

Broker Channel Check

Early View on the Second Quarter

We talked with over a dozen brokers in the last several weeks regarding the current state of the market. The overall view is that 2011 is shaping up to be much better than 2010, and for the most part, the second quarter should show moderate improvement compared with the first quarter.

Retail property-and-casualty up slightly: Organic growth is up modestly in the second quarter compared with the first quarter. Most accounts are flat or showing gradual increases. The environment is relatively stable with easier comparisons as headwinds have abated.

Rates better, but still negative: Rates are moving closer to a barbell graph with a relatively good portion of the market close to flat and the amount of accounts with negative rates moving closer to the number of accounts with positive rates. However, on balance, the depth of the rate decreases is still outweighing the degree of the increases. Overall, rates are still down 3% or more in most commercial lines. Workers' compensation and coastal property are experiencing notably less pressure than several months ago.

Benefit brokerage is more challenging: Benefit organic growth is slowing from 2%-3% to closer to flat. Generally, clients are being hit with big rate increases and do not have tolerance to pay higher commissions or fees. Brokers are under pressure from new legislation. Commissions for accounts with fewer than 50 lives are declining and larger clients are placing more emphasis on fee-based relationships.

Reinsurance brokerage should provide moderate tailwind: It is a challenge to discern a true average for property catastrophe reinsurance pricing given that in addition to price changes, there was also material movement in layers and retention. In comparison to January 1 renewals (rates were -5% to -10%), there was definitely an upward bias to rates, although the movement was not uniform. The median range (i.e., there are extremes at either end) appears to be -5% to up 10%, with data spread across the range.

Stocks poised to move: The broker stocks got moderately ahead of themselves with the 30% move at the end of 2010. This resulted in the one-year-forward P/E multiple rising from 15 to 18 times. The stocks should begin to move again as indications of a strong 2012 become evident. We expect earnings to jump in 2012 as a result of increasing organic growth and in some cases material costs savings. The result is that stocks are trading at only 15 times 2012 estimates and current estimates could be conservative. Catalysts include accelerating organic growth and improved visibility on costs savings. Aon and Willis Group are our two top picks, based on higher-than-expected 2012 earnings growth and lower-than-average valuations.

Financial | Insurance Brokers

June 20, 2011

Aon Corporation

Stock Rating: **Outperform**
 Company Profile: **Established Growth**
 Symbol: AON (NYSE)
 Price: \$49.58 (52-Wk.: \$35-\$55)

Arthur J. Gallagher & Co.

Stock Rating: **Market Perform**
 Company Profile: **Established Growth**
 Symbol: AJG (NYSE)
 Price: 28.1 (52-Wk.: 23.96-31.92)

Brown & Brown, Inc.

Stock Rating: **Market Perform**
 Company Profile: **Established Growth**
 Symbol: BRO (NYSE)
 Price: 25.02 (52-Wk.: 18.85-27.07)

Marsh & McLennan Companies, Inc.

Stock Rating: **Market Perform**
 Company Profile: **Established Growth**
 Symbol: MMC (NYSE)
 Price: 29.79 (52-Wk.: 22.13-31.1)

Willis Group Holdings Public Limited Company

Stock Rating: **Outperform**
 Company Profile: **Established Growth**
 Symbol: WSH (NYSE)
 Price: 40.14 (52-Wk.: 28.91-42.42)

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Please consult the last page of this report for all disclosures.

**Insurance Brokers
Valuation Comparison**

Ticker	Rating	Price	GAAP EPS			GAAP P/E			Cash P/E			EV / EBITDA		
			2010	2011E	2012E	2010	2011E	2012E	2010	2011E	2012E	2010	2011E	2012E
AON	O	49.58	\$3.07	\$3.35	\$4.00	16.2x	14.8x	12.4x	15.0x	13.4x	10.1x	9.7x	7.1x	6.4x
AJG	M	28.15	\$1.36	\$1.35	\$1.60	20.7x	20.9x	17.5x	15.1x	16.1x	13.9x	10.3x	8.7x	7.6x
BRO	M	25.08	\$1.13	\$1.17	\$1.32	22.2x	21.5x	19.1x	16.8x	16.2x	14.6x	10.3x	9.9x	8.9x
MMC	M	29.85	\$1.66	\$1.88	\$2.17	18.0x	15.9x	13.8x	17.3x	15.1x	13.1x	9.3x	8.5x	7.9x
WSH	O	39.91	\$2.69	\$2.87	\$3.60	14.8x	13.9x	11.1x	13.1x	19.3x	10.2x	9.7x	9.3x	7.9x
Average						18.4x	17.4x	14.8x	15.5x	16.1x	12.4x	9.9x	8.7x	7.7x
Median						18.0x	15.9x	13.8x	15.1x	16.1x	13.1x	9.7x	8.7x	7.9x

Sources: Company reports, Thomson One, and William Blair & Company L.L.C.

