AON CORP
Form 10-Q
November 03, 2009

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2009

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 1-7933

Aon Corporation

(Exact Name of Registrant as Specified in Its Charter)

DELAWARE (State or Other Jurisdiction of Incorporation or Organization)	**36-3051915** (I.R.S. Employer Identification No.)
200 E. RANDOLPH STREET, CHICAGO, ILLINOIS (Address of Principal Executive Offices)	**60601** (Zip Code)

(312) 381-1000

(Registrant s Telephone Number,
Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x NO o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES o NO x

Number of shares of common stock, $1.00 par value, outstanding as of September 30, 2009: 273,922,587

Part I Financial Information

ITEM 1. FINANCIAL STATEMENTS

Aon Corporation

Condensed Consolidated Statements of Income

(Unaudited)

	Three Months Ended		Nine Months Ended	
(millions, except per share data)	**Sept. 30, 2009**	**Sept. 30, 2008**	**Sept. 30, 2009**	**Sept. 30, 2008**
Revenue				
Commissions, fees and other	$ 1,780	$ 1,756	$ 5,466	$ 5,493
Investment income	28	90	81	214
Total revenue	1,808	1,846	5,547	5,707
Expenses				
Compensation and benefits	1,119	1,131	3,267	3,428
Other general expenses	424	419	1,287	1,333
Depreciation and amortization	56	49	174	157
Total operating expenses	1,599	1,599	4,728	4,918
	209	247	819	789
Interest expense	32	32	87	96
Other (income) expense	(1)	(3)	1	(9)
Income from continuing operations before income taxes	178	218	731	702
Income taxes	47	59	212	192
Income from continuing operations	131	159	519	510
Income (loss) from discontinued operations before income taxes		(57)	93	1,440
Income taxes	(3)	(19)	38	470
Income (loss) from discontinued operations	3	(38)	55	970
Net income	134	121	574	1,480
Less: Net income attributable to noncontrolling interests	14	4	25	12
Net income attributable to Aon stockholders	$ 120	$ 117	$ 549	$ 1,468
Net income attributable to Aon stockholders				
Income from continuing operations	$ 117	$ 155	$ 494	$ 498
Income (loss) from discontinued operations	3	(38)	55	970
Net income	$ 120	$ 117	$ 549	$ 1,468
Basic net income (loss) per share attributable to Aon stockholders				
Continuing operations	$ 0.41	$ 0.55	$ 1.74	$ 1.68
Discontinued operations	0.01	(0.13)	0.19	3.26
Net income	$ 0.42	$ 0.42	$ 1.93	$ 4.94
Diluted net income (loss) per share attributable to Aon stockholders				

Continuing operations	$	0.40	$	0.53	$	1.69	$	1.61
Discontinued operations		0.01		(0.13)		0.19		3.14
Net income	$	0.41	$	0.40	$	1.88	$	4.75
Dividends paid per share	$	0.15	$	0.15	$	0.45	$	0.45
Weighted average common shares outstanding - basic		283.8		281.7		284.5		296.9
Weighted average common shares outstanding - diluted		292.1		293.9		292.2		308.9

See the accompanying notes to the condensed consolidated financial statements (unaudited).

Aon Corporation

Condensed Consolidated Statements of Financial Position

(millions)		Sept. 30, 2009 (Unaudited)		Dec. 31, 2008
ASSETS				
CURRENT ASSETS:				
Cash and cash equivalents	$	580	$	582
Short-term investments		602		684
Receivables		1,844		1,990
Fiduciary assets		9,551		10,678
Other current assets		349		355
Assets held for sale				237
Total Current Assets		12,926		14,526
Goodwill		5,957		5,637
Other intangible assets, net		763		779
Fixed assets, net		453		451
Investments		297		332
Other non-current assets		1,245		1,215
TOTAL ASSETS	$	21,641	$	22,940
LIABILITIES				
CURRENT LIABILITIES:				
Fiduciary liabilities	$	9,551	$	10,678
Short-term debt		12		105
Accounts payable and accrued liabilities		1,377		1,560
Other current liabilities		277		314
Liabilities held for sale				146
Total Current Liabilities		11,217		12,803
Long-term debt		1,998		1,872
Pension and other post employment liabilities		1,245		1,694
Other non-current liabilities		1,051		1,156
TOTAL LIABILITIES		15,511		17,525
EQUITY				
AON STOCKHOLDERS EQUITY:				
Common stock-$1 par value				
Authorized: 750 shares (issued: 9/30/09 - 362.7; 12/31/08 - 361.7)		363		362
Additional paid-in capital		3,166		3,220
Retained earnings		7,189		6,816
Treasury stock at cost (shares: 9/30/09 - 88.7; 12/31/08 - 89.9)		(3,556)		(3,626)
Accumulated other comprehensive loss		(1,172)		(1,462)
TOTAL AON STOCKHOLDERS EQUITY		5,990		5,310
Noncontrolling interests		140		105
TOTAL EQUITY		6,130		5,415
TOTAL LIABILITIES AND EQUITY	$	21,641	$	22,940

