AON CORP
Form 10-Q
May 05, 2011

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 MARCH 31, 2011

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	**36-3051915**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

200 E. RANDOLPH STREET, CHICAGO, ILLINOIS	**60601**
(Address of Principal Executive Offices)	(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 March 31, 2011: 330,540,849

Part I Financial Information

ITEM 1. FINANCIAL STATEMENTS

Aon Corporation

Condensed Consolidated Statements of Income

(Unaudited)

(millions, except per share data)	Three Months Ended Mar. 31, 2011	Mar. 31, 2010
Revenue		
Commissions, fees and other	$ 2,748	$ 1,891
Fiduciary investment income	11	13
Total revenue	2,759	1,904
Expenses		
Compensation and benefits	1,597	1,163
Other general expenses	766	468
Total operating expenses	2,363	1,631
Operating income	396	273
Interest income	6	1
Interest expense	(63)	(34)
Other income	17	7
Income from continuing operations before income taxes	356	247
Income taxes	103	61
Income from continuing operations	253	186
Income from discontinued operations before income taxes	4	2
Income taxes	2	2
Income from discontinued operations	2	
Net income	255	186
Less: Net income attributable to noncontrolling interests	9	8
Net income attributable to Aon stockholders	$ 246	$ 178
Net income attributable to Aon stockholders		
Income from continuing operations	$ 244	$ 178
Income from discontinued operations	2	
Net income	$ 246	$ 178
Basic net income per share attributable to Aon stockholders		
Continuing operations	$ 0.72	$ 0.65
Discontinued operations		
Net income	$ 0.72	$ 0.65
Diluted net income per share attributable to Aon stockholders		
Continuing operations	$ 0.71	$ 0.63
Discontinued operations		
Net income	$ 0.71	$ 0.63
Cash dividends per share paid on common stock	$ 0.15	$ 0.15
Weighted average common shares outstanding - basic	339.4	275.9
Weighted average common shares outstanding - diluted	345.4	283.4

See accompanying notes to the Condensed Consolidated Financial Statements (unaudited).

Aon Corporation

Condensed Consolidated Statements of Financial Position

(millions, except share data)	Mar. 31, 2011 (Unaudited)	Dec. 31, 2010
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 682	$ 346
Short-term investments	589	785
Receivables, net	2,650	2,701
Fiduciary assets	10,609	10,063
Other current assets	681	624
Total Current Assets	15,211	14,519
Goodwill	8,895	8,647
Intangible assets, net	3,547	3,611
Fixed assets, net	791	781
Investments	318	312
Other non-current assets	1,040	1,112
TOTAL ASSETS	$ 29,802	$ 28,982
LIABILITIES AND EQUITY		
LIABILITIES		
CURRENT LIABILITIES		
Fiduciary liabilities	$ 10,609	$ 10,063
Short-term debt and current portion of long-term debt	502	492
Accounts payable and accrued liabilities	1,544	1,810
Other current liabilities	604	584
Total Current Liabilities	13,259	12,949
Long-term debt	4,409	4,014
Pension and other post employment liabilities	1,849	1,896
Other non-current liabilities	1,798	1,817
TOTAL LIABILITIES	21,315	20,676
EQUITY		
Common stock-$1 par value		
Authorized: 750 shares (issued: 2011 - 386.3; 2010 - 385.9)	386	386
Additional paid-in capital	3,942	4,000
Retained earnings	8,039	7,861
Treasury stock at cost (shares: 2011 - 55.8; 2010 - 53.6)	(2,230)	(2,079)
Accumulated other comprehensive loss	(1,714)	(1,917)
TOTAL AON STOCKHOLDERS EQUITY	8,423	8,251
Noncontrolling interests	64	55
TOTAL EQUITY	8,487	8,306
TOTAL LIABILITIES AND EQUITY	$ 29,802	$ 28,982

See 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	Comprehensive Income
Balance at December 31, 2010	385.9	$ 4,386	$ 7,861	$ (2,079)	$ (1,917)	$ 55	$ 8,306	$ 532
Net income			246			9	255	$ 255
Shares issued - employee benefit plans	0.4	38					38	
Shares purchased				(350)			(350)	
Shares reissued - employee benefit plans		(199)	(17)	199			(17)	
Tax benefit - employee benefit plans		29					29	
Stock compensation expense		74					74	
Dividends to stockholders			(51)				(51)	
Change in net derivative gains/losses					(4)		(4)	(4)
Net foreign currency translation adjustments					195		195	195
Net post-retirement benefit obligations					12		12	12
Balance at March 31, 2011	386.3	$ 4,328	$ 8,039	$ (2,230)	$ (1,714)	$ 64	$ 8,487	$ 458

See accompanying notes to the Condensed Consolidated Financial Statements (unaudited).

