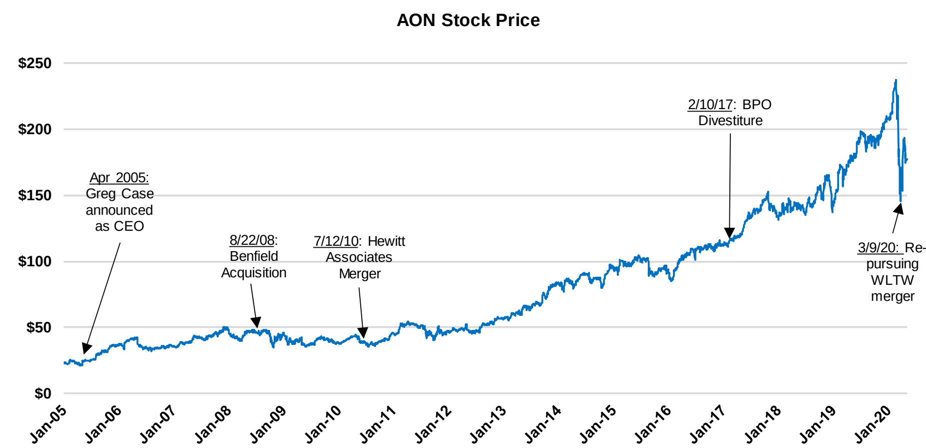
Aon PLC (NYSE: AON) Freda Zhuo
Recommendation: LONG with $297 PT (67% upside; 75% TR)

AON	5/5/2020
Price	$177.68
Shares Outstanding	231.1
Market Cap	**$41,059**
+ Total Debt	9,295.0
- Cash	647.1
Enterprise Value	**$49,707**
52-wk high	$238.19
52-wk low	$143.93
Avg Daily Volume	0.19
Float (%)	99%
Short Interest	4%
5-yr Beta	0.84
Dividend Yield	1.0%
S&P Issuer Rating	A-
Shares for WLTW	140.4
PF Net Debt	$11,279
PF Enterprise Value	**$77,284**

Stock Price Summary Chart



Executive Summary

With market uncertainty surrounding COVID-19, recent drawdowns in insurance broker Aon ("AON", -25% since peak on 2/19) have created an opportunity for the 5x5x5 Fund to own a high-quality, capital-light, defensive business at reasonable valuations. AON's insurance brokerage model is best-in-class and is characterized by sticky recurring revenues (85% of mix, as insurance, risk, and retirement are considered nondiscretionary expenses for larger clients) and high cash flow, and the industry structure (Top 2 with fragmented tail end) enables ample room for top players to reinvest at higher rates of return. The base case price target of **$297** represents 67% upside with bull/bear return of 147%/-27% a highly favorable skew.

Why this opportunity exists: The market is understandably skeptical about AON's $30bn proposed merger with Willis Towers Watson ("WLTW", announced March 9), execution risk concerns are focused on near-term impact to earnings and undervalues the combination's stronger global platform potential and enhanced economies of scale to compete even more effectively longer-term. In addition, 1Q earnings has somewhat alleviated concerns on COVID-19 impact with AON reducing expenses to limit hit to EPS, but fundamentals still have reduced near-term visibility on commercial spend.

Investment Thesis:
1. AON/WLTW creates a powerful platform that should expand AON's competitive advantages
2. Sustainable organic growth with multiple incremental market/cross-selling opportunities
3. High-quality business model led by strong management team = continued ROIC expansion

Business Description

AON is currently the 2nd-largest insurance broker that provides services along three primary verticals – Risk (~60% of sales, comprised of 42% Commercial Risk and 15% Reinsurance), Retirement (16% of sales), and Health (15% of sales). Additional Data & Analytics revenue act as "add-on"-type services (~10% of sales). Since its 1979 IPO, AON has only had two CEOs, with founder Patrick Ryan pursuing growth through acquisitions and consolidation, and current CEO Greg Case (2005-present) prioritizing moving into higher-growth and higher-margin businesses.

Relevant Industry Dynamics

An insurance broker acts as an intermediary for employers and insurance carriers, and in many ways acts as a risk management consultant to help employers understand their underlying commercial risk profile and needs to find a level of coverage with an insurance carrier that best services their needs. For this service, insurance brokers typically earn a commission on the dollar amount of premiums placed, fees for service (more common for larger employer clients), and "earn-outs" from the carriers (contingent commissions). But this "intermediary" definition obscures critical aspects that makes the insurance brokerage industry special:

- **Recurring revenue and sticky relationships:** The typical commission-based contract is structured as an annual commission as a % of the premiums placed (for example, 10-20% of the premium placed in Y1, then 10% annually as long as the policy is renewed). A typical policy renewal cycle is 3 years, but retention is high (>90%; ~95% for AON) due to brokers' focus on longer-term relationships and, once business is entrenched (across multiple business lines), high switching/search costs for the client.

- **Consolidation → emerging "duopoly":** Barriers to entry are not high for a small broker (who may offer basic services to local businesses and may just need a few agents) but barriers to scale are high as larger client organizations require broad geographic coverage and more complex expertise across a wider variety of services. M&A has been high in the industry (including among PE investors given high & stable cash flow), and the industry structure is emerging as a duopoly with PF AON/WLTW and Marsh & McLennan ("MMC") #1 and #2 respectively, with PE-backed platforms more focused on small/mid-size businesses and finally, the tail end of 30,000 independents in the U.S.

- **Relative bargaining power makes brokers hard to disintermediate:** P&C insurance carriers are much more fragmented than the insurance brokers, and the carriers are the ones who bear the pricing cycle and underwriting risk. Brokers enable the carriers to staff less to handle customer touchpoints, and getting on a broker's "product list" for customers to choose between means that brokers are a key distribution channel for new markets/customer acquisition that carriers cannot disenfranchise.

Investment Thesis

1. AON/WLTW creates a powerful platform that should retain its competitive advantages

On March 9, AON announced an agreement to combine with WLTW in an all-stock transaction valuing WLTW at $30bn, with WLTW shareholders receiving 1.08 AON shares per WLTW share, with the pricing representing a 16% premium to WLTW's share price on March 6. 2019PF metrics for AON would be $20bn of revenue, $4.9bn of EBIT, $2.4bn of free cash flow, and an EPS base of ~$9.50. As an all-stock deal, Aon will not be incurring additional debt. Given the size and complexity of the proposed integration, sell-side and investor sentiment are focused on nearer-term issues (deal passage, revenue dis-synergies, and slower organic growth from lost new business during integration), providing an opportunity for longer-term holders to reap the rewards of a larger platform with enhanced economies of scale.

