

Insurance—Cash Flow and Reserve Insight

A Weekly Report Spotlighting Key Issues Driving Insurance Stocks

Highlighted Analysis:

Marsh DCF Suggests Untapped Potential

Featured Stock: Marsh and McLennan Companies, Inc.

Issue Summary: Cash flow generation should become increasingly important given a higher level of macro uncertainty. Marsh's free cash flow should rise materially in the next two years, providing more flexibility to grow earnings and take advantage of strategic opportunities.

Conclusion: We forecast that Marsh's free cash flow will increase over the next five years, from \$1.1 billion in 2011 to \$1.6 billion by 2015. Growth in free cash flow will be due to revenue growth from the consulting and RIS segments, internal cost savings derived from restructuring efforts, and exposure to both global markets and core large-cap customers that should prove more resilient over the next few years.

Stock Implications: Our DCF analysis suggests that the stock is undervalued. In line with traditional valuation measures (P/E and EV/EBITDA), the DCF analysis suggests that long-term upside would be in the 40% range if multiples returned to their historical averages. However, we are reiterating our Market Perform rating on Marsh and believe that Aon (AON \$44.32; Outperform) presents greater near-term upside. Marsh's ability to use a large cash position/unlevered balance sheet could translate into materially higher free cash flow and ultimately a greater DCF valuation. **We would prefer to see Marsh actively deploying cash before we become more excited about the stock.** In contrast, Aon has been more aggressive in cash deployment and appears to have stronger potential free cash generation; therefore, it is significantly more attractive on a DCF basis. Free-cash-flow yields are 8.3% for Marsh and 11.5% for Aon.

Insurance Trading Pattern

Middle-Market Brokerage Stocks Lagging

Trend to Monitor: Arthur J. Gallagher (AJG \$27.44; Market Perform) and Brown & Brown (BRO \$18.16; Market Perform) have both been hit hard over the past six months as economic uncertainty and high U.S. unemployment levels continue to take their toll on the middle-market segment in particular (where these companies tend to focus their business). Consequently, the stocks have underperformed and are trading at significant discounts to their historical average EV/EBITDA ratios. On a relative basis, they are trading at valuation multiples similar to the large-broker peer group, including Willis (WSH \$35.32; Outperform), Aon, and Marsh. While we currently favor the larger brokers due to their more diverse business models, both geographically and operationally, the middle-market brokers are approaching attractive valuation levels. At some point in the not-too-distant future, these stocks will be great buys, as they have the most leverage to a hardening P&C market. We believe mid- to late 2012 could be a good time to start buying these stocks.

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Please consult the last page of this report for all disclosures. William Blair & Company, L.L.C. receives or seeks to receive compensation for investment banking services from Marsh & McLennan Companies, Inc. Investors should consider this report as a single factor in making an investment decision.

October 11, 2011

Marsh & McLennan Companies, Inc.
 Stock Rating: **Market Perform**
 Company Profile: **Established Growth**

Symbol: MMC (NYSE)
 Price: \$27.20 (52-Wk.: \$24-\$32)
 Market Value (mil.): \$14,441
 Fiscal Year End: December
 Long-Term EPS Growth Rate: 10%
 Dividend/Yield: \$0.88/3.2%

	2010A	2011E	2012E
Estimates			
EPS FY	\$1.66	\$1.81	\$2.14
CY		\$1.81	\$2.14
Valuation			
FY P/E	16.4x	15.0x	12.7x
CY P/E		15.0x	12.7x

Trading Data (Thomson Financial)	
Shares Outstanding (mil.)	542
Float (mil.)	534
Average Daily Volume	4,574,306

Financial Data (Thomson Financial)	
Long-Term Debt/Total Capital (MRQ)	32.5
Book Value Per Share (MRQ)	14.7
Enterprise Value (mil.)	16,068.9
EBITDA (TTM)	1,962.0
Enterprise Value/EBITDA (TTM)	8.2x
Return on Equity (TTM)	14.4

Two-Year Price Performance Chart



Sources: Thomson Financial, William Blair & Company estimates

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Highlighted Analysis: Marsh DCF Suggests Untapped Potential

Executive Summary

Given uncertainties in the marketplace, investors are looking for businesses that not only have great balance sheets, but can also generate substantial amounts of cash. Cash generation can be used to grow a firm's earnings even in a difficult environment, as capital management becomes a crucial component in running a profitable business.

Marsh should generate increasingly higher levels of cash flow over the next several years, even with a more challenging economic environment. We are projecting that annual free-cash-flow generation will increase from \$1.1 billion in 2011 to more than \$1.5 billion by 2015 and grow at a 5% rate in the long run. Growth in free cash flow will be due to revenue growth from the consulting and RIS segments and internal cost savings derived from restructuring efforts.