Aon Corporation

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(millions)	Three Months Ended Mar. 31, 2011	Mar. 31, 2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 255	$ 186
Adjustments to reconcile net income to cash provided by operating activities:		
Gain from sales of businesses, net		(6)
Depreciation of fixed assets	53	31
Amortization of intangible assets	91	27
Stock compensation expense	74	66
Deferred income taxes	11	(12)
Change in assets and liabilities:		
Change in funds held on behalf of clients	427	396
Receivables, net	108	45
Accounts payable and accrued liabilities	(327)	(274)
Restructuring reserves	(28)	(1)
Current income taxes	58	65
Pension and other post employment liabilities	(81)	(55)
Other assets and liabilities	(59)	(1)
CASH PROVIDED BY OPERATING ACTIVITIES	582	467
CASH FLOWS FROM INVESTING ACTIVITIES		
Sales of long-term investments	17	66
Purchases of long-term investments	(6)	(10)
Net sales of short-term investments - non-fiduciary	218	97
Net purchases of short-term investments - funds held on behalf of clients	(427)	(396)
Acquisition of businesses, net of cash acquired	(3)	(47)
Capital expenditures	(56)	(33)
CASH USED FOR INVESTING ACTIVITIES	(257)	(323)
CASH FLOWS FROM FINANCING ACTIVITIES		
Purchase of treasury stock	(350)	(50)
Issuance of stock for employee benefit plans	85	35
Issuance of debt	429	75
Repayment of debt	(79)	(2)
Cash dividends to stockholders	(51)	(41)
Dividends paid to noncontrolling interests		(3)
CASH PROVIDED BY FINANCING ACTIVITIES	34	14
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	(23)	47
NET INCREASE IN CASH AND CASH EQUIVALENTS	336	205
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	346	217
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 682	$ 422
Supplemental disclosures:		
Interest paid	$ 76	$ 30
Income taxes paid, net of refunds	36	10

See accompanying notes to the Condensed Consolidated Financial Statements (unaudited).

Notes to the Condensed Consolidated Financial Statements (Unaudited)

1. Basis of Presentation

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 Condensed Consolidated Financial Statements for all periods presented. The consolidated financial statements include the accounts of Aon and its wholly and majority-owned subsidiaries and variable interest entities (VIEs) for which Aon is considered to be the primary beneficiary. The consolidated financial statements exclude special-purpose entities (SPEs) considered VIEs for which Aon is not the primary beneficiary. All material intercompany accounts and transactions have been eliminated.

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, 2010. The presentation of certain amounts in prior period financial statements and related notes has been changed to conform to the 2011 presentation. The results for the three months ended March 31, 2011 are not necessarily indicative of operating results that may be expected for the full year ending December 31, 2011.

Use of Estimates

The preparation of the accompanying unaudited Condensed Consolidated Financial Statements in conformity with U.S. GAAP requires management to make 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. These estimates and assumptions are based on management s best estimates and judgments. Management evaluates its estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment, which management believes to be reasonable under the circumstances. Aon adjusts such estimates and assumptions when facts and circumstances dictate. Illiquid credit markets, volatile equity markets, and foreign currency movements have combined to increase the uncertainty inherent in such estimates and assumptions. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates. Changes in estimates resulting from continuing changes in the economic environment will be reflected in the financial statements in future periods.

2. Accounting Principles and Practices

Changes in Accounting Principles

On January 1, 2010, the Company adopted guidance requiring additional disclosures regarding fair value measurements. The amended guidance required entities to disclose additional information regarding assets and liabilities that are transferred between levels of the fair value hierarchy. This guidance also clarified existing guidance pertaining to the level of disaggregation at which fair value disclosures should be made and the requirements to disclose information about the valuation techniques and inputs used in estimating Level 2 and Level 3 fair value measurements. The guidance also required entities to disclose information in the Level 3 rollforward about purchases, sales, issuances and settlements on a gross basis. See Note 15 Fair Value and Financial Instruments for these disclosures.

In September 2009, the Financial Accounting Standards Board (FASB) issued guidance which updated principles related to revenue recognition when there are multiple-element arrangements. This revised guidance related to the determination of when the individual deliverables included in a multiple-element arrangement may be treated as separate units of accounting and modified the manner in which the transaction consideration is allocated across the separately identifiable deliverables. The guidance also expanded the disclosures required for multiple-element revenue arrangements. The effective date for this guidance was January 1, 2011. The Company early adopted this guidance in the fourth quarter 2010 and applied its requirements to all revenue arrangements entered into or materially modified after January 1, 2010. The adoption of this guidance did not have a material impact on the Company s consolidated financial statements.

3. Cash and Cash Equivalents

Cash and cash equivalents include cash balances and all highly liquid investments with initial maturities of three months or less. Cash and cash equivalents included restricted balances of $179 million and $60 million at March 31, 2011 and December 31, 2010, respectively.