VAR calls suggest the targeted $800mn of cost synergies should be "easy" to realize for a management well-versed in executing on transactions, and that the combination positions Aon well for how they want to innovate and succeed in a digital environment going forward. Former employees have also noted that WLTW had at times been more aggressive in terms of pricing and poaching business while MMC had been more rational, indicating that AON is taking a "major competitor out of the action". Finally, a net negative market view on dis-synergies and potential divestitures (none have yet announced) obscures optionality on streamlining to the core business and potential for incremental proceeds to invest in growth initiatives. From a strategic perspective, beyond strengthening the Risk business the merger should give Aon greater scale (~$6.7bn core PF Health/Retirement revenue) to compete much more effectively against MMC's Mercer consulting business ($4.7bn revenue), bridging an important gap in comparative capabilities.

2. Sustainable growth with multiple incremental market/cross-selling opportunities

Broader perceptions of insurance brokerage as a slow-growth sector (i.e., in-line with GDP) are not entirely accurate, particularly as larger organizations face an increasing complexity of risks beyond P&C to insure against. AON has been proactive at focusing on growing share-of-wallet as well as finding incremental, higher-growth market opportunities. The success of this is seen through the increasing divergence between AON's organic revenue growth (from flat-2% in 2007-2011 to a 5-6% rate in 2018-2019) and that of broader U.S. GDP growth (~400bps outperformance by 2019). Importantly, sell-side and investor sentiment has yet to give full credit for the durability of this growth amidst skepticism that AON can fundamentally outperform/win clients as strategic focus turns to integrating WLTW, much as what occurred with MMC as it integrated Jardine Lloyd Thompson ("JLT") in 2019. Indeed, while baseline industry growth is in the low-to-mid single digits, this view does not integrate AON's competitive advantages at driving above-market rates of growth and in a way that should be sustainable.

Aon's "Aon United" one-segment operating model (implemented in 2017) creates a holistic and integrated Aon team across business lines to serve each customer. This has a few important purposes: 1) it mitigates key-man risk if an account manager were to leave, as each customer is served by multiple people; 2) it aligns the team to focus on "share-of-wallet" by creating a more seamless client experience that helps with winning, retaining, and cross-selling more business; and 3) it can eliminate duplicative functions by leveraging regional service centers and operational platforms across products, vs. competitors WLTW, MMC, and AJG who are more siloed by business lines.

Aon has also been investing in incremental, higher-growth market opportunities both organically and via tuck-in acquisitions. Organically, Aon's New Ventures Group enables the company to scale innovation faster through the operating model, while it has been investing heavily in internal data and analytics capabilities to improve its risk modeling and increase add-on services to clients (~$400mn spend annually). Multiple tuck-in acquisitions in adjacent higher-growth categories have also accelerated the expansion of Aon's TAM by over $50bn in its core Risk business. This willingness to invest in technology and innovation should serve to improve the company's overall growth profile and mitigate technological disruption risk. A simplified analysis assuming AON reaches its current market share in these new markets and valuing the potential at 15X P/E and 15% margins (for conservatism), equates to incremental value of $48/share, or 27% lift vs. current price.

3. High quality business model led by strong management team = continued ROIC expansion

In addition to favorable industry structure, recurring revenue, and growth opportunities, AON is not capital-intensive (capex is 2% of sales), is not overly levered (2.0X Net Debt/EBITDA as of YE2019), and has strong FCF conversion overall (103% 15-year average, or 123% excluding restructuring charges). This, alongside a strong management team, indicates plenty of capacity to productively reinvest.

- **Portfolio optimization:** The current management team led by CEO Greg Case has developed an outstanding track record of optimizing the portfolio mix over the past decade (~80 acquisitions/~80 divestitures) that have focused on changing the overall growth profile of the firm. After performance had lagged in the early 2000's and an Elliot Spitzer-led antitrust settlement was reached in March 2005, AON tapped a "low-profile outsider" (re: *NYTimes*) as CEO, Mr. Case, who had been the head of financial services at McKinsey. Capabilities that have been augmented over the past 15 years include that of reinsurance (a more entrenched duopoly with MMC's Guy Carpenter, from the acquisition of Benfield in 2008), HR consulting solutions (from the merger with Hewitt Associates in 2010), and data/IP (through tuck-in acquisitions). The company has also worked to divest non-core businesses like benefits process outsourcing (BPO, via a divestiture to Blackstone in 2017). Importantly, this slate of transactions has not been a case of mere empire-building, as demonstrated by strong shareholder value creation (+689% vs. S&P +142% and peer avg. +165% since 4/1/2005).

- **High returns on incremental capital:** Operating margins have expanded by 1300bps since 2005 to ~27%, while the capital allocation policy remains disciplined, as management has worked hard to establish a view throughout the organization that incremental investment (M&A, capex) must yield a higher expected return than the return it expects from buybacks. ROIC has expanded significantly in tandem from 6.9% in 2005 to 20% in 2019, as capital has been reinvested into opportunities with higher rates of return. As this management team leverages its strong track record and integrates WLTW, drives further operational improvement, and invests in share-of-wallet activities, I believe continued ROIC expansion is not only credible but likely, with base case 2025E ROIC reaching 22.5% and bull case ROIC reaching 26.0%.

Valuation and Return Profile

The target valuation for PF AON is $297, which represents 67% upside and 75% total return inclusive of dividends over a 5-year holding period. Key assumptions for the base case include a +3.6% revenue CAGR (inclusive of COVID-19; 5% organic growth run-rate) and PF operating margins of 30.2% as AON realizes cost synergies and continues operational improvement initiatives; note that I do not view the base case assumptions as overly aggressive in the context of the investment thesis.

