Marsh & McLennan Companies, Inc.

Third-Quarter Outperformance Driven by Tax Credit and Strong Margins Within Consulting, Environment Remains Tough

Highlights

- Third-quarter adjusted EPS more than doubled, to $0.48, compared with our estimate of $0.31 and consensus of $0.26. However, the upside was strengthened by an $0.18 per share benefit related to the favorable resolution of an income tax audit settlement. Excluding the impact from the tax credit, the $0.01 shortfall relative to our estimate was due to a lower operating margin within risk and insurance services, offset by a much higher operating margin within Mercer. Our risk and insurance services margin, however, was well above management's guidance and why our estimate was above consensus.

- Organic revenue growth within risk and insurance services excluding fiduciary interest income was negative 1.0%, compared with 2% last quarter and our 2% estimate. Insurance brokerage (Marsh) had negative 2.0% organic growth mainly due to weakness in North America and Europe, and reinsurance brokerage (Guy Carpenter) was up 6% after a difficult 2008. We expect continued pressure on organic growth in the fourth quarter given sustained soft pricing coupled with persistent economic headwinds.

- The adjusted risk and insurance services operating margin was 12.9% compared with 20.2% last quarter, 5.3% in third quarter 2008, and our 14.5% estimate. The improvement compared with the prior year was driven by cost savings from aggressive expense management, including the benefits from formal restructuring. Management expects the operating margin to be higher in fourth quarter 2009 versus fourth quarter 2008 as well, but not to the same degree as it has year-to-date. Our 2009 risk and insurance services margin estimate is now 19.2%, down from nearly 20.0%.

- Consulting results were mixed, with revenue growth remaining under pressure, particularly in more economically sensitive practice areas, coupled with the adverse impact from foreign exchange. Organic revenue growth was negative 10%—negative 14% at more economically sensitive Oliver Wyman (27% of total consulting). However, the operating margin improved to 11.4%, down modestly from 11.9% a year ago, but above our 9.5% estimate, and a marked improvement from less than 8% in the first half given better expense management.

- We are maintaining our Market Perform rating and increasing our 2009 EPS estimate to $1.57 from $1.45 given the outperformance this quarter, but lowering our fourth-quarter EPS estimate to $0.39 per share from $0.41 per share. We are lowering our 2010 EPS estimate to $1.80 from $1.90 given continued pressure on organic revenue growth and margins due to economic weakness and persistent pressure on commercial property-casualty insurance prices. We lowered our estimates on Aon (AOC $39.00) this quarter as well.

Financial | Commercial P/C Insurance

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Stock Rating:	**Market Perform**
Company Profile:	**Core Growth**
Symbol:	MMC (NYSE)
Price:	$23.38 (52-Wk.: $17-$26)
Market Value (mil.):	$12,242
Fiscal Year End:	December
Long-Term EPS Growth Rate:	14%
Dividend/Yield:	$0.82/3.5%

	2008A	2009E	2010E
Estimates			
EPS Q1	$0.46	A$0.40	NA
Q2	$0.41	A$0.33	NA
Q3	$0.21	A$0.48	NA
Q4	$0.37	$0.39	NA
FY	$1.45	$1.57	$1.80
CY		$1.57	$1.80
Valuation			
FY P/E	16.1x	14.9x	13.0x
CY P/E		14.9x	13.0x

Trading Data (Thomson Financial)	
Shares Outstanding (mil.)	524
Float (mil.)	NA
Average Daily Volume	4,337,272

Financial Data (Thomson Financial)	
Long-Term Debt/Total Capital (MRQ)	32.5
Book Value Per Share (MRQ)	14.7
Enterprise Value (mil.)	14,306.8
EBITDA (TTM)	1,177.0
Enterprise Value/EBITDA (TTM)	12.2x
Return on Equity (TTM)	1.0

Two-Year Price Performance Chart

Source: Thomson Financial, William Blair & Company estimates

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

Discussion

Respectable Third-Quarter Results; Expense Management Continues to Be Excellent

Third-quarter adjusted EPS, excluding restructuring charges, other nonrecurring expenses, and earnings attributed to unvested shares, more than doubled, to $0.48, compared with our estimate of $0.31 and consensus of $0.26. However, the upside was strengthened by a $0.18 per share benefit related to the favorable resolution of an income tax audit settlement. Excluding the impact from the tax credit, the $0.01 shortfall relative to our estimate was due to a lower operating margin within risk and insurance services, offset by a much higher operating margin within Mercer. Our risk and insurance services margin, however, was well above management's guidance and why our estimate was above consensus. While EPS results were above consensus, we view these results as qualitatively similar to Aon's third-quarter results, as both companies feel pressure on top-line growth from a challenging global economy and pricing pressure within the commercial property-casualty insurance industry. GAAP EPS were $0.40 from continuing operations. The difference between adjusted EPS and GAAP EPS is principally due to restructuring charges.