4. Other Income

Other income consists of the following (in millions):

	Three months ended March 31, 2011		2010	
Equity earnings	$	6	$	2
Realized gain on sale of investments		10		1
Gain on disposal of businesses				4
Other		1		
	$	17	$	7

5. Acquisitions and Dispositions

Acquisitions

In first quarter 2011, the Company completed the acquisition of one company, which was included in the Risk Solutions segment. In first quarter 2010, the Company completed the acquisition of the JP Morgan Compensation and Benefit Strategies Division of JP Morgan Retirement Plan Services, LLC, which is included in the HR Solutions segment, as well as seven other companies, which are included in the Risk Solutions segment. The following table includes the aggregate consideration transferred and the preliminary value of intangible assets recorded as a result of the Company s acquisitions.

(millions)	Three months ended March 31, 2011	2010
Consideration transferred:	$ 3	$ 85
Intangible assets:		
Goodwill	$ 1	$ 35
Other intangible assets	3	33
	$ 4	$ 68

The results of operations of these acquisitions are included in the Condensed Consolidated Financial Statements from the dates they were acquired. The results of operations would not have been materially different if these acquisitions had been reported from the beginning of the period.

Hewitt Associates, Inc.

On October 1, 2010, the Company completed its acquisition of Hewitt Associates, Inc. (Hewitt), one of the world s leading human resource consulting and outsourcing companies. Aon purchased all of the outstanding shares of Hewitt common stock in a cash-and-stock transaction valued at approximately $4.9 billion, of which the total amount of cash paid and the total number of shares of stock issued by Aon each represented approximately 50% of the aggregate consideration.

The Company incurred certain acquisition and integration costs associated with the transaction that were expensed as incurred. In the first quarter 2011, the Company s HR Solutions segment incurred $15 million of these Hewitt related costs which are recorded in Other general expenses in the Condensed Consolidated Statements of Income.

The transaction has been accounted for using the acquisition method of accounting which requires, among other things, that most assets acquired and liabilities assumed be recognized at their fair values as of the acquisition date. The following table summarizes the preliminary amounts recognized for assets acquired and liabilities assumed as of the acquisition date. Certain estimated values are not yet finalized (see below) and are subject to change, which could be significant. The Company will finalize the amounts recognized as information necessary to complete the analyses is obtained. The Company expects to finalize these amounts as soon as possible but no later than one year from the acquisition date.

The following table summarizes the preliminary values of assets acquired and liabilities assumed as of the acquisition date (in millions):

		Amounts recorded as of the acquisition date
Working capital (1)	$	391
Property, equipment, and capitalized software		319
Identifiable intangible assets:		
Customer relationships		1,800
Trademarks		890
Technology		215
Other noncurrent assets (2)		344
Long-term debt		346
Other noncurrent liabilities (3)		361
Net deferred tax liability (4)		1,035
Net assets acquired		2,217
Goodwill		2,715
Total consideration transferred	$	4,932

(1) Includes cash and cash equivalents, short-term investments, client receivables, other current assets, accounts payable and other current liabilities.

(2) Includes primarily deferred contract costs and long-term investments.

(3) Includes primarily unfavorable lease obligations and deferred contract revenues.

(4) Included in Other current assets ($31 million), Deferred tax assets ($62 million), Other current liabilities ($32 million) and Deferred tax liabilities ($1.1 billion) in the Company s Consolidated Statements of Financial Position.

The acquired customer relationships are being amortized over a weighted average life of 12 years. The technology asset is being amortized over 7 years and trademarks have been determined to have indefinite useful lives.

The recorded amounts are preliminary and subject to change. The following items are still subject to change:

- Amounts for intangible assets and property, equipment and capitalized software assets, pending finalization of valuation efforts.
- Amounts for contingencies, pending the finalization of the Company s assessment of the portfolio of contingencies.
- Amounts for income tax assets, receivables and liabilities pending the filing of Hewitt pre-acquisition tax returns and the receipt of information from taxing authorities which may change certain estimates and assumptions used.

- Amounts for deferred tax assets and liabilities pending the finalization of the valuations of assets acquired, liabilities assumed and resulting goodwill.

A single estimate of fair value results from a complex series of the Company s judgments about future events and uncertainties and relies heavily on estimates and assumptions. The Company s judgments used to determine the estimated fair value assigned to each class of assets acquired and liabilities assumed, as well as asset lives, can materially impact the Company s results of operations.

Dispositions Discontinued Operations

Income from discontinued operations before income taxes, as presented in the Condensed Consolidated Statements of Income, of $4 million and $2 million, for the three months ended March 2011 and 2010, respectively, represents the gain on sale of businesses sold in prior periods.

6. Goodwill and Other Intangible Assets

The change in the net carrying amount of goodwill by operating segment for the three months ended March 31, 2011 is as follows (in millions):

	Risk Solutions	HR Solutions	Total
Balance as of December 31, 2010	$ 5,549	$ 3,098	$ 8,647
Goodwill related to current year acquisitions	1		1
Foreign currency revaluation	217	30	247
Balance as of March 31, 2011	$ 5,767	$ 3,128	$ 8,895

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

	March 31, 2011			December 31, 2010		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Intangible assets with indefinite lives:						