The methodology chosen was EV/EBITDA because that valuation metric has correlated most closely to the growth seen in AON's ROIC over the past 15 years, with an R^2 of 85%, vs. correlations with P/E (R^2 of 49%) and P/FCF (R^2 of 4%). The other reason is due to the high levels of PE activity in the insurance brokerage sector, in which EV/EBITDA multiples are often used. The high demand for insurance brokerage assets in the PE industry (such that most major PE firms have a core broker asset to pursue a roll-up strategy) helps provide a backstop for AON's valuation. Note that AON can sell assets to PE buyers, as it did with its BPO platform to Blackstone in 2017. PE transaction multiples have increased in recent years – albeit pre-COVID – from 12X EV/EBITDA to 14-15X for larger platforms (though even then these assets are only ~5-10% the size of PF AON), while bolt-on acquisition multiples have increased from 7-8X to 9-10X. In this context, I use a multiple range from 10X-14X for the bear, base, and bull scenarios.

What makes valuation even more compelling are a few factors: (1) Favorable risk-reward, with a bear case downside of -27% and bull case upside of +147% based on revenue growth CAGRs from -1% to +6% and PF operating margins of 22.7%-32.7%; (2) The market appears not to be embedding any growth/giving much credit for adjustments related to the business' intangible amortization for trade names/contracts given a standalone AON earnings power valuation of $201/share (13% upside); and (3) AON/WLTW deal termination would be perceived as a positive given higher market risk reversion and removal of execution risk overhang.

Risks

- **Technological disruption and disintermediation:** Though brokers have historically been difficult to disintermediate, some industry participants view the space as "ripe for disruption" (U.S. insurtech startups raised >$2.5bn of VC funding in 2018). However, startups have thus far had difficulty gaining significant traction, and AON has both the capital (the company's PF FCF is >$2.4bn alone) and has invested in internal (~400mn/annually) and via tuck-ins to keep abreast of disruptive technologies.

- **Execution risk from WLTW merger:** Concerns relate to timing with COVID-19, revenue dis-synergies from overlapping client bases, and drag on organic growth (citing MMC's $5.6bn integration of JLT in 2019). In addition to the reasons listed earlier in the write-up as to why the integration is likely to be successful, both the AON CEO/CFO have extended their employment agreements to at least April 2023, mitigating leadership turnover risk past Y1, providing a runway to focus on implementation.

- **More protracted impact from COVID-19:** While a more defensive business, there will be revenue impact from COVID-19 (ex. carriers implementing premium holidays, a reduction in contingent commissions, fewer new sales). However, AON has stated that retention remains high and its business skews to larger companies that should have better liquidity situations. In addition, prior cycles suggest muted impact (2009 organic revenue was only -1%).

Appendix

AON PF business is stronger across Risk, Reinsurance, and Health, even assuming dis-synergies/divestiture

AON Segment	Detail	AON (2019)	WLTW (2019)	PF, No Divest	% Mix	Potential Divestiture	Net PF (Illustrative)	% Mix	Notes
Commercial Risk	Retail Brokerage, Risk Consulting, Cyber Risk, Captive Solutions	4,673	3,325	7,998	**40%**		**7,998**	**42%**	*complementary to AON's core business*
Reinsurance	Underwriting/Capital Objectives, Treaty, Facultative, Capital Markets	1,686	1,285	2,971	**15%**	(33)	**2,939**	**16%**	
Retirement	Retirement/Pension, Human Capital, Investments	1,817	2,074	3,891	**19%**	(602)	**3,289**	**17%**	*AON can better compete vs. MMC's Mercer ($4.7bn revenue)*
Health	Health & Benefits Strategy, Compliance Requirements, Healthcare	1,667	2,356	4,023	**20%**	(531)	**3,491**	**18%**	
Data & Analytics	Affinity, InPoint, ReView products	1,170		1,170	**6%**		**1,170**	**6%**	
		11,013	**9,039**	**20,052**	**100%**	**(1,166)**	**18,886**	**100%**	

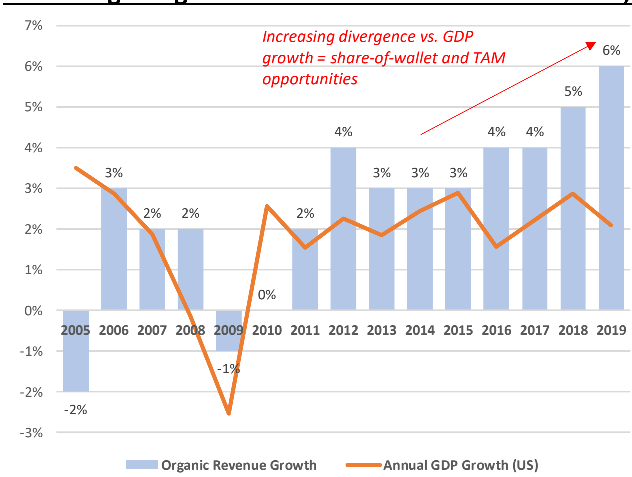
Source: Company data. WLTW 2019 segment estimates are based on a reallocation of their existing business segments; identified WLTW's DC/DB Pension Administration and Benefits Outsourcing businesses as having potential to divest.

PF Snapshot with AON/WLTW (2019 Base)

	AON	WLTW	Adj.	2019 PF	2019 PF Post Synergy	Potential Divestiture	2019 PF LT Run-Rate	Notes
Revenue	11,013	9,039	-	20,052	20,052	(1,166)	18,886	*Market concern on dissynergies*
								**MSD+ organic growth target*
EBITDA	3,138	2,547	-	5,685	6,485	(329)	6,156	
EBITDA Margin	*28.5%*	*28.2%*		*28.4%*	*32.3%*		*32.6%*	**$800mn 3-yr cost synergy target*
EBIT	3,025	1,831	-	4,856	5,656	(236)	5,420	**does not include Y1-Y3 integration*
EBIT Margin	*27.5%*	*20.3%*		*24.2%*	*28.2%*		*28.7%*	*costs $1.4bn ($280mn in opex)*
Net Income	2,208	1,427		3,641	4,293		4,100	
Shares Outstanding	241	130	140	381	381		381	
EPS	**$9.18**			**$9.56**	**$11.27**		**$10.76**	*LT: "High-Teens" Accretive*
EPS Lift/("Accretion")				**4%**	**23%**		**17%**	
FCF	**1,610**	**776**		**2,386**	**2,813**		**2,687**	*LT: 10%+ Accretive*
Net Debt/EBITDA	2.1X	1.9X		2.0X	1.7X		1.8X	
P/E at current AON price	*19.4X*			*18.6X*	*15.8X*		*16.5X*	
EV/EBITDA at current TEV/PF TEV	*15.8X*			*13.6X*	*11.9X*		*12.6X*	
FCF yield at current MC/PF MC	*3.9%*			*3.6%*	*4.3%*		*4.1%*	

Source: Company data.

