

# Insurance Brokers

## Highlights From Discussion With a Risk Manager (Insurance Buyer)

- **Risk management role:** The risk manager is an insurance buyer for large corporations. The risk manager's role is not just to purchase insurance, but to manage and administer large complex insurance programs.
- **Competitive landscape:** The market for large risks remains competitive and pricing is soft (based on this company's experience). The risk manager recently took a large program to the market. The tone and positioning of insurers actually weakened from last year for this particular program.
- **Property and casualty pricing:** In the last five years, this risk experienced an overall pricing decrease of roughly 40%. The risk manager related that there was continued pressure from the corporation to reduce premiums (i.e., insurance spend) as part of cost-saving efforts.
- **Broker insight:** The risk manager confirmed that even at the *Fortune* 500 level relationship was the most important aspect in selecting a broker. There has been pressure on fees. This manager estimated that the fees that this company pays to brokers are down by roughly 15% in the last several years.
- **Captive usage:** This company has actually been increasing usage of the captive despite a soft pricing market. This effectively reduces premium for the traditional insurance market.
- **Bottom line:** The property and casualty market continues to be soft. This confirms our thesis that the insurance brokers are attractive on a relative basis to the underwriters. The brokers should continue to gain momentum as the effects of an improving economy and acquisitions outweigh declining premium rates. Aon and Willis are our top picks in the group (see our February 22, 2012, broker initiation report for greater detail).

## Financial: Insurance Brokers

February 25, 2011

### Aon Corporation

Stock Rating: **Outperform**  
 Company Profile: **Established Growth**  
 Symbol: AON (NYSE)  
 Price: \$51.92 (52-Wk.: \$35-\$53)

### Arthur J. Gallagher & Co.

Stock Rating: **Market Perform**  
 Company Profile: **Established Growth**  
 Symbol: AJG (NYSE)  
 Price: \$30.64 (52-Wk.: \$23-\$32)

### Brown & Brown, Inc.

Stock Rating: **Market Perform**  
 Company Profile: **Established Growth**  
 Symbol: BRO (NYSE)  
 Price: \$25.75 (52-Wk.: \$17-\$27)

### Marsh & McLennan Companies, Inc.

Stock Rating: **Market Perform**  
 Company Profile: **Established Growth**  
 Symbol: MMC (NYSE)  
 Price: \$29.98 (52-Wk.: \$20-\$31)

### Willis Group Holdings Public Limited Company

Stock Rating: **Outperform**  
 Company Profile: **Established Growth**  
 Symbol: WSH (NYSE)  
 Price: \$38.30 (52-Wk.: \$29-\$40)

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**Risk management role:** The risk manager is an insurance buyer for large corporations. The risk manager's role is not just to purchase insurance, but to manage and administer large complex insurance programs. Most corporations buy a range of coverages, including property, general liability, commercial auto, workers' compensation, and company-specific-focused coverages. Risk managers typically work with brokers. Aon and Marsh dominate the *Fortune* 500 market, although midsize brokers occasionally win niche pieces of business. Brokers are mainly compensated on a fee basis for these large accounts. Commission arrangements are used in specific situations. Risk managers typically use a combination of underwriting markets, as the programs can be quite large. Chartis, Ace, Zurich, Munich Re, Swiss Re are some of the larger participants in this market, although, Bermuda and Lloyds get their fair share of business as they fill out the programs. In addition captive vehicles (i.e., self insurance) are often employed to augment capacity, maintain pricing leverage, and generate profits.

**Competitive landscape:** The market for large risks remains competitive and pricing remains soft (based on this company's experience). The risk manager recently took a large program to the market. Despite being a large program (over \$1 billion of coverage), there was plenty of capacity. In fact, several good-sized carriers are already lobbying for a bigger position next year. One large international insurer returned to the program for the first time in a number of years. The tone and positioning of the renewal process changed from last year. In 2010, underwriters originally positioned the program for rate increases. As the renewal process progressed, discipline weakened and the program renewed at less than expiring. For this year, the underwriters discussed the need to hold profitability, but acknowledged that pricing would likely be down from the start. The carriers discussed the need for pricing to eventually go up, but did not try to push for it on this program. One note is that this risk has been a relatively low loss program and therefore is considered a good risk.

**Property and casualty pricing:** In the last five years, this risk experienced an overall pricing decrease of roughly 40%. The risk manager related that there was continued pressure from the company to reduce premiums (i.e., insurance spend) as part of costs saving programs. Pricing on property for the risk is down more than 10% from last year. Casualty is expected to be relatively flat. However, this is mainly due to several unique risks that are emerging in the clients' insurance program. Also, the buyer said the premium is already very low.

**Broker insight:** The risk manager confirmed that even at the *Fortune* 500 level, relationship was the most important aspect in selecting a broker. One of the major reasons the manager switched brokers several years ago was due to a change in the relationship manager at the incumbent broker. There has been pressure on fees. This manager estimated that the fees that this company pays to brokers are down by roughly 15% in the last several years.

**Captive usage:** Insurance captives are essentially self-insurance vehicles that companies use as an alternative to the traditional insurance market. Captive vehicles (i.e., self insurance) are often employed to augment capacity, maintain pricing leverage and to generate profits. Captive usage is relatively common among *Fortune* 500 companies that have sophisticated risk management department and also larger balance sheets that absorb additional risk. Most companies utilize a combination of the captive capacity and the traditional market. This company has actually been increasing usage of the captive despite a soft pricing market. This effectively reduces premium for the traditional insurance market.