See the accompanying notes to the condensed consolidated financial statements (unaudited).

Aon Corporation

Condensed Consolidated Statement of Stockholders Equity

(Unaudited)

(millions)	Shares	Common Stock and Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss, Net of Tax	Non-controlling Interests	Total
Balance at January 1, 2009	361.7	$ 3,582	$ 6,816	$ (3,626)	$ (1,462)	$ 105	$ 5,415
Net income			549			25	574
Shares issued - employee benefit plans	1.0	96					96
Shares purchased				(250)			(250)
Shares reissued - employee benefit plans		(320)	(52)	320			(52)
Tax benefit - employee benefit plans		24					24
Stock compensation expense		152					152
Dividends to stockholders			(124)				(124)
Change in net derivative gains/losses					6		6
Change in net unrealized investment gains/losses					(10)		(10)
Net foreign currency translation adjustments					223	4	227
Net post-retirement benefit obligation					71		71
Purchase of subsidiary shares from noncontrolling interests		(5)				(3)	(8)
Capital contribution by noncontrolling interests						35	35
Dividends paid to noncontrolling interests on subsidiary common stock						(26)	(26)
Balance at September 30, 2009	362.7	$ 3,529	$ 7,189	$ (3,556)	$ (1,172)	$ 140	$ 6,130

See accompanying notes to condensed consolidated financial statements (unaudited).

Aon Corporation

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(millions)	Nine Months Ended September 30, 2009	September 30, 2008
Cash Flows from Operating Activities:		
Net income	$ 574	$ 1,480
Adjustments to reconcile net income to cash provided by operating activities:		
Gain from disposal of operations	(97)	(1,403)
Depreciation and amortization of fixed assets	105	117
Amortization of intangible assets	69	40
Stock compensation expense	152	194
Deferred income taxes	81	(68)
Change in assets and liabilities:		
Change in funds held on behalf of brokerage and consulting clients	46	50
Net receivables	218	111
Accounts payable and accrued liabilities	(399)	(357)
Restructuring reserves	16	47
Pension and other post employment liabilities	(284)	(86)
Other assets and liabilities	(300)	(88)
Cash Provided by Operating Activities	181	37
Cash Flows from Investing Activities:		
Sales of long-term investments	21	270
Purchase of long-term investments	(17)	(281)
Sales (purchases) of short-term investments, net	61	(761)
Acquisition of businesses, net of cash acquired	(55)	(85)
Proceeds from sale of businesses	139	2,803
Capital expenditures	(86)	(80)
Cash Provided by Investing Activities	63	1,866
Cash Flows from Financing Activities:		
Issuance of common stock	50	42
Treasury stock transactions - net	(158)	(1,773)
Short-term repayments, net	(370)	(232)
Issuance of long-term debt	683	364
Repayments of long-term debt	(339)	(297)
Cash dividends to stockholders	(124)	(130)
Cash Used for Financing Activities	(258)	(2,026)
Effect of Exchange Rate Changes on Cash	12	17
Net Decrease in Cash and Cash Equivalents	(2)	(106)
Cash and Cash Equivalents at Beginning of Period	582	584
Cash and Cash Equivalents at End of Period	$ 580	$ 478
Supplemental disclosures:		
Interest paid	$ 84	$ 96
Income taxes paid, net of refunds	165	638

See the accompanying notes to the condensed consolidated financial statements (unaudited).

