

Marsh & McLennan Companies, Inc.

Solid Second-Quarter Results Benefiting From Higher Insurance Brokerage Margins; Consulting Remains Under Pressure

- Second-quarter adjusted EPS declined 16%, to \$0.33, compared with our estimate and consensus of \$0.32. The outperformance relative to our estimate was principally due to a higher operating margin within risk and insurance services and a lower tax rate, offset by lower revenue and operating margins within Mercer.
- Organic revenue growth within risk and insurance services excluding fiduciary interest income (66% of segment earnings in the quarter) was 2%, compared with 1% last quarter and our 0% estimate. Insurance brokerage (Marsh) was flat, driven by growth overseas, and reinsurance brokerage (Guy Carpenter) was up 10% after a difficult 2008. We expect very modest organic growth in second half 2009 given the slow stabilization in pricing more than offset by persistent economic headwinds.
- The adjusted insurance brokerage operating margin was an impressive 20.2%, compared with a seasonally strong 25.0% last quarter, 14.6% in second quarter 2008, and our 16.5% estimate. The improvement compared with the prior year was driven by cost savings from aggressive expense management including the benefits from formal restructuring. We expect margins to move higher in 2009 as well, through continued client retention and improvement in operating efficiencies. Management revised its targeted adjusted margin for 2009 to 18.0% from 17.0%. Our estimate is now closer 20.0%, up from 18.0%.
- Consulting results continue to disappoint given pressure on revenue, particularly in more economically sensitive practice areas, and the adverse impact from foreign exchange. Organic revenue growth was negative 9%—negative 19% at more economically sensitive Oliver Wyman (27% of total consulting), and the operating margin declined to 8.8% from 12.0%, and below our 9.5% estimate.
- Management's view on the agreement between competitor Arthur J. Gallagher (AJG \$23.51) and the Illinois Attorney General to once again allow the company to receive contingent commissions was generally in line with Aon Corporation's (AOC \$40.14) take on the decision. Management views the move as a positive step toward the promotion of greater transparency and establishing a level playing field between the large national brokers and regional brokers, as opposed to simply being a win for the reinstatement of the contingent commission practice, specifically. Management is hopeful that its settlement agreement will also be sunsetted at some point—Marsh & McLennan is regulated by the New York Attorney General.

Financial | Commercial P/C Insurance

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Stock Rating: **Market Perform**
Company Profile: **Core Growth**

Symbol: MMC (NYSE)
Price: \$22.66 (52-Wk.: \$17-\$37)
Market Value (mil.): \$10,921
Fiscal Year End: December
Long-Term EPS Growth Rate: 14%
Dividend/Yield: \$0.80/3.5%

	2008A	2009E	2010E
Estimates			
EPS Q1	\$0.46	A\$0.40	NA
Q2	\$0.41	A\$0.33	NA
Q3	\$0.21	\$0.31	NA
Q4	\$0.37	\$0.41	NA
FY	\$1.45	\$1.45	\$1.90
CY		\$1.45	\$1.90

Valuation			
FY P/E	15.6x	15.6x	11.9x
CY P/E		15.6x	11.9x

Trading Data (Thomson Financial)

Shares Outstanding (mil.)	523
Float (mil.)	520
Average Daily Volume	4,789,721

Financial Data (Thomson Financial)

Long-Term Debt/Total Capital (MRQ)	32.5
Book Value Per Share (MRQ)	14.7
Enterprise Value (mil.)	13,818.5
EBITDA (TTM)	1,190.0
Enterprise Value/EBITDA (TTM)	11.6x
Return on Equity (TTM)	5.5

Two-Year Price Performance Chart



Source: Thomson Financial, William Blair & Company estimates

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- We are maintaining our Market Perform rating and increasing our 2009 EPS estimate to \$1.45 from \$1.43 and our 2010 EPS estimate to \$1.90 from \$1.80.