**Insurance Brokers
Organic Revenue Growth Trends**

Company	Ticker	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10	1Q11	2006	2007	2008	2009	2010	2011E	2012E
Aon Corporation	AON	1.0%	0.0%	-3.0%	-1.0%	-3.0%	-0.8%	-0.5%	3.0%	2.0%	2.0%	3.0%	2.0%	-1.0%	0.0%	2.9%	3.3%
Arthur J. Gallagher	AJG	-4.0%	-1.0%	-4.0%	0.0%	-3.0%	-3.0%	0.0%	0.0%	1.6%	5.0%	2.0%	0.0%	-2.0%	-2.0%	2.7%	4.0%
Brown & Brown	BRO	-9.2%	-8.0%	-8.3%	-9.4%	-4.0%	-3.6%	-5.0%	-4.5%	-3.0%	3.9%	-3.4%	-5.5%	-5.1%	-4.6%	0.7%	4.0%
Marsh & McLennan	MMC	-1.0%	0.0%	-3.0%	-2.0%	0.0%	1.0%	2.0%	5.0%	4.0%	0.0%	-1.0%	0.0%	-1.0%	2.0%	3.8%	3.8%
Willis Group Holdings	WSH	2.0%	1.0%	2.0%	2.0%	3.0%	4.0%	4.0%	4.0%	4.0%	8.0%	3.0%	4.0%	2.0%	4.0%	5.1%	6.3%
Median		-1.0%	0.0%	-3.0%	-1.0%	-3.0%	-0.8%	0.0%	3.0%	2.0%	3.9%	2.0%	0.0%	-1.0%	0.0%	2.9%	4.0%
Average		-2.2%	-1.6%	-3.3%	-2.1%	-1.4%	-0.5%	0.1%	1.5%	1.7%	3.8%	0.7%	0.1%	-1.4%	-0.1%	3.0%	4.3%

Sources: Company reports and William Blair & Company L.L.C.

Retail Property-and-Casualty Brokerage

- Organic growth is up modestly in the second quarter compared with the first quarter. Most accounts are flat or showing gradual increases. The environment is relatively stable with easier comparison as headwinds have abated.
- Exposures have moved from negative in the prior year to almost flat. Payrolls are still relatively flat, with most middle-market clients being conservative in growing their business.
- Growth is split, with technology and healthcare showing good growth, manufacturing and transportation relatively neutral, and construction still negative.
- Return premium audits are much lower than last year. However, in general, they have yet to turn positive.
- Rates are moving closer to a barbell graph with a relatively large portion close to flat and the amount of accounts with negative rates moving closer to the number of accounts with some level of increases. However, on balance, the depth of the increases is still outweighing the depth of the decreases. Overall, rates are still down 3% or more in most commercial lines. Workers' compensation and coastal property are seeing less pressure than several months ago.

Benefits/Consulting

- Benefit organic growth is slowing from 2%-3% to closer to flat. Generally, clients are being hit with such big increases that they do not have tolerance to increase commissions or fees.
- Brokers are under pressure from new legislation. Benefit change—under 50 lives, commissions are down materially.
- Aetna (AET \$44.77), in cases involving a greater number of lives, has made brokers carve out commissions and is pushing for a movement to fee-based.
- Larger Blues are being less aggressive for now with brokers, but some are pushing for per member per month charges (effectively makes it a fee orientation).
- There has been some element of fee competition, with brokers willing to reduce fees or commissions if threatened with losing business.
- The overall push is to take away inflation-oriented increases. Aside from the small-lives market, there has not been pressure to reduce level of commissions/fees, but that could be the next step.
- The consulting market is seeing some life in discretionary spending items, such as talent reward and leadership studies.
- Outsourcing is stable, but not seeing improvement. The business is large and highly recurring, but it is tough to move the needle—companies need job growth or big client wins, and it is too early for that.

Acquisitions

- The acquisition market has become more competitive in the last six months. Brokers are more aggressive and bidding up even smaller properties.

- The supply of benefit brokers willing to sell is higher than usual—most likely over fear of the future of the business.