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NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. Statement of Accounting Principles

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) and include all normal recurring adjustments which Aon Corporation (Aon or the Company) considers necessary to present fairly the Company s consolidated financial statements for all periods presented.

Certain information and footnote disclosures normally included in the financial statements prepared in accordance with U.S. GAAP have been condensed or omitted. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2008. The results for the three and nine months ended September 30, 2009 are not necessarily indicative of operating results that may be expected for the full year ending December 31, 2009. Certain amounts in prior period financial statements and related notes have been reclassified to conform to the 2009 presentation. In addition, due to the adoption of new principles regarding noncontrolling interests and participating securities, certain amounts in prior period financial statements and related notes have been restated to conform with the requirements of these new principles.

The preparation of financial statements in conformity with U.S. GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of reserves and expenses during the reporting periods. Actual amounts could differ from those estimates.

Management has reviewed all material subsequent events through November 3, 2009, the date the financial statements were issued, to determine whether any event required either recognition or disclosure in the financial statements.

2. Accounting Principles and Practices

Changes in Accounting Principles

On January 1, 2009, Aon adopted revised principles related to business combinations and noncontrolling interests. The revised principle on business combinations applies to all transactions or other events in which an entity obtains control over one or more businesses. It requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date. Business combinations achieved in stages require recognition of the identifiable assets and liabilities, as well as the noncontrolling interest in the acquiree, at the full amounts of their fair values when control is obtained. This revision also changes the requirements for recognizing assets acquired and liabilities assumed arising from contingencies, and requires direct acquisition costs to be expensed. In addition, it provides certain changes to income tax accounting for business combinations which apply to both new and previously existing business combinations. In April 2009, additional guidance was issued which revised certain business combination guidance related to accounting for contingent liabilities assumed in a business combination. The Company has adopted this guidance in conjunction with the adoption of the revised principles related to business combinations. The adoption of the revised principles related to business combinations has not had a material impact on the consolidated financial statements.

The revised principle related to noncontrolling interests establishes accounting and reporting standards for the noncontrolling interests in a subsidiary and for the deconsolidation of a subsidiary. The revised principle clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as a separate component of equity in the consolidated statements of financial position. The revised principle requires retrospective adjustments, for all periods presented, of stockholders equity and net income for noncontrolling interests. In addition to these financial reporting changes, the revised principle provides for significant changes in accounting related to changes in ownership of noncontrolling interests. Changes in Aon s controlling financial interests in consolidated subsidiaries that do not result in a loss of control are accounted for as equity transactions similar to treasury stock transactions. If a change in ownership of a consolidated subsidiary result in loss of control and deconsolidation, any retained ownership interests are remeasured at fair value with the gain or loss reported in net income. In previous periods, noncontrolling interests for operating subsidiaries were reported in other general expenses in the condensed consolidated statements of income. Prior period amounts have been restated to conform to the current year s presentation.

The principal effect on the prior years balance sheets related to the adoption of the new guidance related to noncontrolling interests is summarized as follows (in millions):

	December 31, 2008	December 31, 2007
Equity, as previously reported	$ 5,310	$ 6,221
Increase for reclassification of non-controlling interests	105	40
Equity, as adjusted	$ 5,415	$ 6,261

The revised principle also requires that net income be adjusted to include the net income attributable to the noncontrolling interests and a new separate caption for net income attributable to Aon stockholders be presented in the consolidated statements of income. The adoption of this new guidance increased net income by $16 million, $13 million and $10 million for 2008, 2007 and 2006, respectively. Net income attributable to Aon stockholders equals net income as previously reported prior to the adoption of the new guidance.

On January 1, 2009, Aon adopted a new principle which supplements current disclosure requirements for derivative instruments and hedging activities, under which Aon is required to provide enhanced qualitative and quantitative information. See Note 12 for these disclosures.

Effective January 1, 2009, the Company adopted additional guidance which states that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents, whether paid or unpaid, are participating securities, as defined, and therefore should be included in computing basic and diluted earnings per share using the two class method. Certain of Aon s restricted stock awards allow the holder to receive a non-forfeitable dividend equivalent. See Note 9 for further discussion of the effect of adopting this new guidance on the Company s financial statements.