From a cash flow perspective, Marsh appears undervalued based on its free-cash-flow growth rate. Discounted cash flow modeling suggests that Marsh could be up to 40% undervalued, which is confirmed by other relative valuation techniques. Importantly, increasing cash flow gives the company more flexibility on the capital management front, which should provide additional leverage to earnings growth in the future.


However, Marsh's projected upside from a DCF perspective is currently less than Aon's. Due to Aon's recent acquisition activity and more active capital management, it is able to generate significantly higher levels of free cash flow off a similar revenue base. Marsh, on the other hand, has been less active on the capital management front and has materially more flexibility with its current levels of cash on the balance sheet and lower debt leverage. A potential increase in acquisition activity could result in higher cash generation and a great DCF valuation. ***We would prefer to see Marsh actively deploying cash before we become more excited about the stock.***

Valuation Using Common Methodologies

Company	Rating	Current Price	Valuation Method	Estimate Type	2012 Estimate	Current Multiple	Historic Multiple	Price Given Historic	Free Cash Flow Yield
Marsh	M	\$27.60	P/E	EPS	\$2.14	12.9x	18.3x	\$39.11	
			EV/ EBITDA	EBITDA	\$2,164	6.9x	9.6x	\$35.53	
			DCF	Cash Flow	\$1,278			\$37.40	8.3%
AON	O	\$44.41	P/E	EPS	\$3.77	11.8x	14.3x	\$54.34	
			EV/ EBITDA	EBITDA	\$2,607	7.5x	9.3x	\$58.35	
			DCF	Cash Flow	\$1,757			\$72.78	11.5%

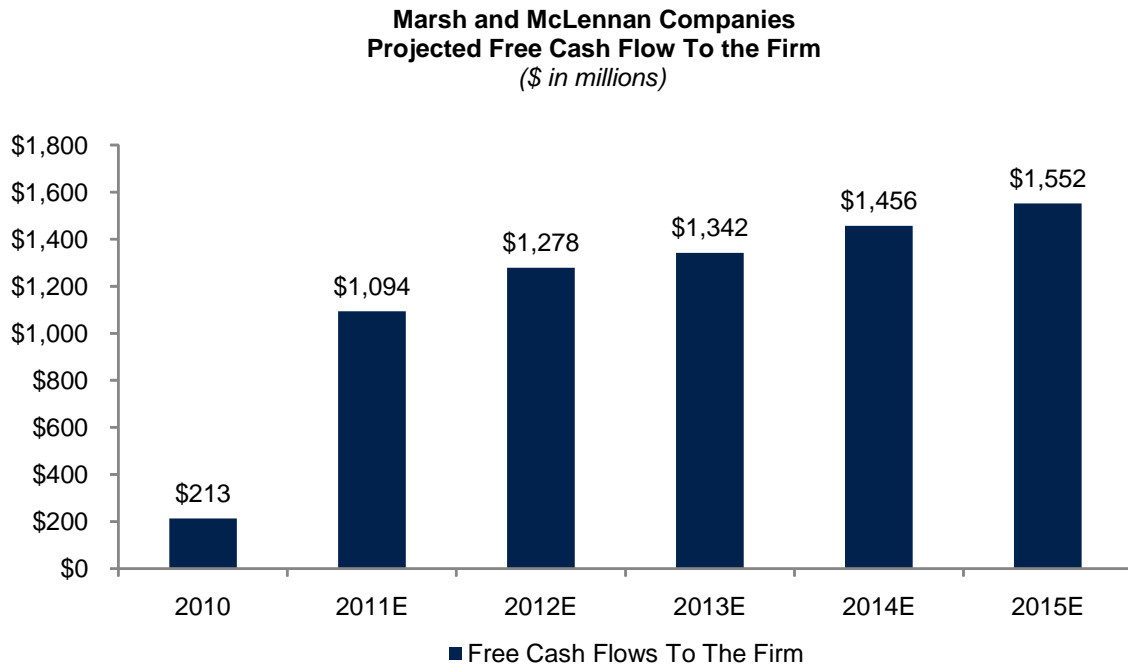
Source: Company Reports, SNL, and William Blair & Company LLC Estimates

Featured Stock

	Ticker	Rating	Price	2011 EPS Estimate	2012 EPS Estimate	2011 P/E	2012 P/E
	MMC	Market Perform	\$27.60	\$1.81	\$2.14	15.2x	12.9x
	Investment Summary: Margin expansion and best-in-class organic are paramount to improving our view of the company. While we view the recent trends favorably, we would like to see a few more quarters of improvement in those metrics, as well as some pick-up in acquisition activity, before getting more excited about the stock. In addition, at current valuation levels (the stock is trading at 14.7 times projected 2011 cash EPS and 12.3 times projected 2012 cash EPS), we believe there are better values in the sector.						