AON's organic growth of +MSD should be sustainable, buoyed by higher-growth TAM opportunities



Risk TAM Analysis		**Growth**
Core Market: Commercial Risk (~65% of AON business)	***$bn***	
U.S. Net Commercial P&C Premiums Written	304.0	**3-5%**
U.S. Net Reinsurance Premiums Written	102.0	**3-5%**
Total Relevant Premiums Written	406.0	
AON Risk Premiums Placed Annually	125.0	**5%+**
Assumed US Mix (as % of $ placed)	*60%*	
Estimated AON share	**18%**	
Selected Incremental Market Opportunities		
Cyber Risk Premium Market (Cytelligence)	6.0	**>10%**
IP/Patent Insurance Market (601West)	10.0	**5%+**
Marketing Spend Insurance Carriers (Tranzact)	8.0	**5%+**
Digital Insurance Platform, US estimate (CoverWallet)	30.5	**>10%**
Lift to U.S. Risk TAM (conservative estimate)	**13%**	

Estimated Value/Share	
Revenue potential (at current AON share)	10.1
EBIT potential (assume 15% margins)	1.5
EPS Lift (on PF AON shares)	**$3.23**
Value per Share	**$48**

Valuation of New TAM Opportunities

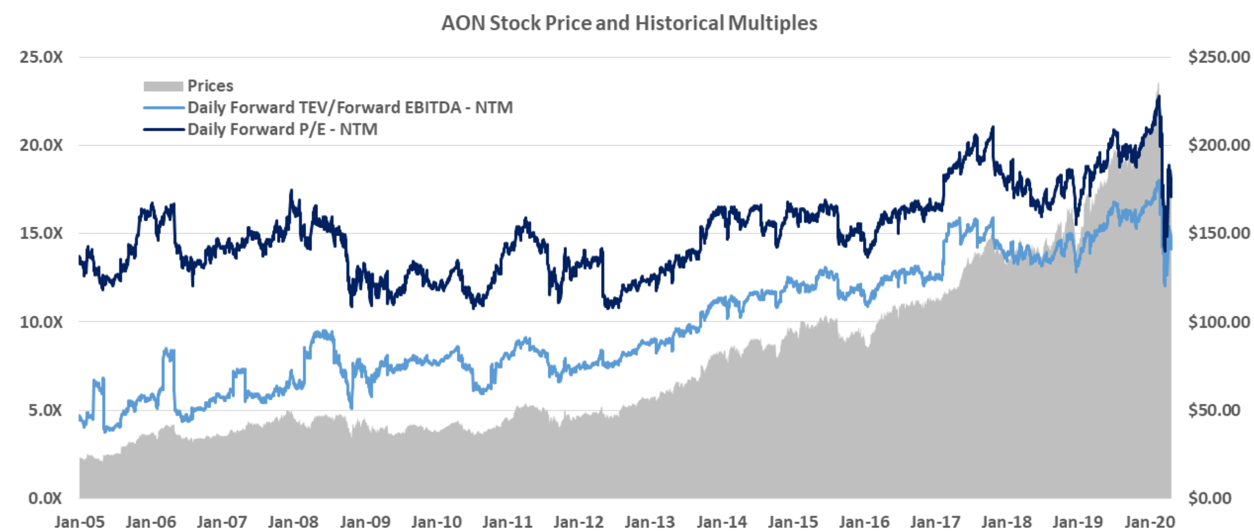
	Multiple						
Market Share	12.0X	13.0X	14.0X	15.0X	16.0X	17.0X	18.0X
5%	$10	$11	$12	$13	$14	$15	$16
10%	$21	$23	$24	$26	$28	$30	$31
18%	$39	$42	$45	**$48**	$52	$55	$58
20%	$42	$45	$49	$52	$56	$59	$63
25%	$52	$57	$61	$66	$70	$74	$79

Lift to Current AON Share Price

	Multiple						
Market Share	12.0X	13.0X	14.0X	15.0X	16.0X	17.0X	18.0X
5%	6%	6%	7%	7%	8%	8%	9%
10%	12%	13%	14%	15%	16%	17%	18%
18%	22%	24%	25%	**27%**	29%	31%	33%
20%	24%	26%	28%	29%	31%	33%	35%
25%	29%	32%	34%	37%	39%	42%	44%

Source: World Bank, NAIC, Allied Market Research, InsuranceERM, IA Magazine, Company Data. Valuation analysis assumes 18% AON share, 15% EBIT margins, 18.5% tax rate, 15X P/E multiple, and 381mn PF share count for WLTW merger.

Valuation Cases – Bear, Base, Bull, and Earnings Power Summary



Combined AON/WLTW - EV/EBITDA

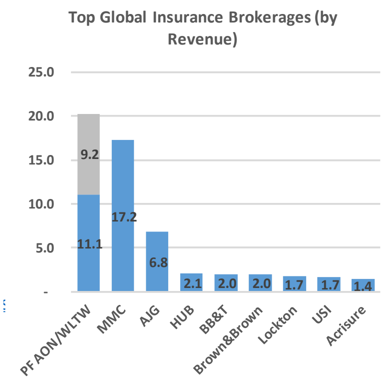
2025E	Bear	Base	Bull
Revenue	19,049	24,853	28,405
Revenue CAGR	***-0.9%***	***3.6%***	***6.0%***
EBITDA	5,669	9,121	10,639
EBITDA % Margin	***29.8%***	***36.7%***	***37.5%***
Target Multiple	**10.0X**	**12.0X**	**14.0X**
Enterprise Value	**56,694**	**109,450**	**148,939**
Total Debt (YE24)	12,956	12,956	12,956
Cumulative Chg. In Cash (YE24)	347	364	2,603
Cash & Cash EQ (YE24)	2,024	2,041	4,280
Equity Value (YE24)	45,762	98,535	140,264
Shares Outstanding (YE24)	352	331	320
Share Value (YE24)	**$130**	**$297**	**$439**
Current Price	$178	$178	$178
Upside	**-27%**	**67%**	**147%**
IRR	**-7%**	**12%**	**22%**
Cumul. Dividend/Share (YE24)	**$14**	**$14**	**$15**
Total Return	**-19%**	**75%**	**155%**
2025 EPS	$8.52	$17.35	$23.19
Implied P/E Multiple	**15.2X**	**17.1X**	**18.9X**
2025 FCF	2,052	4,758	6,299
Implied FCF yield	4%	5%	4%
Run-rate ROIC	13.0%	22.5%	26.0%