Solid Second-Quarter Results; Expense Management Continues to Be Excellent

Second-quarter adjusted EPS, excluding restructuring charges, other nonrecurring expenses, and earnings attributed to unvested shares, declined 16%, to \$0.33, compared with our estimate and consensus of \$0.32. The outperformance relative to our estimate was principally due to a higher operating margin within risk and insurance services, and a lower tax rate, offset by lower revenue and operating margins within Mercer (see attached table). The company recorded a \$31 million investment loss in the second quarter attributed to mark-to-market adjustments in its private-equity portfolio (results are reported on a one-quarter lag). Management estimates that given market conditions year-to-date, it anticipates an investment gain of \$20 million in third quarter 2009 (\$0.03 per share after-tax).

The GAAP loss was \$0.37 per share, or a loss of \$0.31 from continuing operations. The difference between adjusted EPS and GAAP EPS is principally due to restructuring charges related to a loss on the disposal of the U.K. corporate advisory business; a goodwill impairment charge of \$315 million, or \$0.60 per share, related to the sale of Kroll's government services operations; and regulatory and legal fees within the risk and insurance services segment. The goodwill impairment provides no tax benefit, and does not affect the company's cash flows or tangible equity by definition. The impact from foreign-currency translation decreased EPS by \$0.03 (all within the consulting segment), although this was largely included in our estimates. Management expects foreign-currency translation to negatively affect results for one more quarter. According to management, the market remains soft and the business environment continues to be weighed down by a weak global economy, coupled with a highly competitive market—sentiment consistent across the industry.

Marsh & McLennan Companies, Inc.
2Q09 Results—Actual Versus William Blair & Company Estimates
Adjusted Basis
(\$ millions except per share)

	Actual	WB Estimate	Difference
<u>Segment operating income</u>			
Risk and insurance services	\$271	\$220	\$51
Risk consulting and technology	7	20	(13)
Consulting	101	114	(13)
Corporate	(40)	(39)	(1)
Total segment operating income	339	315	24
Interest income	4	7	(3)
Interest expense	(65)	(54)	(11)
Investment income	(31)	(30)	(1)
Pretax income from continuing operations	247	238	9
Provision for income taxes	66	70	(4)
Effective tax rate	26.7%	29.4%	-2.7%
Minority interest, net of tax	5	3	2
Net income from continuing operations	176	165	11
Earnings attributable to unvested shares	4	0	4
Net income from continuing operations—adjusted ¹	172	165	7
Net income per share	\$0.33	\$0.32	\$0.01
Average diluted shares	522	518	4

¹Excludes all nonrecurring expenses/charges in all segments. Beginning 1Q09, also adjusted using the "two-class method" where earnings attributed to unvested shares are excluded.

Source: Company reports and William Blair & Company L.L.C. estimates

Risk and Insurance Services Operating Margin Continues to Benefit From Aggressive Expense Management

Organic revenue growth within risk and insurance services excluding fiduciary interest income (roughly 50% of earnings) was 2%, compared with 1% last quarter and our 0% estimate. Insurance brokerage (Marsh) was flat, driven by growth overseas, and reinsurance brokerage (Guy Carpenter) was up 10% after a difficult 2008. We expect very modest organic growth in second half 2009 given the slow stabilization in pricing more than offset by persistent economic headwinds.

Marsh & McLennan's organic growth exceeded all major competitors in the quarter as Brown & Brown Inc. (BRO \$19.73) reported 4.7% negative organic growth, Arthur J. Gallagher & Company reported 1.2% negative organic growth, Aon reported flat organic growth, and Willis Group Holdings (WSH \$25.64) reported 1.0% organic growth. Organic revenue growth in the company's international insurance brokerage operations, a high-margin business, had flat organic growth in the quarter, compared with 4% organic growth last quarter. United States and Canada had flat organic growth in the quarter, which was encouraging considering the challenging environment and negative 8% organic growth last quarter. Management has made a significant investment in talent within its insurance brokerage business (Marsh), adding roughly 150 managing directors and senior vice presidents since second quarter 2008, with over 80% of the new hires in client-facing roles.