Marsh Cash Flow Analysis

Strong cash flow growth should lead to materially higher earnings power. Marsh should begin a strong period of substantial cash flow growth. We are forecasting that cash flow will increase to more than \$1.5 billion by 2015, driven by strong expected growth in the brokerage and consulting divisions, and substantial margin improvement. A potential property-and-casualty cycle turn in 2013 or 2014 could result in cash flow materially above our forecast. This forecast takes into consideration our recent 5% reduction in earnings (2012 from \$2.24 to \$2.14) and cash flow per share estimates to reflect the potential for a slower growth economy.



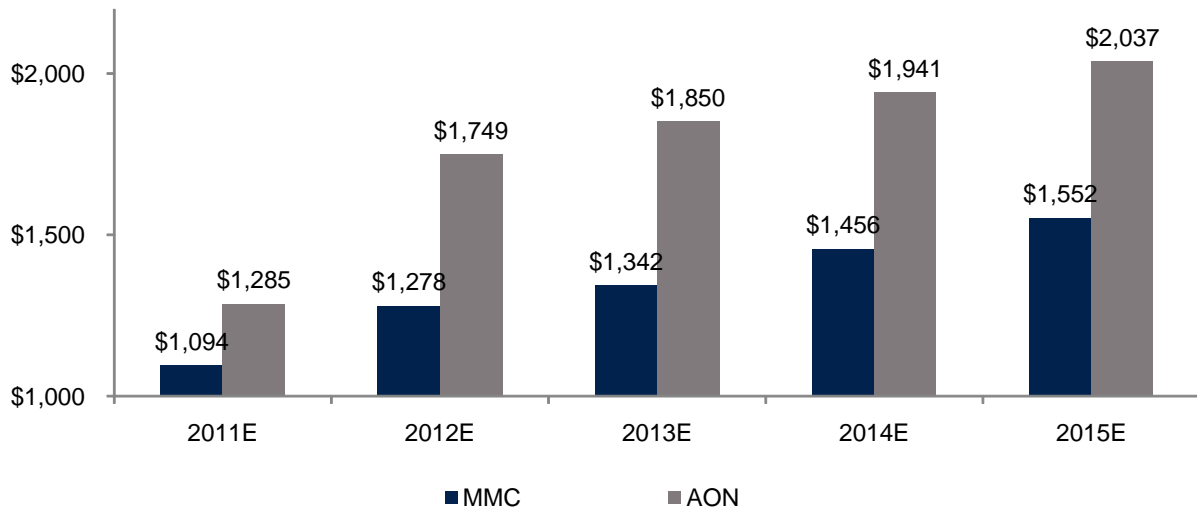
Source: Company Reports, SNL, and William Blair & Company LLC Estimates

Accelerating cash flow has the potential to increase earnings growth. The ability to increase share buybacks, acquisitions, and internal investments should augment earnings between 2013 and 2015. We believe that share buybacks and dividends in particular should become a much bigger part of Marsh's capital management philosophy as its free cash flow grows by 50% over the next five years.

Free Cash Flow Growth Lags Peer Aon

Cash flow growth is not quite as fast as that for rival Aon, due mainly to the fact that Aon has been more active on the capital management and acquisition fronts. The newly acquired Hewitt business should help Aon's cash flow grow markedly ahead of Marsh in the next few years. However, Marsh has the potential to narrow the gap if it becomes more aggressive in deploying excess cash and increasing leverage levels.

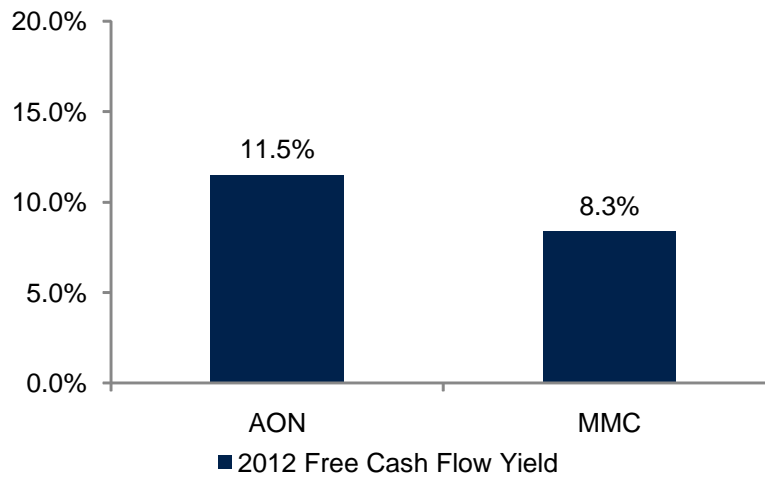
Projected Free Cash Flow to the Firm



Source: Company Reports, William Blair & Company LLC

This leads to a far higher free-cash-flow yield (free cash flow per share/price per share) for Aon versus Marsh.