**Bottom line:** The property and casualty market continues to be soft. This confirms our thesis that the insurance brokers are attractive on a relative basis to the underwriters. The brokers should continue to gain momentum as the effects of an improving economy and acquisitions outweigh declining premium rates. In contrast, softening rates suggest potentially lower returns for the underwriters. Aon and Willis are our top picks in the group. Higher potential earnings growth and lower-than-average valuation outweigh greater-than-average execution risk for both these stocks.

**Insurance Brokers  
Valuation Comparison**

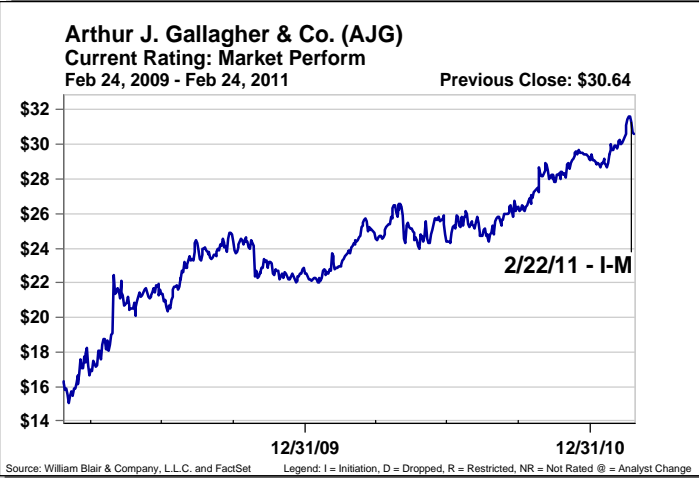
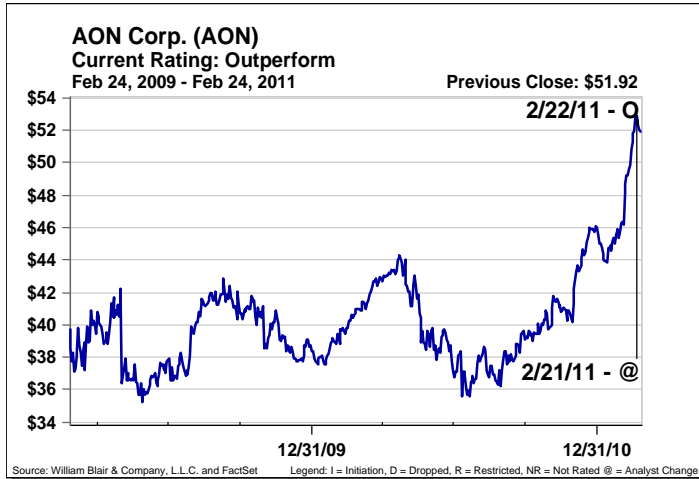
Ticker	Rating	Price	GAAP EPS			GAAP P/E			Cash P/E			EV/EBITDA		
			2010	2011E	2012E	2010	2011E	2012E	2010	2011E	2012E	2010	2011E	2012E
AON	O	\$51.92	\$3.07	\$3.25	\$3.84	16.9x	16.0x	13.5x	15.7x	14.4x	10.0x	10.2x	7.4x	6.9x
AJG	M	\$30.64	\$1.41	\$1.50	\$1.75	21.7x	20.4x	17.5x	15.9x	16.2x	14.2x	11.5x	10.0x	8.9x
BRO	M	\$25.75	\$1.13	\$1.17	\$1.32	22.8x	21.9x	19.5x	17.3x	16.6x	15.1x	11.4x	10.9x	9.9x
MMC	M	\$29.98	\$1.66	\$1.82	\$2.04	18.1x	16.5x	14.7x	17.4x	15.8x	14.1x	10.3x	10.0x	9.4x
WSH	O	\$38.30	\$2.69	\$2.80	\$3.55	14.2x	13.7x	10.8x	12.6x	12.5x	10.1x	9.7x	9.5x	8.1x
Average						18.8x	17.7x	15.2x	15.8x	15.1x	12.7x	10.6x	9.6x	8.6x
Median						18.1x	16.5x	14.7x	15.9x	15.8x	14.1x	10.3x	10.0x	8.9x

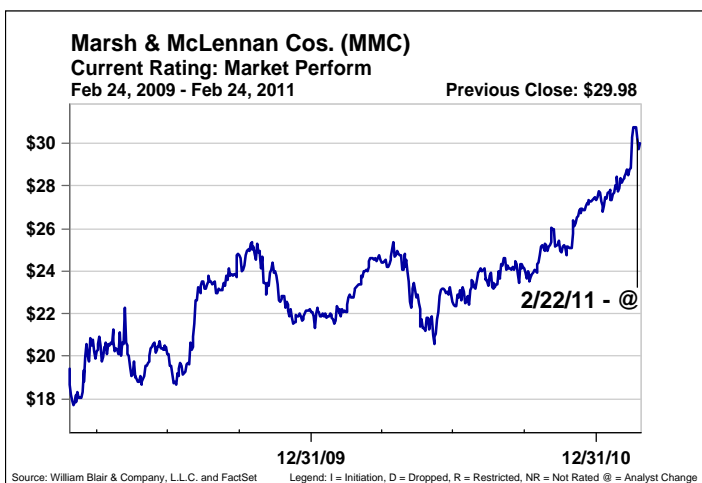
Sources: Company reports, Thomson One, and William Blair & Company, L.L.C.

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Additional information is available upon request.





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Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	65	Outperform (Buy)	9
Market Perform (Hold)	34	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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