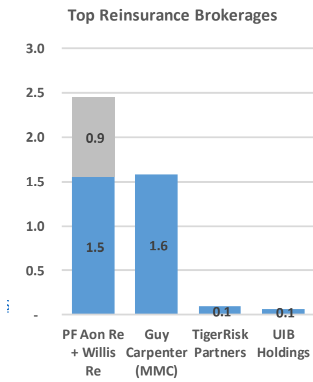
Earnings Power Valuation

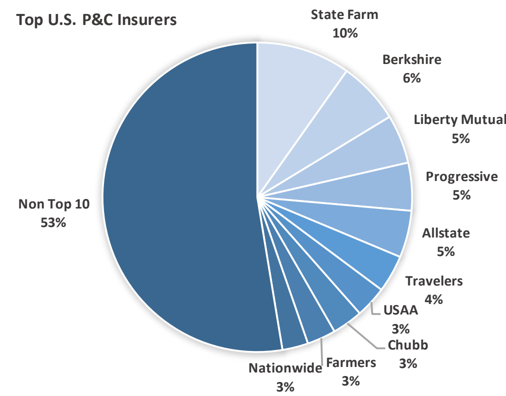
	2019 Standalone	2019PF - Core
Revenue	11,013	18,886
EBIT - adj. for amortization	3,025	5,188
Amortization	*(392)*	*(881)*
EBIT % Margin	***27%***	***27%***
Avg. Tax Rate	17.5%	18.5%
NOPAT	**2,495**	**4,228**
	2171	3510
WACC	**4.7%**	**4.6%**
Cost of Debt	4.1%	4.1%
Cost of Equity	4.9%	4.9%
MV Debt	7,339	12,956
MV Equity	41,559	66,506
% Debt	15%	16%
% Equity	85%	84%
Enterprise Value	53,629	91,293
Net Debt	6,549	11,279
Equity Value	47,080	80,014
Shares Outstanding	234	374
(1) Core EPV	**$201**	**$214**
Upside	13%	20%
(2) Core EPV (full amortization)	**$172**	**$172**
Upside/Downside	-3%	-3%
(3) New Market TAM EPV	**$48**	**$48**
(1) + (3) Total EPV	**$250**	**$262**
Upside	**41%**	**48%**

Source: S&P Capital IQ.

Comparison of PF Industry Structure – Insurance Brokers and Reinsurance Brokers vs. P&C Insurers







Source: Business Insurance 2018 World Rankings. Publicly-traded brokers = 2019 Revenue.

Management track record of compounding value, and capital allocation focus on ROIC

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
NOPAT	624	670	692	863	1,039	1,186	1,555	1,584	1,675	1,908	1,919	2,012	1,988	2,276	2,495
Invested Capital	7,429	7,503	8,366	7,392	7,439	12,812	12,612	11,970	12,584	12,213	11,759	11,737	10,614	10,463	10,788
ROIC (AON definition)	8.5%	9.0%	8.7%	11.0%	14.0%	11.7%	12.2%	12.9%	13.6%	15.4%	16.0%	17.1%	17.8%	21.6%	23.5%
ROIC (FZ)	6.9%	7.4%	7.9%	9.2%	9.8%	8.3%	11.7%	12.6%	12.3%	15.6%	16.3%	17.1%	13.6%	17.7%	20.0%
P/E	13.6X	14.5X	14.8X	14.6X	12.2X	12.3X	13.9X	12.3X	14.0X	15.8X	15.7X	15.9X	18.9X	17.4X	19.3X
EV/EBITDA	5.0X	5.7X	6.2X	7.8X	7.5X	7.4X	8.0X	8.0X	9.7X	11.4X	12.1X	12.4X	14.7X	13.9X	15.6X
P/FCF	15.1X	13.4X	12.7X	14.2X	29.2X	25.2X	19.5X	15.4X	16.6X	17.4X	14.3X	13.5X	60.8X	24.2X	30.3X
Organic Revenue Growth	-2%	3%	2%	2%	-1%	0%	2%	4%	3%	3%	3%	4%	4%	5%	6%
Annual GDP Growth (US)	4%	3%	2%	0%	-3%	3%	2%	2%	2%	2%	3%	2%	2%	3%	2%
Operating Margin		14%	16%	17%	20%	20%	19%	19%	19%	20%	20%	21%	23%	25%	27%

		15-yr	10-yr	5-yr	3-yr
(1)	Cumulative Earnings	16,389	11,861	6,673	3,892
(2)	Incremental Capital Invested	3,359	(2,024)	(971)	174
(3)	Cumulative Dividend	3,782	2,888	1,824	1,156
(4)	Cumulative Buyback	18,219	14,191	8,636	5,829
(1)/(2)	Reinvestment Rate	20%	-17%	-15%	4%
ΔEBIT/ΔIC	ROIIC	64%	-67%	-71%	396%
(Re)*(ROIIC)	**Value Compounding Rate**	**13%**	**11%**	**10%**	**18%**
	Share Price Compounding Rate	**16%**	**18%**	**17%**	**23%**

Source: Company filings, S&P Cap IQ. Note: Figures on invested capital impacted by divestitures. Incremental Capital Invested is on a net basis.

"And then everything we do on capital, everything we do on capital starts with return on invested capital and cash-on-cash return. So it goes into an entire pool. By the way, it's taken us a decade to sort of get to this place, maybe a little more than that, to get our country leaders, everyone [to] understand this philosophy."

– CEO Greg Case, Credit Suisse Conference, Feb 2020

Management Incentives appear largely aligned; total NEO compensation is 1.5% of EBIT/2.1% of NI

2019 Proxy (on FY18 Results): Comments on Compensation/Incentives

(+) High proportion of performance-based pay for CEO (90% of mix) and NEOs (81% of mix)
(+) Largely appropriate peer group (AJG, MMC, WLTW all included; + business services firms)
(+) Lower turnover risk: Extension of CEO/CFO employment term agreements through April 2023

(=) Annual Incentives - Minimum Threshold determined by Adjusted OI, with qualitative determination based on **(1) organic revenue growth, (2) adjusted OPMs; (3) adjusted EPS; (4) FCF**
65% in cash, 35% in RSUs (3-yr)
(=) PSUs: Leadership Performance Plan (13th iteration) is based on 3-year performance on **cumulative adjusted EPS** (measured against 3-year publicly reported adjusted cumulative EPS growth rate)

(-) Compensation Committee does not use transparent formula/benchmark, but uses "judgment and experience"
Source: 2019 Proxy.