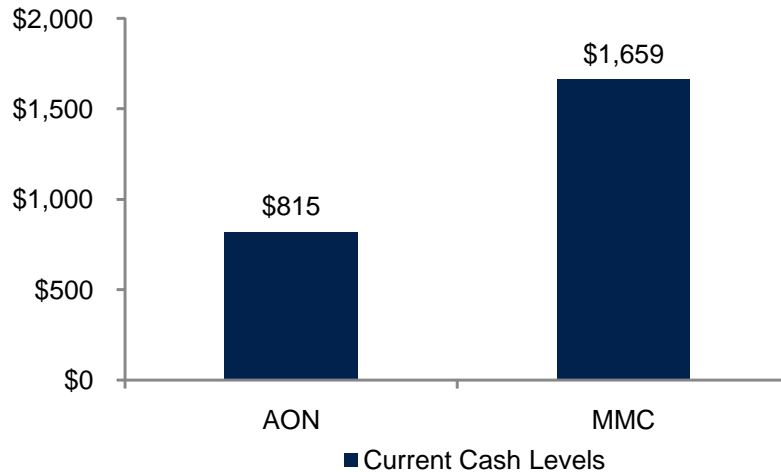
2012 Projected Free Cash Flow Yield (Based on Current Price)



Source: Company Reports, William Blair & Company LLC

On the other hand, Marsh is sitting on a much larger cash stockpile than Aon. Aon's cash levels are severely diminished after spending more than \$2.5 billion on the Hewitt acquisition in late 2010.

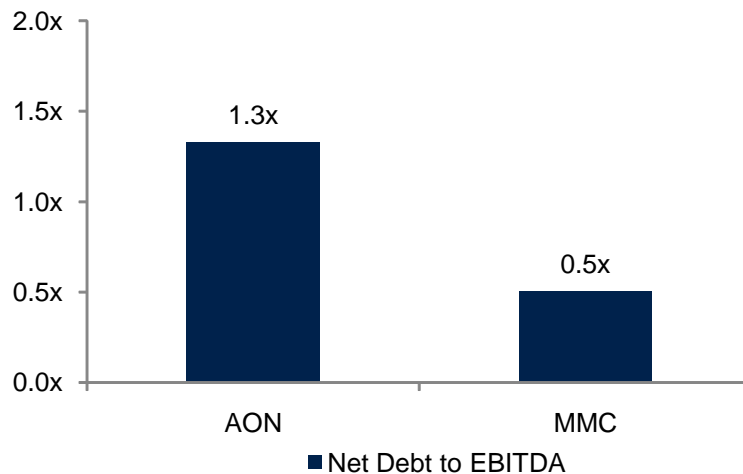
Current Cash and Short Term Investments on The Balance Sheet
(as of Q2 2011)



Source: Company Reports, William Blair & Company LLC

Combining Marsh's significant cash levels, along with its extremely conservative long-term debt position, we believe it is in an extremely enviable and flexible position from a capital management perspective. We hope to see some more aggressive action taken by Marsh's management on this front over the next 6 to 12 months, especially a large acquisition that could help improve top-line growth.

Net Debt to EBITDA
(Projected as of December 31, 2011)



Source: Company Reports, William Blair & Company LLC

Discounted cash flow modeling suggests Marsh is undervalued. DCF modeling is a particularly useful valuation metric when future cash flows closely mirror the profitability of the firm. We believe this to be the case for Marsh in the intermediate term, after integration and restructuring efforts are complete.

Marsh and McLennan Companies							
Free Cash Flow Summary							
(\$ in millions, except per share)							
	2010	2011E	2012E	2013E	2014E	2015E	
	AY	BD	BI	BN			
Earnings before interest and after tax	1,065.1	1,165.0	1,272.9	1,386.5	1,511.3	1,617.1	
Add: Depreciation and Amortization	357.0	340.0	340.0	340.0	340.0	340.0	
Add: Other Non-Cash Charges	17.0	75.0	75.0	75.0	75.0	75.0	
Less: Change in NWC	955.0	196.0	110.0	150.0	150.0	150.0	
Operating Cash Flow	484.1	1,384.0	1,577.9	1,651.5	1,776.3	1,882.1	
Less: Capital expenditures	(271.0)	(290.0)	(300.0)	(310.0)	(320.0)	(330.0)	
= Free Cash Flows To The Firm (\$ millions)	213.1	1,094.0	1,277.9	1,341.5	1,456.3	1,552.1	
Growth Rate of Free Cash Flows	-84%	413%	17%	5%	9%	7%	
PV Multiplier		0.95	0.86	0.77	0.69	0.63	
PV of Free Cash Flows To The Firm		1,038.4	1,092.7	1,033.4	1,010.7	970.4	

Source: Company Reports, SNL, and William Blair & Company LLC Estimates

Our DCF model projects a potential stock price for Marsh of \$37.40, compared with the current price of \$27.60, which represents modest upside potential. For our projections, we conservatively assume a 5% long-run growth rate for free cash flow and a discount rate of 11%. Long-run growth rates could be higher with significant acquisition activity, or rapid economic expansion.