Reinsurance broker Guy Carpenter (17% of risk and insurance services revenue) had another strong quarter, with 11% organic growth, a significant improvement from negative organic growth throughout 2008, and marked the first time in over five years that the company achieved double-digit organic growth in back-to-back quarters. According to management, Guy Carpenter's new business growth

was strong (20% growth) for the fourth consecutive quarter; this, coupled with an increase in client retention and good expense management, has led to a significant increase in profitability in the segment. Guy Carpenter underwent a management change in late February 2008 and is beginning to realize the benefits from a new sales group—the company made additional hires during the quarter to its executive and sales teams, adding over 30 strategic hires since the beginning of the year—and its decision to expand into underserved markets (United Kingdom, Europe, and Japan as well as specialty lines: marine and energy, aviation, etc.). In April, Guy Carpenter completed the acquisition of John B. Collins Associates—the fifth-largest reinsurance intermediary in the United States and seventh-largest in the world.

The adjusted risk and insurance operating margin was an impressive 20.2%, compared with a seasonally strong 25.0% last quarter, 14.6% in second quarter 2008, and our 16.5% estimate. The improvement in profitability compared with the prior year was driven by cost savings from aggressive expense management including the benefits from formal restructuring. We expect margins to move higher in 2009 as well, through continued client retention and improvement in operating efficiencies. Management revised its targeted adjusted margin for 2009 to 18.0% from 17.0%, given the improvement in profitability in the second quarter and a more favorable outlook for ongoing expense management for the balance of the year—a significant improvement from the 2008 adjusted risk and insurance operating margin of 13.2%. Our estimate is now closer to 20.0%, up from 18.0%.

Consulting Revenue—Recessionary Conditions Continue to Pressure Results

Overall, consulting results continue to disappoint, but not entirely surprising given pressure on revenue, particularly in more economically sensitive practice areas, and the adverse impact from foreign exchange. Organic revenue growth was negative 9.0%, and the operating margin declined to 8.8%, from 12.0% a year ago, and compared with our 9.5% estimate. The consulting business should be able to produce midteens percentage operating margins over time, in our view, but we expect further pressure on growth in the near term and flattish margins in 2009 with the benefit from cost-savings efforts. Management stated that it believes first quarter 2009 marked the bottom of the profitability cycle for consulting, and having aggressively brought down expenses, it is our view that the company is well positioned to benefit from a return of top-line growth and a midteens margin should be achievable once market conditions improve.

The core Mercer business had 5% negative organic growth and Oliver Wyman (27% of total), which includes the specialty consulting businesses and is more economically sensitive, declined 19%. Mercer's two-largest consulting practices, retirement and health and benefits, each had 2% decline in revenue during the quarter, compared with positive 2% and positive 4% growth last quarter, respectively. The adverse impact from a pullback in discretionary spending continues to plague Mercer's other consulting lines, with negative 18% growth in the quarter, compared with negative 12% last quarter. Outsourcing experienced a 5% decline in organic growth in the quarter, as 25% of revenue in this business is tied to assets under administration and is therefore positively correlated with equity market performance, which has declined sharply compared with the year-ago period. Mercer's smallest practice, investment consulting, had organic growth of 2% in the quarter, after 6% growth last quarter. The cost-cutting initiatives started in the fourth quarter continued to benefit profitability, leading to a nearly 14% year-over-year reduction in operating expenses. The strengthening of the U.S. dollar versus the euro, British pound, and Canadian dollar adversely affected consulting operating income by \$26 million, a \$19 million adverse impact to Mercer's operating income, and management expects foreign-currency translations will likely continue to adversely affect operating results in the third quarter. The Oliver Wyman business is navigating in a very difficult operating environment. Cost-cutting initiatives in the business have significantly reduced staff during the first half of the year. While revenue declined 19%, expenses were also reduced by an impressive 17% in the quarter—which includes \$8 million of severance expenses.