Reinsurance Brokerage

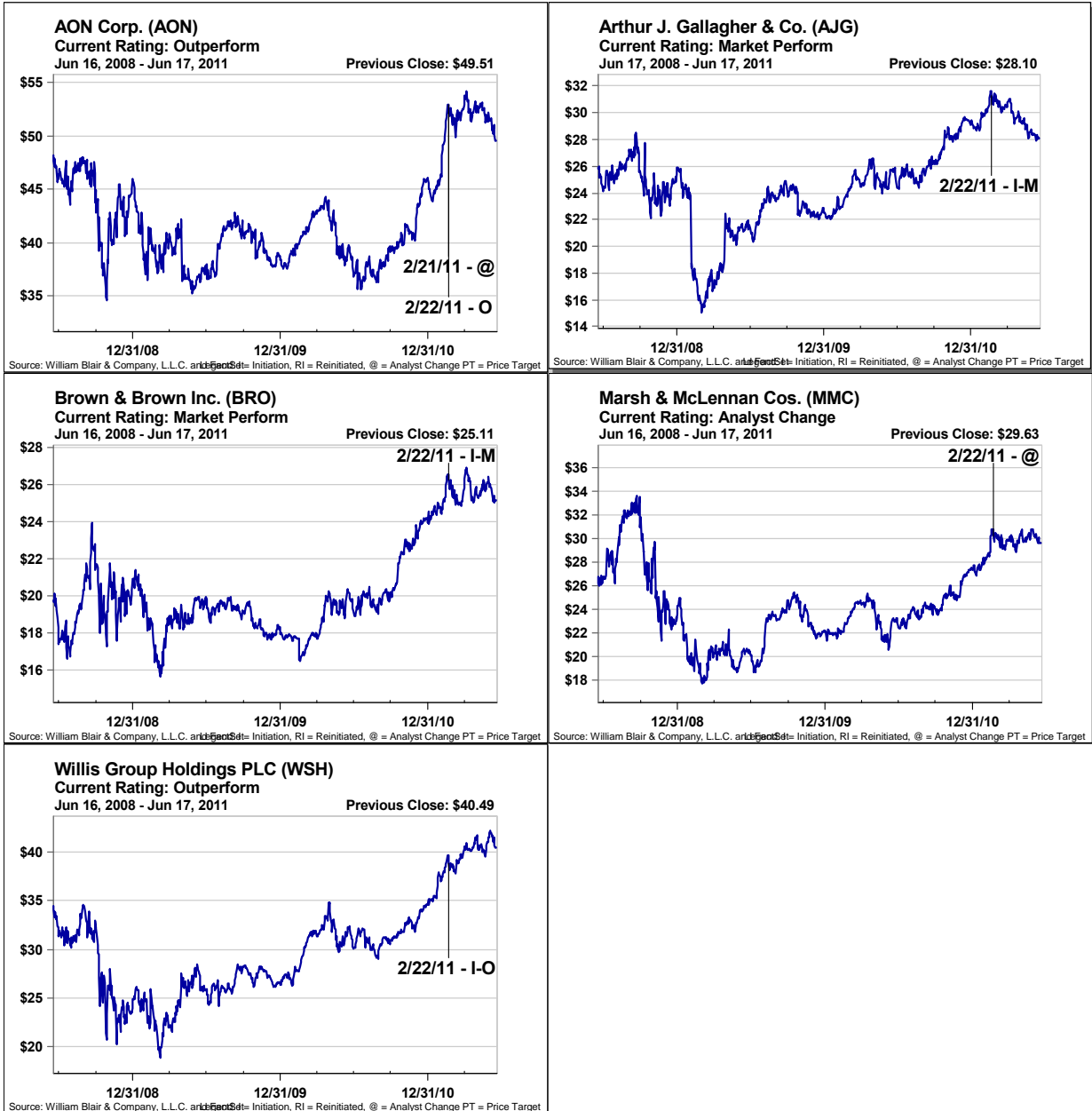
The market tended to have significant variation in renewal pricing. It is a challenge to discern a true average given that in addition to price changes, there was also material movement in layers and retention. In comparison to January 1 renewals (rates were -5% to -10%), there was definitely an upward bias to rates, although the movement was not uniform. The median range (i.e., there are extremes at either end) appears to be -5% to up 10%, with data spread across the range.

- Florida homeowners' company: These companies were supposedly under significant pressure from RMS changes. However, in conversation with one of the larger Florida insurers, it said its renewal rate was actually flat with expiring policies. The company had actually pulled back exposure from the prior year and was in need of less capacity. Some of the Florida-only competitors that added business during the year and thus need additional capacity were incurring material rate increases.
- Prior level of pricing: On an anecdotal basis, several larger programs that had relative low market prices in the last renewal were brought closer in line with the market. This resulted in 5%-plus rate increases. This had more to do with relative pricing and less to do with underexposure related to RMS.
- Citizens (CIA \$6.53) and TWIA add to market: Several large programs added over \$1 billion of limit placed into the market in comparison to the last renewal period. This is good and bad news for the market. The placement of these programs should generate additional premiums for the reinsurers and fees for reinsurance brokers. However, it also shows that capacity is still sufficient given that reinsurers had to extend material amounts of additional limit.
- Large Europeans: Munich Re and Swiss Re participate in June 1 on a selective basis. Often these reinsurers tend to provide capacity to the larger, more established risks. Despite major international earthquake losses, these reinsurers continue to be focused on maintaining relationships with core clients.
- Retro/ILW market: Early indications are that the retro and ILW (where reinsurers buy protection) market had been materially firmer than the core reinsurance market. This market will likely heat up in the next several weeks after June 1 renewals are fully placed.

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Outperform (Buy)	61	Outperform (Buy)	9
Market Perform (Hold)	29	Market Perform (Hold)	1
Underperform (Sell)	1	Underperform (Sell)	0

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