Marsh and McLennan Companies
Free Cash Flow Valuation
(\$ in millions, except per share)

Valuation:	Current
Terminal Value (perpetuity)	\$27,162
PV of Terminal Value	\$16,983
Sum of Present Value of FCF's through 20	\$5,146
Firm Value	\$22,128
Debt Value, Net of Cash	\$1,374
Value of Firm Equity	\$20,754
Number of Shares Outstanding	555
Per-Share DCF Value of MMC Equity	\$37.40

Assumptions:	
Long Term FCFF Growth Rate	5.0%
Long Term Discount Rate	11.0%

Source: Company Reports, SNL, and William Blair & Company LI

Below is a sensitivity table that shows what happens to our projections if our long-term free-cash-flow growth rates or discount rates are adjusted. Our current expected scenario with a 5% long-term growth rate and an 11% discount rate is \$37. Our bear-case scenario of 3% growth and an 11% discount rate suggests a stock price of \$29. Our bull-case scenario of 6% growth with an 11% discount rate suggests a stock price of \$44.

**Marsh and McLennan Companies
Stock Price Sensitivity Table**

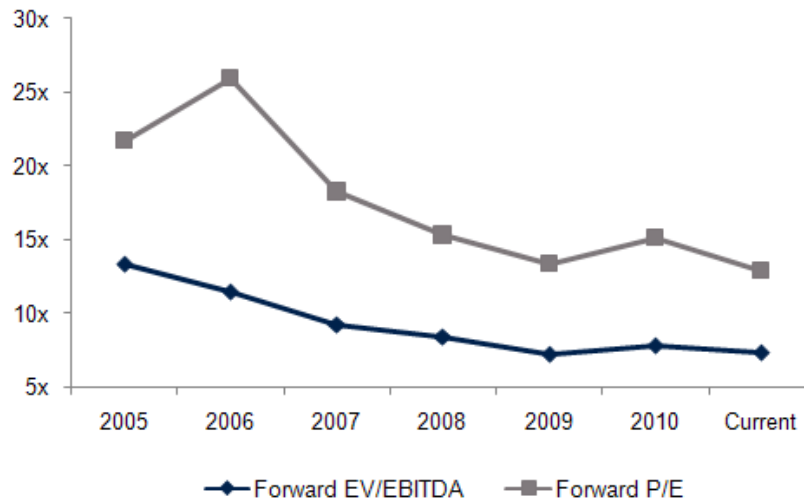
		Long-Term FCFF Growth Rate			
		3%	4%	5%	6%
Long-Term Discount Rate	9%	\$39.80	\$46.69	\$57.03	\$74.27
	10%	\$33.80	\$38.57	\$45.25	\$55.27
	11%	\$29.31	\$32.77	\$37.40	\$43.86
	12%	\$25.81	\$28.43	\$31.78	\$36.26

=Selected Values

Source: Company Reports, SNL, and William Blair & Company LLC Estimates

Other valuation techniques yield similar results. More-traditional relative valuation techniques like the P/E and EV/EBITDA ratios also show that Marsh is undervalued on a historical basis. The current 2012 P/E ratio is 13 times, well below its historical average of 18 times. Similarly, the EV/EBITDA ratio is at 7 times, well below its historical average of 10 times.

**Marsh and McLennan Companies
Historic EV/EBITDA and P/E Trading Ranges**



Source: Company Reports, SNL, and William Blair & Company LLC Estimates

Upside projections are similar to the DCF model, with the P/E and EV/EBITDA ratios suggesting that the current point still represents a very attractive entry into the stock, with potential upside of 30% to 40% depending on how much multiple expansion occurs.

**Marsh and McLennan Companies
Valuation Using Common Methodologies**

	Estimate Type	2012 Estimate	Current Multiple	Historic Multiple	Price Given Historic Multiple	Price Given Peak Multiple	Price Given Peak Multiple
P/E	EPS	\$2.14	12.9x	18.3x	\$39.16	22.0x	\$47.08
EV/EBITDA	EBITDA	\$2,164	7.3x	9.6x	\$31.96	12.0x	\$41.30
DCF	Cash Flow	\$1,278			\$37.40		

Source: Company Reports, SNL, and William Blair & Company LLC Estimates

Within the universe of publicly traded brokers, Marsh appears fairly valued. We believe that Willis and Aon both represent better values at current price points.