Effective April 1, 2009, Aon adopted a new principle which establishes the period after the balance sheet date during which management is required to evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements. This principle also requires that Aon disclose the date through which subsequent events have been evaluated, as well as whether that date is the date the financial statements were issued or the date the financial statements were available to be issued. See Note 1 for this disclosure.

Aon adopted the following fair value guidance effective April 1, 2009:

- additional guidance for estimating fair value in accordance with current principles, when the volume and level of activity for the asset or liability has significantly decreased. This guidance also assists in identifying circumstances that indicate when a transaction is not orderly.

- guidance related to debt securities, which requires an entity to recognize the credit component of an other-than-temporary impairment of a debt security in earnings and the non-credit component in other comprehensive income when the entity does not intend to sell the security and it is more likely than not that the entity will not be required to sell the security prior to recovery. Entities are required to record a cumulative effect adjustment for the non-credit component of previously recognized other-than-temporary impairments that meet certain criteria.

- disclosure guidance related to the fair value of financial instruments for interim reporting periods as well as in annual financial statements.

The adoption of the preceding guidance did not have a material impact on the Company s financial statements. See Note 15 for the disclosure regarding interim reporting of the carrying and fair value of Aon s long-term debt.

Recent Accounting Pronouncements

In December 2008, the FASB issued an amendment to current principles regarding employers disclosures about pensions and other postretirement benefits. These changes provide guidance as to an employer s disclosures about plan assets of a defined benefit pension or other postretirement plan. This amendment requires pension and other postretirement plan disclosures be expanded to include investment allocation decisions, the fair value of each major category of plan assets based on the nature and risks of assets in the plans, and inputs and valuation techniques used to develop fair value measurements of plan assets. The Company is currently evaluating this amendment to determine any additional disclosures required in the 2009 annual report.

In June 2009, the FASB issued guidance amending current principles related to the transfers of financial assets and variable interest entities (VIEs). This guidance eliminates the concept of a qualifying special-purpose entity (QSPE), creates more stringent conditions for reporting the transfer of a portion of a financial asset as a sale, clarifies other sale-accounting criteria, and changes the initial measurement of a transferor s interest in transferred financial assets. Former QSPEs will be evaluated for consolidation based on the updated VIE guidance. There are also changes to the approach a company must take in determining a VIE s primary beneficiary and requires companies to more frequently reassess whether they must consolidate VIEs. Additional year-end and interim period disclosures will also be required. These changes will be effective for Aon beginning in the first quarter of 2010. The adoption of this guidance is not expected to have a material impact on the Company s financial statements.

In September 2009, the FASB issued guidance updating current principles related to revenue recognition when there are multiple-element arrangements. This revised guidance relates to the determination of when the individual deliverables included in a multiple-element arrangement may be treated as separate units of accounting and modifies the manner in which the transaction consideration is allocated across the separately identifiable deliverables. The guidance also expands the disclosures required for multiple-element revenue arrangements. These changes will be effective for Aon beginning in the first quarter of 2011, and may be applied retrospectively for all periods presented or prospectively to arrangements entered into or modified after the adoption date. Early adoption is permitted. The

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Company is currently evaluating this guidance to determine what impact, if any, it will have on its consolidated financial statements.

3. Cash and Cash Equivalents

Cash and cash equivalents at September 30, 2009 and December 31, 2008 included restricted balances of $99 million and $194 million, respectively. Restricted balances are held in trust for the benefit of reinsurance contract holders.

4. Goodwill and Other Intangible Assets

The changes in the net carrying amount of goodwill by operating segment for the nine months ended September 30, 2009 are as follows (in millions):

	Risk and Insurance Brokerage Services	Consulting	Total
Balance as of December 31, 2008	$ 5,259	$ 378	$ 5,637
Goodwill acquired	40		40
Benfield adjustments	15		15
Goodwill related to disposals	(13)		(13)
Foreign currency revaluation	273	5	278
Balance as of September 30, 2009	$ 5,574	$ 383	$ 5,957

The Company is in the process of finalizing the Benfield purchase price allocation. Therefore, the final goodwill to be recorded is still subject to refinement. This process will be finalized in the fourth quarter 2009. During the third quarter, the Company updated its allocation to reflect the impact of changes in actual employee severance costs compared to original estimates and the resolution of certain tax matters.