Additional Sources

Company – Managing Director (former), Aon
Company – Division COO (former), Aon
Company – Division CFO (former), Aon
Industry – Consultant at CEO Advisory Firm, Insurance
Industry – Managing Director at Consultancy, Insurance Deal Advisory

Model – Base Case

Income Statement	2017	2018	AON 2019	WLTW 2019	Adj.	AON 2019 PF	2020PF	2021PF	2022PF	2023PF	2024PF	2025PF
Total Revenue	**9,985**	**10,770**	**11,013**	**9,039**		**20,052**	**19,851**	**20,447**	**21,469**	**22,543**	**23,670**	**24,853**
% y/y		*7.9%*	*2.3%*				*-1.0%*	*3.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*
Compensation	(6,007)	(6,103)	(6,054)	(5,249)		(11,303)	(10,512)	(11,037)	(11,479)	(11,938)	(12,416)	(12,912)
% y/y	*-13.1%*	*1.6%*	*-0.8%*				*-7.0%*	*5.0%*	*4.0%*	*4.0%*	*4.0%*	*4.0%*
% of sales	*60.2%*	*56.7%*	*55.0%*	*58.1%*		*56.4%*	*53.0%*	*54.0%*	*53.5%*	*53.0%*	*52.5%*	*52.0%*
IT (Infrastructure)	(419)	(484)	(494)	(452)		(946)	(955)	(984)	(1,033)	(1,085)	(1,139)	(1,196)
% y/y		*15.5%*	*2.1%*				*1.0%*	*3.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*
% of sales	*4.2%*	*4.5%*	*4.5%*	*5.0%*		*4.7%*	*4.8%*	*4.8%*	*4.8%*	*4.8%*	*4.8%*	*4.8%*
Depreciation	(187)	(176)	(172)	(240)		(412)	(415)	(427)	(449)	(471)	(495)	(520)
% y/y	*-19.4%*	*-5.9%*	*-2.3%*				*0.7%*	*3.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*
Amortization	(704)	(593)	(392)	(489)		(881)	(884)	(911)	(956)	(1,004)	(1,054)	(1,107)
% y/y	*154.2%*	*-15.8%*	*-33.9%*				*0.4%*	*3.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*
Other	(1,620)	(1,870)	(1,732)	(1,280)		(3,012)	(3,072)	(3,365)	(3,157)	(2,525)	(2,626)	(2,731)
% y/y	*-29.5%*	*15.4%*	*-7.4%*				*2.0%*	*9.5%*	*-6.2%*	*-20.0%*	*4.0%*	*4.0%*
Operating Expenses	**(8,937)**	**(9,226)**	**(8,844)**	**(7,710)**		**(16,554)**	**(15,839)**	**(16,725)**	**(17,075)**	**(17,024)**	**(17,730)**	**(18,466)**
Operating Income	**1,048**	**1,544**	**2,169**	**1,329**		**3,498**	**4,013**	**3,722**	**4,395**	**5,519**	**5,940**	**6,387**
Restructuring	497	485	451	13		464	-	560	392	168		
Other	28	75	13			13						
EBIT, adj - AON def.	**2,277**	**2,697**	**3,025**	**1,831**		**4,856**	**4,897**	**5,193**	**5,743**	**6,691**	**6,994**	**7,494**
% EBIT Margin	*22.8%*	*25.0%*	*27.5%*	*20.3%*		*24.2%*	*24.7%*	*25.4%*	*26.8%*	*29.7%*	*29.5%*	*30.2%*
Net Interest	(255)	(273)	(299)	(234)		(533)	(534)	(546)	(559)	(572)	(585)	(598)
Other	3	12	1	229		230	-	-	-	-	-	-
Pre-Tax Income (AON)	**2,025**	**2,436**	**2,727**	**1,826**		**4,553**	**4,363**	**4,646**	**5,184**	**6,119**	**6,409**	**6,896**
Taxes	(301)	(379)	(478)	(370)		(842)	(807)	(860)	(959)	(1,132)	(1,186)	(1,276)
% Effective Tax Rate	*14.9%*	*15.6%*	*17.5%*	*20.3%*		*18.5%*	*18.5%*	*18.5%*	*18.5%*	*18.5%*	*18.5%*	*18.5%*
Minority Interest	(37)	(40)	(41)	(29)		(70)	(69)	(71)	(75)	(79)	(83)	(87)
Net Income (AON)	**1,687**	**2,017**	**2,208**	**1,427**		**3,641**	**3,487**	**3,715**	**4,150**	**4,908**	**5,141**	**5,533**
Shares Outstanding	260.7	247.0	240.6	130.0	140.4	381.0	381.0	372.4	359.4	345.0	331.5	318.9
Earnings Per Share	**$6.47**	**$8.17**	**$9.18**	**$10.98**		**$9.56**	**$9.15**	**$9.98**	**$11.55**	**$14.23**	**$15.51**	**$17.35**
% y/y	*-8.4%*	*26.2%*	*12.4%*				*-0.3%*	*9.0%*	*15.7%*	*23.2%*	*9.0%*	*11.9%*
Interest Rate	4.3%	4.4%	4.1%	4.2%		4.1%	4.1%	4.2%	4.3%	4.4%	4.5%	4.6%
Share Price Assumption							$178	$190	$203	$218	$233	$249
Dividend/Share	$1.40	$1.55	$1.70	$2.53		$1.94	$2.15	$2.39	$2.65	$2.94	$3.27	$3.63
Dividend y/y% growth	9.3%	10.8%	10.2%				11.0%	11.0%	11.0%	11.0%	11.0%	11.0%