**Insurance Brokers and Insurance Services
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	44.41	\$3.07	\$3.37	\$3.77	14.5x	13.2x	11.8x	13.4x	12.0x	9.4x	9.9x	7.4x	6.9x
AJG	M	27.75	\$1.36	\$1.35	\$1.65	20.4x	20.6x	16.8x	14.9x	15.7x	13.2x	10.2x	8.4x	7.1x
BRO	M	18.28	\$1.13	\$1.07	\$1.10	16.2x	17.1x	16.6x	12.3x	12.7x	12.2x	7.5x	7.6x	7.3x
MMC	M	27.60	\$1.66	\$1.81	\$2.14	16.7x	15.3x	12.9x	16.0x	14.7x	12.3x	8.6x	8.0x	7.5x
WSH	O	36.33	\$2.69	\$2.80	\$3.45	13.5x	13.0x	10.5x	11.9x	19.4x	9.7x	9.0x	8.7x	7.8x
Average						16.2x	15.8x	13.7x	13.7x	14.9x	11.4x	9.0x	8.0x	7.3x
Median						16.2x	15.3x	12.9x	13.4x	14.7x	12.2x	9.0x	8.0x	7.3x

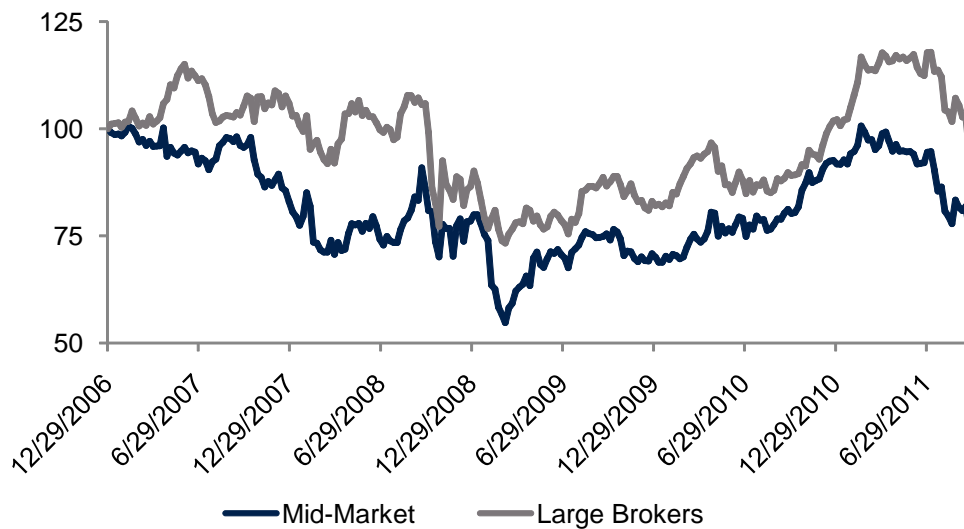
Source: Company reports, Thomson One, and William Blair & Company L.L.C.

**Insurance Trading
Pattern:**

Middle-Market Brokerage Stocks Lagging

Arthur J. Gallagher's and Brown & Brown's stock performance have suffered during 2011 due to continuing economic uncertainty, a lack of clarity in the regulatory environment, and unemployment levels that remain above historical levels. These factors have hammered small and midsize businesses to a much greater extent than *Fortune* 500 companies, and thus have affected Gallagher and Brown more severely than other publicly traded brokers.

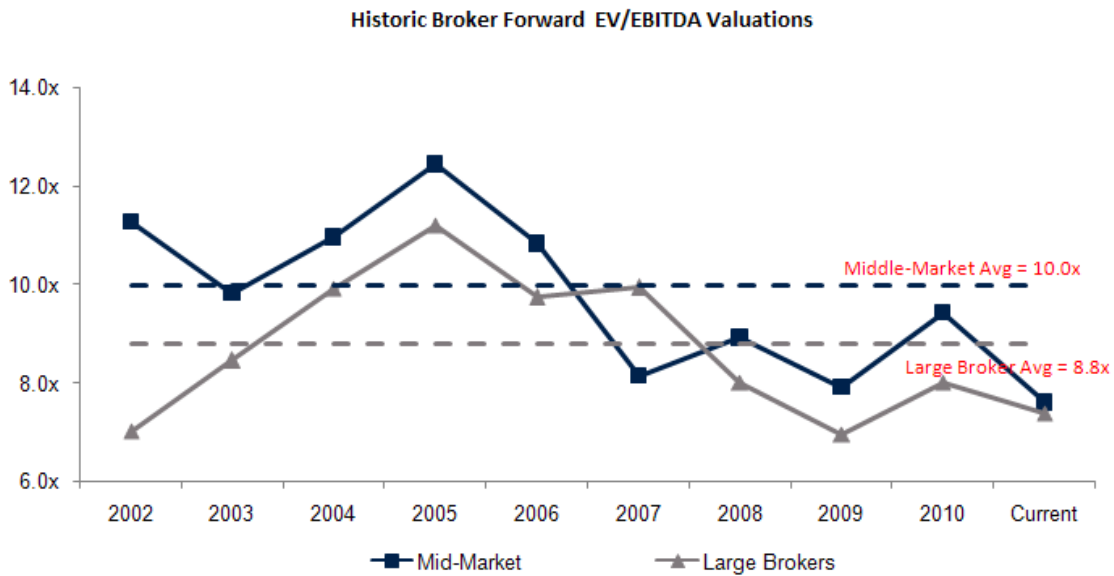
**Stock Performance for Brokers
(2007-2011)**