Kroll, risk consulting and technology business, had negative 24% organic growth in the quarter, as the recessionary conditions continue to weigh on its business lines, risk mitigation and response had negative 33% organic growth, litigation support and data recovery had negative 29% organic growth, and employment background screening had negative 9% organic growth in the quarter. Kroll has been in a period of transition over the past 12 months with the divestiture of its corporate advisory and restructuring business in late 2008, and in May the company completed the disposition of its U.S.

government security clearance screening business, resulting in the goodwill impairment charge mentioned above.

Maintaining Market Perform Rating, Increasing Estimates

We are increasing our 2009 EPS estimate to \$1.45 from \$1.43 and increasing our 2010 EPS estimate to \$1.90 from \$1.80 given enhanced profitability within insurance brokerage. Given the outperformance within insurance brokerage in the first half and the underperformance within consulting, insurance brokerage is a larger driver of overall earnings. We have started to view shares as a bit more compelling recently given significance underperformance from the market bottom in early March, although valuation has crept up over the last two weeks. We are pleased with the progress of the new management team at Marsh & McLennan, and believe it is taking the company in the right direction. Marsh & McLennan has very valuable assets, no balance-sheet risk, and no business model risk. Risks for the company are industry-related with pricing stabilization expected to be a slow grind and recessionary factors continuing to restrain top-line growth, especially within the consulting business. The stock is trading at about 12 times our 2010 EPS estimate of \$1.90, and we view 10 to 12 times in the current environment as an attractive entry point. Similar to Aon, we see the stock outperforming in a more severe pullback in equity markets and/or if commercial property-casualty insurance price increases accelerate. That said, we favor Aon over Marsh & McLennan in the near term at the same valuation level given less economic sensitivity and more conviction regarding execution.

Marsh & McLennan Companies, Inc.
Condensed Income Statement Comparison
(\$ in millions, except per share data)