Risk and Insurance Services, Pressure on Growth, Operating Margin Below Our Expectations

Organic revenue growth within risk and insurance services excluding fiduciary interest income (roughly 50% of earnings) was negative 1.0%, compared with 2% last quarter and our 2% estimate. Insurance brokerage (Marsh) had negative 2.0% organic growth mainly due to weakness in North America and Europe, and reinsurance brokerage (Guy Carpenter) was up 6% after a difficult 2008. We expect continued pressure on organic growth in the fourth quarter given sustained soft pricing coupled with persistent economic headwinds.

Marsh & McLennan's organic growth exceeded nearly all major competitors in the quarter as Arthur J. Gallagher & Company (AJG $22.51) reported 5.5% negative organic growth, Brown & Brown Inc. (BRO $18.26) reported 5.2% negative organic growth, and Aon Corporation reported negative 3.0% organic growth, while Willis Group Holdings (WSH $27.08) reported positive 2.0% organic growth—the only insurance broker to have positive organic growth in the quarter. Organic revenue growth in the company's international insurance brokerage operations, a high-margin business, had flat organic growth in the quarter, compared with 0% organic growth last quarter. United States and Canada had negative 5% organic growth in the quarter, given the challenging environment and compared with flat organic growth last quarter and negative 8% organic growth in first quarter 2009. While reducing expenses, management continues to invest in talent within its insurance brokerage business (Marsh), adding 300 sales professional globally since early 2008 and adding roughly 186 managing directors and senior vice presidents since second quarter 2008, with the majority of the new hires in client-facing roles.

Reinsurance broker Guy Carpenter (18% of risk and insurance services revenue) had another strong quarter, with 6% organic growth, a significant improvement from negative organic growth throughout 2008. According to management, Guy Carpenter's new business growth was strong for the fifth consecutive quarter, and 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.).

The adjusted risk and insurance services operating margin was 12.9% compared with 20.2% last quarter, 5.3% in third quarter 2008, and our 14.5% estimate. The improvement compared with the prior year was driven by cost savings from aggressive expense management including the benefits from formal restructuring. Management expects the operating margin to be higher in fourth quarter 2009 versus fourth quarter 2008 as well, but not to the same degree as it has year-to-date. On its second-quarter conference call, management raised its 2009 adjusted operating margin guidance for risk and insurance services to 18% from 17%, versus 13.3% in 2008, and reiterated its goal of 18% again this quarter, but a year-over-year improvement in the fourth quarter would easily drive the operating margin above that goal for the year. Our 2009 risk and insurance services brokerage margin estimate is now nearly 19%, down from nearly 20%. Our 2009 risk and insurance services margin estimate is now 19.2%, down from nearly 20%. Our adjusted risk and insurance services margin for Aon is 20.1%. Our fourth-quarter operating margin estimate is up about 350 basis points versus a 650-basis-point improvement through the first three quarters.

Consulting Results Mixed, With Sequential Margin Improvement

Consulting results were mixed and revenue growth remained under pressure, particularly in more economically sensitive practice areas, coupled with the adverse impact from foreign exchange. Organic revenue growth was negative 10%—negative 14% at more economically sensitive Oliver Wyman (27% of total consulting). However, the operating margin improved to 11.4%, down modestly from 11.9% a year ago, but above our 9.5% estimate, and a marked improvement from less than 8% in the first half given better expense management. 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. 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 8% negative organic growth and Oliver Wyman (27% of total), which includes the specialty consulting businesses and is more economically sensitive, declined 14%. Mercer’s two largest consulting practices, retirement and health and benefits, each had a 7% decline in revenue during the quarter, compared with negative 2% growth in both businesses last quarter. The adverse impact from a pullback in discretionary spending continues to plague Mercer’s other consulting lines, with negative 21% growth in the quarter, compared with negative 18% last quarter. Outsourcing experienced a 9% decline in organic growth in the quarter, even though 25% of revenue in this business is tied to assets under administration and is therefore positively correlated with equity market performance, which has improved compared with the year-ago period. Mercer’s smallest practice, investment consulting, had organic growth of 8% in the quarter, after 2% growth last quarter. The cost-cutting initiatives started in fourth quarter 2008 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 Mercer’s operating income by $9 million in the quarter and, given where the dollar is today, management expects foreign-currency translations may result in a modest benefit to results in the fourth quarter of this year. The Oliver Wyman business is navigating in a very difficult operating environment. Cost-cutting initiatives in the business have significantly reduced staff during the year. While revenue declined 14%, expenses were also reduced by 14% in the quarter.

