	20,676	21,432	22,681	22,056	23,141	20,824	21,083	21,440	22,203	25,956
Accounts Payable		1,832	1,853	1,931	1,805	1,772	1,604	1,961	1,943	1,939
Long-Term Debt	4,506	4,492	4,165	4,389	5,582	5,700	6,205	5,966	6,244	7,339
Total Equity	8,251	8,078	7,762	8,145	6,571	6,002	5,475	4,583	4,151	3,375
D/E Ratio	0.55	0.56	0.54	0.54	0.85	0.95	1.13	1.30	1.50	2.17

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	2.7%	3.3%	3.3%	3.7%	4.7%	4.9%	5.2%	4.7%	4.3%	5.5%
Return on Equity	10.4%	12.0%	12.5%	14.0%	19.0%	22.0%	24.3%	24.4%	26.0%	40.7%
ROIC	7.0%	7.7%	8.1%	9.1%	11.3%	11.6%	11.9%	11.0%	10.8%	14.4%
Shares Out.	332	325	311	301	280	270	262	254	245	237
Revenue/Share	28.55	33.11	34.62	37.46	40.20	33.40	34.81	38.35	43.60	45.77
FCF/Share	2.02	2.28	3.46	4.83	5.19	6.37	8.03	2.11	5.85	6.69

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