Other intangible assets by asset category are as follows (in millions):

	September 30, 2009		December 31, 2008	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Trademarks	$ 134	$	$ 128	$
Customer Related and Contract Based	703	222	697	180
Marketing, Technology and Other	386	238	331	197
	$ 1,223	$ 460	$ 1,156	$ 377

Amortization expense on intangible assets was $24 million and $69 million for the three and nine months ended September 30, 2009, respectively. Amortization expense was $15 million and $40 million for the three and nine months ended September 30, 2008, respectively. As of September 30, 2009, the estimated amortization for intangible assets is as follows (in millions):

Remainder of 2009	$	28
2010		99
2011		93
2012		82
2013		73
Thereafter		254
Total	$	629

5. Disposal of Operations

Continuing Operations

In December 2008, Aon signed a definitive agreement to sell the U.S. operation of the premium finance business of Cananwill, Inc. (Cananwill). This disposition was completed in February 2009. Cananwill s results are included in the Risk and Insurance Brokerage Services segment. A pretax loss totaling $7 million was recognized, of which $2 million was recorded in first quarter 2009 and $5 million in fourth quarter 2008. This disposal did not meet the criteria for discontinued operations reporting. Aon may receive up to $10 million from the buyer over the next two years based on the volume of insurance premiums and related obligations financed by the buyer over this period that are generated by certain of Cananwill s producers.

Discontinued Operations

Property and Casualty Operations

In January 2009, the Company signed a definitive agreement to sell FFG Insurance Company (FFG), Atlanta International Insurance Company (AIIC) and Citadel Insurance Company (Citadel) (together the P&C operations). FFG and Citadel are property and casualty insurance operations that were in runoff. AIIC is a property and casualty insurance operation that was previously reported in discontinued operations. The sale was completed in August 2009. A pretax loss totaling $194 million was recognized, of which $3 million was recorded in third quarter 2009 and $191 million in fourth quarter 2008. As part of the sale, the purchaser also assumed an indemnification in respect of certain reinsured property and casualty balances. The fair value of this indemnification was $9 million at June 30, 2009.

AIS Management Corporation

In 2008, Aon reached a definitive agreement to sell AIS Management Corporation (AIS), which was previously included in the Risk and Insurance Brokerage Services segment, to Mercury General Corporation, for $120 million in cash at closing, plus a potential earn-out of up to $35 million payable over the two years following the completion of the agreement. The disposition was completed in January 2009 and resulted in a pretax gain of $86 million in first quarter 2009.

Accident, Life & Health Operations

On April 1, 2008, the Company sold its Combined Insurance Company of America (CICA) subsidiary to ACE Limited and its Sterling Life Insurance Company (Sterling) subsidiary to Munich Re Group. These two subsidiaries were previously included in the Company s former Insurance Underwriting segment. After final adjustments, Aon received $2.525 billion in cash for CICA and $341 million in cash for Sterling. Additionally, CICA paid a $325 million dividend to Aon before the sale transaction was completed. A pretax gain of $1.4 billion was recognized in the second quarter 2008 on the sale of these businesses.

The operating results of all businesses classified as discontinued operations are as follows (in millions):

	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
Revenue:				
CICA and Sterling	$	$	$	$ 677
AIS		23		71
P&C Operations		1	2	4
	$	$ 24	$ 2	$ 752
Income (loss) before income taxes:				
Operations:				
CICA and Sterling	$	$	$	$ 66
AIS		(22)		(13)
P&C Operations	(1)	(2)	4	(5)
Other				(1)
	(1)	(24)	4	47
Gain (loss) on sale	1	(33)	89	1,393
	$	$ (57)	$ 93	$ 1,440
Net income (loss):				
Operations	$	$ (16)	$ 3	$ 23
Gain (loss) on sale	3	(22)	52	947
	$ 3	$ (38)	$ 55	$ 970

The assets and liabilities reported as held-for-sale were as follows (in millions):