Note: Mid-market include AJG and BRO, Large brokers include WSH, MMC and AON

Source: Company Reports, SNL , William Blair LLC Estimates

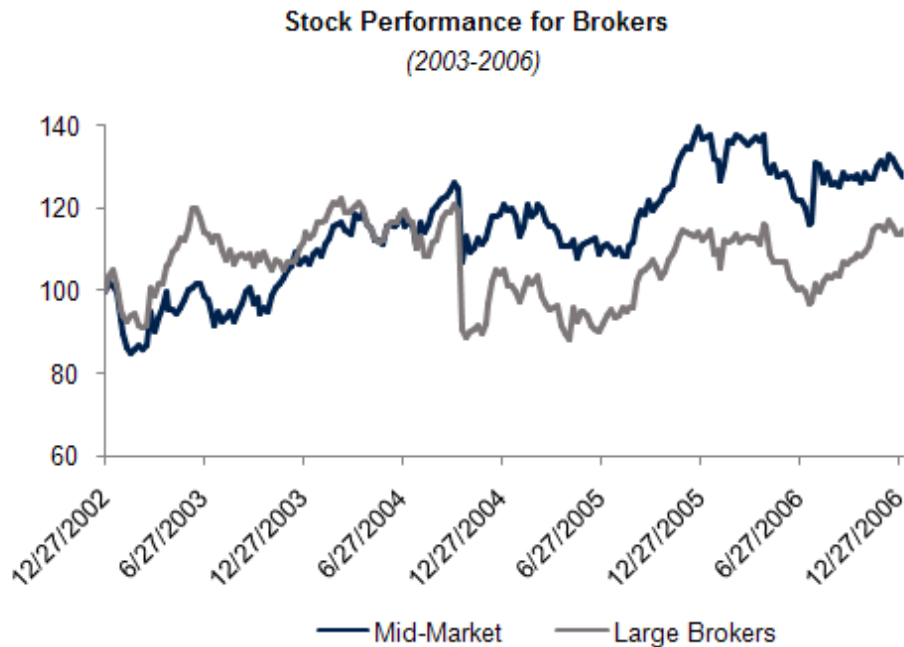
Consequently, the stocks have underperformed their large-cap peers and are trading at significant discounts to their historical average EV/EBITDA ratios. On a relative basis, they are trading at valuation multiples similar to the large-broker peer group, including Willis, Aon, and Marsh, whereas historically they have traded at a modest premium.



Note: Mid-market include AJG and BRO, Large brokers include WSH, MMC and AON
 Source: Company Reports, SNL, William Blair LLC Estimates

While we currently favor the larger brokers due to their more-diverse business models, both geographically and operationally, the middle-market brokers are approaching attractive valuation levels that could result in significant gains should the United States break out of its economic slump, or should a significant hardening of the P&C market occur.

During the last hard market, middle-market brokers outperformed their large-broker peers significantly. Given historically low valuation levels, at some point both Arthur J. Gallagher and Brown & Brown will be great buys, as they have the most leverage to a hardening P&C market. We believe mid- to late 2012 could be a good time to start buying these stocks.