Balance Sheet	**2017**	**2018**	**2019**	**WLTW**	**AON PF**	**2020E**	**2021E**	**2022E**	**2023E**	**2024E**	**2025E**
Cash & Cash EQ	756	656	790	887	1,677	1,970	2,287	1,996	1,924	2,041	2,502
ST Investments	529	172	138		138	138	138	138	138	138	138
Receivables	2,478	2,760	3,112	2,621	5,733	5,733	5,733	5,733	5,733	5,733	5,733
Fiduciary Assets	9,625	10,166	11,834	13,089	24,923	25,723	26,523	27,323	28,123	28,923	29,723
Other	289	618	602	525	1,127	1,127	1,127	1,127	1,127	1,127	1,127
Current Assets	**13,677**	**14,372**	**16,476**	**17,122**	**33,598**	**34,691**	**35,808**	**36,317**	**37,045**	**37,962**	**39,223**
Goodwill	8,358	8,171	8,165	11,194	19,359	18,475	17,564	16,608	15,604	14,549	13,442
Intangibles	1,733	1,149	783	3,478	4,261	4,261	4,261	4,261	4,261	4,261	4,261
PP&E, Net	564	588	621	1,046	1,667	1,785	1,907	2,035	2,170	2,311	2,459
Prepaid Pension	1,060	1,133	1,216	868	2,084	2,084	2,084	2,084	2,084	2,084	2,084
Other LT Assets	696	1,009	2,144	1,803	3,947	3,947	3,947	3,947	3,947	3,947	3,947
Total Assets	**26,088**	**26,422**	**29,405**	**35,511**	**64,916**	**65,243**	**65,571**	**65,252**	**65,111**	**65,114**	**65,416**
A/P and Accrued	1,961	1,943	1,939		1,939	1,939	1,939	1,939	1,939	1,939	1,939
Short-Term Debt	299	251	712	316	1,028	1,028	1,028	1,028	1,028	1,028	1,028
Fiduciary Liabilities	9,625	10,166	11,834	13,089	24,923	24,923	24,923	24,923	24,923	24,923	24,923
Other	870	936	1,086	2,750	3,836	3,836	3,836	3,836	3,836	3,836	3,836
Current Liabilities	**12,755**	**13,296**	**15,571**	**16,155**	**31,726**	**31,726**	**31,726**	**31,726**	**31,726**	**31,726**	**31,726**
Long-Term Debt	5,667	5,993	6,627	5,301	11,928	11,928	11,928	11,928	11,928	11,928	11,928
Pension Liabilities	1,789	1,636	1,738	1,324	3,062	3,062	3,062	3,062	3,062	3,062	3,062
Other LT Liabilities	1,229	1,278	2,020	2,362	4,382	4,382	4,382	4,382	4,382	4,382	4,382
Total Liabilities	**21,440**	**22,203**	**25,956**	**25,142**	**51,098**	**51,098**	**51,098**	**51,098**	**51,098**	**51,098**	**51,098**
Shareholders' Equity	4,583	4,151	3,375	10,249	13,624	13,951	14,279	13,960	13,819	13,822	14,124
Noncontrolling Interests	65	68	74	120	194	194	194	194	194	194	194
Total Shareholders' Equity	**4,648**	**4,219**	**3,449**	**10,369**	**13,818**	**14,145**	**14,473**	**14,154**	**14,013**	**14,016**	**14,318**
Check	-	-	-	-	-	-	-	-	-	-	-
Metrics											
EBITDA	2,671	2,981	3,138	2,547	5,685	6,196	5,971	6,756	7,999	8,543	9,121
EBITDA Margin	*26.8%*	*27.7%*	*28.5%*	*28.2%*	*28.4%*	*31.2%*	*29.2%*	*31.5%*	*35.5%*	*36.1%*	*36.7%*
Net Debt	5,210	5,588	6,549	4,730	11,279	10,986	10,669	10,960	11,032	10,915	10,454
Net Debt/EBITDA	2.0X	1.9X	2.1X	1.9X	2.0X	1.8X	1.8X	1.6X	1.4X	1.3X	1.1X
NOPAT	1,515	1,868	2,123	1,450	3,579	3,991	3,776	4,361	5,317	5,700	6,108
Invested Capital	10,614	10,463	10,788	15,986	26,774	27,101	27,429	27,110	26,969	26,972	27,274
ROIC	13.6%	17.7%	20.0%	9.1%	13.4%	14.8%	13.8%	16.0%	19.7%	21.1%	22.5%

Aon PLC (NYSE: AON) Freda Zhuo

Recommendation: LONG with $297 PT (67% upside; 75% TR)