Kroll, the risk consulting and technology business, had negative 9% organic growth in the quarter, as the recessionary conditions continue to weigh on its business lines; risk mitigation and response had negative 25% organic growth, while litigation support and data recovery had positive 1% organic growth, and employment background screening had negative 8% organic growth in the quarter. Kroll has been in a period of transition over the past 15 months with the divestiture of its corporate advisory and restructuring business in late 2008 and the disposition of its U.S. government security clearance screening business in May.

Looking for More Aggressive Acquisition Activity on U.S. Insurance Brokerage Side

In January the company acquired the remaining stake of DeLima Marsh in Colombia, strengthening its presence in Latin America. 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. In September, the company announced the acquisition of International Advisory Services, the largest independent manager of third-party insurance companies in Bermuda, and most recently, in October, the company acquired Rattner Mackenzie Ltd, a specialty reinsurance broker from HCC Insurance Holdings, Inc. (HCC $26.73). Marsh & McLennan remains active on the acquisition front as always, but not in the segment where we expected more activity—in Marsh & McLennan Agency, which was established in late 2008 to focus on middle-market commercial property/insurance business. Management attributed its delay in deal announcement to a high level of prudence in selecting targets, and stated that it is likely the company will announce several acquisitions closer to year-end.

Maintaining Market Perform Rating: Lowering Fourth Quarter 2009 and 2010 EPS Estimates

We are maintaining our Market Perform rating and increasing our 2009 EPS estimate to $1.57 from $1.45 given the outperformance this quarter, but lowering our fourth-quarter EPS estimate to $0.36 per share from $0.41 per share. We are lowering our 2010 EPS estimate to $1.80 from $1.90 given continued pressure on organic revenue growth and margins due to economic weakness and persistent pressure on commercial property-casualty insurance prices. We lowered our estimates on Aon this quarter as well.

We very 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. That said, we do favor Aon over Marsh & McLennan in the near term at the same valuation level given less economic sensitivity and more conviction regarding execution. The stock is trading at nearly 13 times our 2010 EPS estimate of $1.80, 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.