	1Q08	2Q08	3Q08	4Q08	2008 Actual	1Q09	2Q09	3Q09E	4Q09E	2009 Estimate	2010 Estimate
Operating revenue:											
Risk & Insurance Services	\$1,500	\$1,415	\$1,313	\$1,276	\$5,504	\$1,372	\$1,343	\$1,226	\$1,268	\$5,210	\$5,447
% change annual	5%	6%	4%	-6%	2%	-9%	-5%	-7%	-1%	-5%	5%
% organic growth	-4%	1%	-1%	1%	0%	-1%	2%	2%	2%	2%	5%
Risk Consulting & Technology	\$257	\$266	\$254	\$201	\$978	\$187	\$161	\$203	\$171	\$722	\$722
% change annual	10%	7%	-2%	-19%	-1%	-27%	-39%	-20%	-15%	-26%	0%
% organic growth	3%	6%	-5%	-16%	-3%	-8%	-20%	-5%	-5%	-10%	0%
Mercer Consulting	\$1,295	\$1,374	\$1,328	\$1,199	\$5,196	\$1,083	\$1,143	\$1,176	\$1,187	\$4,590	\$4,719
% change annual	15%	13%	9%	-9%	6%	-16%	-17%	-11%	-1%	-12%	3%
% organic growth	8%	7%	6%	-3%	4%	-7%	-9%	-6%	0%	-5%	3%
Total operating revenue	\$3,052	\$3,055	\$2,895	\$2,676	\$11,678	\$2,642	\$2,647	\$2,606	\$2,627	\$10,522	\$10,889
% change annual	9%	9%	6%	-9%	4%	-13%	-13%	-10%	-2%	-10%	3%
Corporate eliminations	(\$13)	(\$22)	(\$19)	(\$14)	(\$68)	(\$13)	(\$18)	(\$20)	(\$20)	(\$71)	(\$80)
% change annual	-63%	-4%	-17%	8%	-28%	0%	-18%	5%	43%	4%	13%
Total revenue	\$3,039	\$3,033	\$2,876	\$2,662	\$11,610	\$2,629	\$2,629	\$2,586	\$2,607	\$10,451	\$10,809
% change annual	10%	9%	6%	-9%	4%	-13%	-13%	-10%	-2%	-10%	3%
Operating income:											
Risk & Insurance Services	\$264	\$207	\$69	\$189	\$729	\$343	\$271	\$178	\$235	\$1,026	\$1,143
% change annual	6%	80%	1280%	105%	58%	30%	31%	158%	24%	41%	11%
% operating segment revenue	17.6%	14.6%	5.3%	14.8%	13.2%	25.0%	20.2%	14.5%	18.5%	19.7%	21.0%
Risk Consulting & Technology	\$16	\$31	\$28	\$11	\$86	\$12	\$7	\$16	\$14	\$49	\$72
% change annual	-33%	3%	-3%	-27%	-12%	-25%	-77%	-42%	24%	-43%	48%
% operating segment revenue	6.2%	11.7%	11.0%	5.5%	8.8%	6.4%	4.3%	8.0%	8.0%	6.8%	10.0%
Mercer Consulting	\$151	\$165	\$158	\$121	\$595	\$74	\$101	\$112	\$131	\$417	\$549
% change annual	7%	2%	6%	-25%	-3%	-51%	-39%	-29%	8%	-30%	32%
% operating segment revenue	11.7%	12.0%	11.9%	10.1%	11.5%	6.8%	8.8%	9.5%	11.0%	9.1%	11.6%
Total operating income	\$431	\$403	\$255	\$321	\$1,410	\$429	\$379	\$306	\$379	\$1,493	\$1,765
% change annual	4%	31%	39%	19%	20%	0%	-6%	20%	18%	6%	18%
% total operating revenue	14.1%	13.2%	8.8%	12.0%	12.1%	16.2%	14.3%	11.7%	14.4%	14.2%	16.2%
Corporate expenses	45	45	38	42	170	39	40	39	39	157	164
Interest income	18	12	10	8	48	6	4	5	5	20	37
Interest expense	56	55	54	55	220	56	65	60	54	235	207
Investment income	8	(16)	(23)	19	(12)	(15)	(31)	20	15	(11)	16
Pretax operating income	\$356	\$299	\$150	\$251	\$1,056	\$325	\$247	\$232	\$306	\$1,110	\$1,447
% change annual	-5%	23%	-20%	26%	5%	-9%	-17%	55%	22%	5%	30%
Income tax expense	\$112	\$88	\$36	\$56	\$292	\$109	\$66	\$68	\$90	\$290	\$429
Effective tax rate	31.5%	29.4%	24.0%	22.3%	27.7%	33.5%	26.7%	29.5%	29.5%	26.1%	29.7%
Minority interest, net of tax	\$3	\$2	\$3	\$3	\$11	\$4	\$5	\$3	\$3	\$15	\$16
Operating income from continuing operations—adjusted¹	\$241	\$209	\$149	\$192	\$791	\$206	\$172	\$160	\$213	\$751	\$986
% change annual	6%	49%	86%	113%	47%	-199%	232%	187%	191%	-2406%	155%
Operating EPS	\$0.46	\$0.41	\$0.29	\$0.37	\$1.54	\$0.40	\$0.33	\$0.31	\$0.41	\$1.45	\$1.90
% change annual	3%	41%	56%	53%	31%	-14%	-19%	7%	10%	-6%	31%
Average diluted shares	519	512	516	514	515	515	522	518	519	518	520

¹Excludes all nonrecurring expenses/charges in all segments. Beginning 1Q09, also adjusted using the "two-class method" where earnings attributed to unvested shares are excluded.

Source: Company reports and William Blair & Company estimates

William Blair & Company, L.L.C. is a market maker in the security of Marsh & McLennan Companies, Inc. and may have a long or short position.

Additional information is available upon request.



Current Rating Distribution (as of 7/31/2009)

Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	59	Outperform (Buy)	2
Market Perform (Hold)	40	Market Perform (Hold)	1
Underperform (Sell)	1	Underperform (Sell)	0

*Percentage of companies in each rating category that are investment banking clients, defined as companies for which William Blair has received compensation for investment banking services within the past 12 months.

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