Note: Mid-market include AJG and BRO, Large brokers include WSH, MMC and AON
 Source: Company Reports, SNL, William Blair LLC Estimates

Insurance Industry: Cash Flow and Reserve Insight
 William Blair Insurance Universe Performance
 (Week of 10/10/2011-10/17/2011)

PERFORMANCE UPDATE:																			
Stock Fundamentals							Stock Performance							Estimates					
Ticker	Market Cap (\$BN)	Rating	Current Price 10/11/11	52-Week Range		Week Ending 10/7/2011	MTD	QTD	YTD	March 9, 2009 ¹ to Date	P/E 2011E	P/E 2012E	Price to Book	William Blair 2011 EPS Estimate	Consensus 2011 EPS Estimate	William Blair 2012 EPS Estimate	Consensus 2012 EPS Estimate		
S&P 500 Index			\$1,194.89	\$1,074.77	-	\$1,370.58	2%	6%	6%	-5%	77%								
S&P Financials Index			\$167.26	\$147.66	-	\$231.20	0%	5%	5%	-22%	100%								
S&P Insurance Index			\$160.51	\$144.05	-	\$202.30	1%	5%	5%	-15%	109%								
Insurance Brokers																			
AON Corporation	AON	\$14,508	Outperform	\$44.41	\$38.82	-	\$54.58	3%	6%	6%	-3%	15%	13.2x	11.8x	1.7x	\$3.37	\$3.40	\$3.77	\$3.81
Arthur J. Gallagher & Co.	AJG	\$3,128	Market Perform	\$27.75	\$24.29	-	\$31.92	3%	6%	6%	-5%	79%	20.6x	16.8x	2.6x	\$1.35	\$1.38	\$1.65	\$1.75
Brown & Brown, Inc.	BRO	\$2,613	Market Perform	\$18.28	\$16.77	-	\$27.07	-1%	3%	3%	-24%	17%	17.1x	16.6x	1.7x	\$1.07	\$1.11	\$1.10	\$1.24
Marsh & McLennan Companies, Inc.	MMC	\$14,950	Market Perform	\$27.60	\$23.59	-	\$31.57	0%	4%	4%	1%	53%	15.3x	12.9x	2.2x	\$1.81	\$1.81	\$2.14	\$2.16
Willis Group Holdings PLC	WSH	\$6,053	Outperform	\$36.33	\$30.91	-	\$42.42	1%	6%	6%	5%	93%	13.0x	10.5x	2.3x	\$2.80	\$2.87	\$3.45	\$3.32
Average Insurance Broker							1%	5%	5%	-5%	51%	15.8x	13.7x	2.1x					
Commercial Insurers																			
AmTrust Financial Services, Inc.	AFSI	\$1,374	Outperform	\$22.92	\$14.95	-	\$24.74	-1%	3%	3%	31%	232%	8.2x	7.9x	1.7x	\$2.78	\$2.83	\$2.91	\$2.87
The Chubb Corporation	CB	\$17,702	Underperform	\$61.91	\$55.39	-	\$66.00	0%	3%	3%	4%	77%	11.0x	11.4x	1.1x	\$5.64	\$5.12	\$5.42	\$6.04
HCC Insurance Holdings, Inc.	HCC	\$3,050	Underperform	\$27.73	\$24.66	-	\$33.12	-1%	3%	3%	-4%	36%	10.5x	10.0x	0.9x	\$2.63	\$2.55	\$2.78	\$3.00
National Interstate Corporation	NATL	\$442	Market Perform	\$22.72	\$18.66	-	\$24.36	0%	3%	3%	6%	56%	11.5x	10.4x	1.3x	\$1.97	\$1.85	\$2.19	\$2.08
RLI Corp.	RLI	\$1,407	Market Perform	\$67.88	\$50.86	-	\$68.28	5%	7%	7%	29%	57%	13.6x	13.5x	1.7x	\$5.01	\$5.09	\$5.02	\$4.29
The Travelers Companies, Inc.	TRV	\$21,988	Market Perform	\$51.10	\$45.97	-	\$64.17	1%	5%	5%	-8%	52%	12.5x	8.4x	0.9x	\$4.07	\$3.63	\$6.10	\$5.96
Tower Group, Inc.	TWGP	\$932	Market Perform	\$22.49	\$20.00	-	\$27.86	-5%	-2%	-2%	-12%	2%	8.5x	7.4x	0.9x	\$2.65	\$2.27	\$3.03	\$3.08
Average Commercial Insurer							0%	3%	3%	6%	73%	10.8x	9.9x	1.2x					
Insurance Services																			
The Crawford Company	CRD'B	\$239	Outperform	\$5.40	\$2.48	-	\$8.39	-10%	1%	1%	59%	-20%	7.8x	7.1x	NA	\$0.69	\$0.72	\$0.76	\$0.65
Fortegra Financial Corporation	FRF	\$107	Market Perform	\$5.21	\$4.81	-	\$12.20	-5%	-1%	-1%	-53%	NA	8.3x	6.8x	0.8x	\$0.63	\$0.67	\$0.77	\$0.89
Average Insurance Services							-7%	0%	0%	3%	-20%	8.0x	6.9x	0.8x					

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 09/30/11)

Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	59	Outperform (Buy)	8
Market Perform (Hold)	31	Market Perform (Hold)	2
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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