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

	1Q08	2Q08	3Q08	4Q08	2008 Actual	1Q09	2Q09	3Q09	4Q09E	2009 Estimate	2010 Estimate
Operating revenue:											
Risk & Insurance Services	$1,500	$1,415	$1,275	$1,276	$5,466	$1,372	$1,343	$1,226	$1,230	$5,171	$5,430
% change annual	5%	6%	1%	-6%	1%	-9%	-5%	-4%	-4%	-5%	5%
% organic growth[1]	-4%	1%	-1%	2%	0%	1%	2%	-1%	0%	0%	2%
Risk Consulting & Technology	$257	$266	$235	$201	$959	$187	$161	$170	$161	$679	$679
% change annual	10%	7%	-9%	-19%	-3%	-27%	-39%	-28%	-20%	-29%	0%
% organic growth	3%	6%	-5%	-16%	-3%	-8%	-20%	-20%	-10%	-15%	0%
Mercer Consulting	$1,295	$1,374	$1,328	$1,199	$5,196	$1,083	$1,143	$1,144	$1,104	$4,474	$4,599
% change annual	15%	13%	9%	-9%	6%	-16%	-17%	-14%	-8%	-14%	3%
% organic growth	8%	7%	6%	-3%	4%	-7%	-9%	-10%	-7%	-8%	3%
Total operating revenue	**$3,052**	**$3,055**	**$2,838**	**$2,676**	**$11,621**	**$2,642**	**$2,647**	**$2,540**	**$2,495**	**$10,324**	**$10,708**
% change annual	9%	9%	4%	-9%	3%	-13%	-13%	-11%	-7%	-11%	4%
Corporate eliminations	($13)	($22)	($19)	($14)	($68)	($13)	($18)	($17)	($20)	($68)	($80)
% change annual	-63%	-4%	-17%	8%	-28%	0%	-18%	-11%	43%	0%	18%
Total revenue	**$3,039**	**$3,033**	**$2,819**	**$2,662**	**$11,553**	**$2,629**	**$2,629**	**$2,523**	**$2,475**	**$10,256**	**$10,628**
% change annual	10%	9%	4%	-9%	3%	-13%	-13%	-11%	-7%	-11%	4%
Operating income:											
Risk & Insurance Services	$264	$207	$69	$189	$729	$343	$271	$158	$221	$993	$1,089
% change annual	6%	80%	1280%	105%	58%	30%	31%	129%	17%	36%	10%
% operating segment revenue	17.6%	14.6%	5.4%	14.8%	13.3%	25.0%	20.2%	12.9%	18.0%	19.2%	20.1%
Risk Consulting & Technology	$16	$31	$22	$11	$80	$12	$7	$21	$16	$56	$68
% change annual	-33%	3%	-24%	-27%	-18%	-25%	-77%	-5%	46%	-30%	21%
% operating segment revenue	6.2%	11.7%	9.4%	5.5%	8.3%	6.4%	4.3%	12.4%	10.0%	8.3%	10.0%
Mercer Consulting	$151	$165	$158	$121	$595	$74	$101	$130	$132	$437	$537
% change annual	7%	2%	6%	-25%	-3%	-51%	-39%	-18%	9%	-26%	23%
% operating segment revenue	11.7%	12.0%	11.9%	10.1%	11.5%	6.8%	8.8%	11.4%	12.0%	9.8%	11.7%
Total operating income	**$431**	**$403**	**$249**	**$321**	**$1,404**	**$429**	**$379**	**$309**	**$370**	**$1,487**	**$1,695**
% change annual	4%	31%	36%	19%	20%	0%	-6%	24%	15%	6%	14%
% total operating revenue	14.1%	13.2%	8.8%	12.0%	12.1%	16.2%	14.3%	12.2%	14.8%	14.4%	15.8%
Corporate expenses	45	45	38	42	170	39	40	36	39	154	164
Interest income	18	12	10	8	48	6	4	3	4	17	28
Interest expense	56	55	54	55	220	56	65	59	58	238	228
Investment income	8	(16)	(23)	19	(12)	(15)	(31)	21	19	(6)	32
Pretax operating income	**$356**	**$299**	**$144**	**$251**	**$1,050**	**$325**	**$247**	**$238**	**$296**	**$1,106**	**$1,363**
% change annual	-5%	23%	-23%	26%	5%	-9%	-17%	65%	18%	5%	23%
Income tax expense	**$112**	**$88**	**$34**	**$56**	**$290**	**$109**	**$66**	**($22)**	**$89**	**$180**	**$409**
Effective tax rate	31.5%	29.4%	23.6%	22.3%	27.6%	33.5%	26.7%	-9.2%	30.0%	16.3%	30.0%
Minority interest, net of tax	**$3**	**$2**	**$3**	**$3**	**$11**	**$4**	**$5**	**$4**	**$4**	**$17**	**$16**
Operating income from continuing operations—adjusted[2]	**$241**	**$209**	**$107**	**$192**	**$749**	**$206**	**$172**	**$251**	**$203**	**$832**	**$938**
% change annual	6%	49%	34%	113%	39%	-199%	232%	1729%	178%	-1230%	116%
Operating EPS	**$0.46**	**$0.41**	**$0.21**	**$0.37**	**$1.45**	**$0.40**	**$0.33**	**$0.48**	**$0.39**	**$1.59**	**$1.80**
% change annual	**3%**	**41%**	**12%**	**53%**	**24%**	**-14%**	**-19%**	**130%**	**3%**	**10%**	**13%**
Average diluted shares	519	512	516	514	515	515	522	526	526	522	522

[1]Organic growth prior to 4Q08 includes organic growth associated with fiduciary interest income.

[2]Excludes 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

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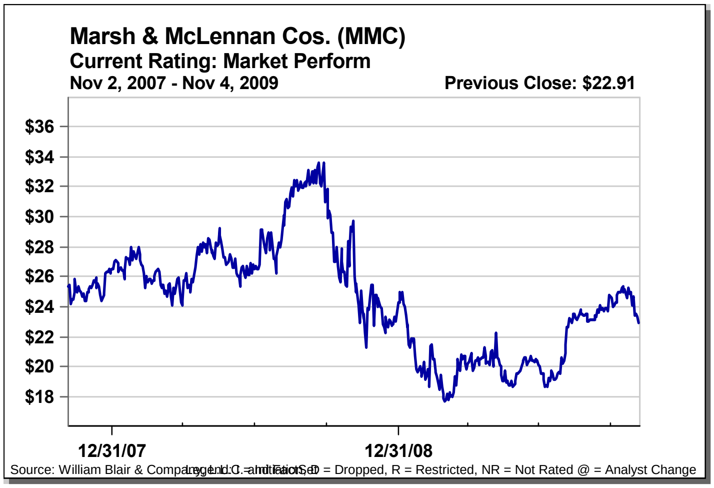
Additional information is available upon request.



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Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	64	Outperform (Buy)	3
Market Perform (Hold)	36	Market Perform (Hold)	0
Underperform (Sell)	0	Underperform (Sell)	0

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