Cash Flow	**2017**	**2018**	**2019**	**WLTW**	**AON PF**	**2020E**	**2021E**	**2022E**	**2023E**	**2024E**	**2025E**
Net Income	1,263	1,174	1,573	1,073	2,646	2,766	2,973	3,370	4,090	4,281	4,631
Discontinued Operations	828	74	(1)		(1)						
D&A	891	769	564	729	1,293	1,299	1,338	1,405	1,475	1,549	1,627
Share-Based Compensation	319	338	317	74	391	374	385	404	424	446	468
Other	8	(219)	(49)	(5)	(54)						
Change in Assets & Liabilities					-						
Fiduciary Receivables	171	(679)	(409)	(449)	(858)	(800)	(800)	(800)	(800)	(800)	(800)
Short-Term Investments (Mged)	(135)	(320)	(1,246)		(1,246)	(500)	(500)	(500)	(500)	(500)	(500)
Fiduciary Liabilities	(36)	999	1,655	449	2,104						
Receivables, Net	(254)	(127)	(371)	(261)	(632)						
A/P and Accrued Liabilities	96	25	(28)		(28)						
Pension Liabilities	(66)	(259)	(156)		(156)	-	-	-	-	-	-
Other	(2,351)	(89)	(14)	(529)	(543)						
Operating Cash Flow	**734**	**1,686**	**1,835**	**1,081**	**2,916**	**3,139**	**3,396**	**3,880**	**4,690**	**4,976**	**5,426**
Capital Expenditures	(183)	(240)	(225)	(305)	(530)	(533)	(549)	(577)	(606)	(636)	(668)
Net (Acquisitions)/Divestitures	3,217	(68)	13	(1,329)	(1,316)	-	-	-	-	-	-
Net Proceeds, Investments	(247)	339	(17)	20	3						
Investing Cash Flow	**2,787**	**31**	**(229)**	**(1,614)**	**(1,843)**	**(533)**	**(549)**	**(577)**	**(606)**	**(636)**	**(668)**
Share Repurchase	(2,399)	(1,470)	(1,960)	(150)	(2,110)	-	(1,500)	(2,500)	(3,000)	(3,000)	(3,000)
Issuance of Shares (Benefit Plan)	(121)	(149)	(131)	45	(86)	-	(140)	(140)	(140)	(140)	(140)
Debt Issuance/(Repayment)	(345)	337	1,111	958	2,069	-	-	-	-	-	-
Dividends	(364)	(382)	(410)	(329)	(739)	(813)	(890)	(953)	(1,016)	(1,083)	(1,157)
Other	(36)	(35)	(103)	(127)	(230)	(1,500)					
Financing Cash Flow	**(3,265)**	**(1,699)**	**(1,493)**	**397**	**(1,096)**	**(2,313)**	**(2,530)**	**(3,593)**	**(4,156)**	**(4,223)**	**(4,297)**
FX	69	(118)	21	(138)	(117)						
Net Change in Cash	**325**	**(100)**	**134**	**(274)**	**(140)**	**293**	**317**	**(291)**	**(72)**	**117**	**461**
Assumptions:											
Depreciation as % of Sales	1.9%	1.6%	1.6%	2.7%	2.1%	2.1%	2.1%	2.1%	2.1%	2.1%	2.1%
Amortization as % of Sales	7.1%	5.5%	3.6%	5.4%	4.4%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%
SBC as % of Sales	3.2%	3.1%	2.9%	0.8%	1.9%	1.9%	1.9%	1.9%	1.9%	1.9%	1.9%
Capex as % of Sales	1.8%	2.2%	2.0%	3.4%	2.6%	2.7%	2.7%	2.7%	2.7%	2.7%	2.7%
Free Cash Flow	**551**	**1,446**	**1,610**	**776**	**2,386**	**2,606**	**2,847**	**3,303**	**4,084**	**4,340**	**4,758**
FCF % growth	*-74%*	*162%*	*11%*				*9%*	*16%*	*24%*	*6%*	*10%*
FCF conversion	44%	123%	102%	72%	90%	94%	96%	98%	100%	101%	103%
FCF yield	1%	4%	4%	2%	6%	6%	7%	8%	10%	11%	12%

Bear and Bull Case Scenarios, on PF AON/WLTW

Bear Case (PF)	**2019**	**2020E**	**2021E**	**2022E**	**2023E**	**2024E**	**2025E**
Revenue	20,052	19,049	19,049	19,049	19,049	19,049	19,049
% growth		***-5.0%***	***0.0%***	***0.0%***	***0.0%***	***0.0%***	***0.0%***
Adj. EBIT	4,856	4,613	4,572	4,515	4,458	4,400	4,324
% margin	***24.2%***	***24.2%***	***24.0%***	***23.7%***	***23.4%***	***23.1%***	***22.7%***
EBITDA	5,685	5,958	5,917	5,860	5,803	5,746	5,669
Interest Expense	(533)	(534)	(546)	(559)	(572)	(585)	(598)
Tax Expense	(842)	(755)	(745)	(732)	(719)	(706)	(689)
Net Income	3,641	3,256	3,209	3,149	3,088	3,027	2,950
Shares Outstanding	381	381	373	366	359	352	346
EPS	**$9.56**	**$8.54**	**$8.60**	**$8.61**	**$8.60**	**$8.59**	**$8.52**
Cash Net Income		2,564	2,518	2,457	2,396	2,335	2,258
D&A		1,247	1,247	1,247	1,247	1,247	1,247
Share Based Comp		359	359	359	359	359	359
Change in A/L		(1,300)	(1,300)	(1,300)	(1,300)	(1,300)	(1,300)
Operating Cash Flow	**2,916**	**2,869**	**2,823**	**2,762**	**2,701**	**2,640**	**2,564**
Capex	(530)	(512)	(512)	(512)	(512)	(512)	(512)
Free Cash Flow	**2,386**	**2,358**	**2,311**	**2,251**	**2,190**	**2,129**	**2,052**
Buyback	(2,196)	-	(1,500)	(1,500)	(1,500)	(1,500)	(1,500)
Dividend	(739)	(820)	(892)	(970)	(1,057)	(1,152)	(1,257)
Debt	2,069	-	-	-	-	-	-
Change in Cash	**(140)**	**1,537**	**(80)**	**(220)**	**(367)**	**(523)**	**(705)**

Bull Case (PF)	**2019**	**2020E**	**2021E**	**2022E**	**2023E**	**2024E**	**2025E**
Revenue	20,052	20,253	21,670	23,187	24,810	26,547	28,405
% growth		***1.0%***	***7.0%***	***7.0%***	***7.0%***	***7.0%***	***7.0%***
EBIT	4,856	5,107	5,790	6,543	7,373	8,287	9,293
% margin	***24.2%***	***25.2%***	***26.7%***	***28.2%***	***29.7%***	***31.2%***	***32.7%***
EBITDA	5,685	6,452	7,135	7,888	8,718	9,632	10,639
Interest Expense	(533)	(534)	(546)	(559)	(572)	(585)	(598)
Tax Expense	(842)	(846)	(970)	(1,107)	(1,258)	(1,425)	(1,609)
Net Income	3,641	3,658	4,202	4,801	5,464	6,194	7,000
Shares Outstanding	381	381	368	353	337	320	302
EPS	**$9.56**	**$9.60**	**$11.42**	**$13.60**	**$16.21**	**$19.37**	**$23.19**
Cash Net Income		2,923	3,415	3,960	4,563	5,231	5,969
D&A		1,325	1,418	1,518	1,624	1,737	1,859
Share Based Comp		381	408	436	467	500	535
Change in A/L		(1,300)	(1,300)	(1,300)	(1,300)	(1,300)	(1,300)
Operating Cash Flow	**2,916**	**3,330**	**3,941**	**4,614**	**5,354**	**6,168**	**7,062**
Capex	(530)	(544)	(582)	(623)	(667)	(713)	(763)
Free Cash Flow	**2,386**	**2,786**	**3,359**	**3,991**	**4,687**	**5,455**	**6,299**
Buyback	(2,196)	-	(2,500)	(3,000)	(3,500)	(4,000)	(4,500)
Dividend	(739)	(820)	(879)	(937)	(992)	(1,045)	(1,095)
Debt	2,069	-	-	-	-	-	-
Change in Cash	**(140)**	**1,965**	**(20)**	**54**	**195**	**409**	**704**