

Marsh & McLennan Companies, Inc.

Quick Look at Fourth-Quarter Results: Roughly in Line with Expectations, Environment Remains Challenging

Results roughly in line with expectations. Fourth-quarter adjusted EPS, excluding restructuring charges and other nonrecurring expenses, increased 6%, to \$0.38, compared with our estimate of \$0.39 and consensus of \$0.37. Results were roughly in line with expectations as higher revenues were largely offset by higher expenses. Marsh & McLennan recorded \$23 million of investment income in the fourth quarter attributed to mark-to-market gains in its private-equity portfolio (results are reported on a one-quarter lag).

There continues to be a sharp contrast between adjusted results and GAAP results, which should not be completely discounted, in our opinion, as some of the difference is cash based. GAAP EPS were \$0.07, or \$0.03 from continuing operations. The difference between adjusted EPS and GAAP EPS is for restructuring charges, settlements and legal fees related to a civil complaint, and a \$205 million net charge paid by Marsh & McLennan in the fourth quarter related to settlement of an ERISA class-action lawsuit. In the fourth quarter, the company paid a total of \$435 million to settle two lawsuits, \$230 million of which was covered by insurance. The balance of \$205 million is tax deductible, and the company expects to realize the tax benefit late in the second quarter or early in the third quarter. Adjusted EPS from continuing operations for 2009 were \$1.58, up from \$1.40 in 2008 given adjusted margin expansion in risk and insurance services, compared with GAAP EPS from continuing operations of \$0.45 in 2009 and a loss of \$0.15 in 2008.

Organic growth roughly in line with peers, still hampered by economic headwinds. Organic revenue in risk and insurance services excluding fiduciary interest income (roughly 50% of earnings) contracted 1.0%, compared with -1% last quarter and our breakeven growth estimate. Insurance brokerage (Marsh) contracted 1.0% organically, mainly due to weakness in North America, and reinsurance brokerage (Guy Carpenter) was up 4% after a difficult 2008. We expect continued pressure on organic growth in the near term given sustained soft pricing coupled with persistent economic headwinds.

Marsh & McLennan outperformed peer Arthur J. Gallagher & Company (AJG \$22.88), which contracted 2.0% organically; was in line with Aon Corporation (AON \$39.64; Market Perform); and fell short of Willis Group Holdings (WSH \$27.81), which had 2.0% organic growth. Brown & Brown (BRO \$17.69) has yet to report fourth-quarter results. Management said that economic headwinds are the most significant factor limiting organic growth despite continued pressure on commercial property-casualty insurance pricing. Consulting improved considerably in the fourth quarter, benefiting from the favorable impact from foreign exchange, while revenue growth remained under pressure in more economically sensitive practice areas. Organic revenue contracted 2%—down 7% at more economically sensitive Oliver Wyman (31% of total consulting).

Financial | Commercial P/C Insurance

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

Symbol: MMC (NYSE)
Price: \$22.10 (52-Wk.: \$17-\$25)
Market Value (mil.): \$11,706
Fiscal Year End: December
Long-Term EPS Growth Rate: 14%
Dividend/Yield: \$0.81/3.7%

	2009A	2010E	2011E
Estimates			
EPS Q1	\$0.40	NA	NA
Q2	\$0.33	NA	NA
Q3	\$0.48	NA	NA
Q4	\$0.38	NA	NA
FY	\$1.58	\$1.75	\$1.95
CY		\$1.75	\$1.95

Valuation			
FY P/E	14.0x	12.6x	11.3x
CY P/E		12.6x	11.3x

Trading Data (Thomson Financial)

Shares Outstanding (mil.)	528
Float (mil.)	NA
Average Daily Volume	3,411,197

Financial Data (Thomson Financial)

Long-Term Debt/Total Capital (MRQ)	32.5
Book Value Per Share (MRQ)	14.7
Enterprise Value (mil.)	13,440.0
EBITDA (TTM)	1,319.0
Enterprise Value/EBITDA (TTM)	10.2x
Return on Equity (TTM)	4.7

Two-Year Price Performance Chart



Source: Thomson Financial, William Blair & Company estimates

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Operating margin improves from year ago; below our expectations—expect modest margin improvement in 2010. The adjusted risk and insurance services operating margin was 15.9%, compared with 12.9% last quarter, 14.8% in fourth quarter 2008, and our 18.0% estimate. The improvement in profitability compared with the prior year was largely attributed to significant cost savings from aggressive expense management. We expect margins to continue to move higher in 2010 through continuing improvement in operating efficiencies; however, management indicated that margins could be under pressure this year as its focus shifts to growing the business as opposed to a focus on profitability.

The adjusted insurance brokerage operating margin improved to 18.6% in 2009, from 13.3% in 2008, and over time should move above 20% as top-line growth improves. The consulting operating margin improved to 11.5%, up from 10.1% a year ago, but below our 12.0% 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 2010 with the benefit from cost-savings efforts. We believe that the company, having aggressively brought down expenses, is well positioned to benefit from a return of top-line growth, and a midteens margin should be achievable once a material economic recovery unfolds.

Acquisition activity picking up—one bright spot. Marsh & McLennan has announced four deals over the past three months to build its presence in the U.S. middle-market segment. The company has tried to go after this market organically for years, but has been unsuccessful with this approach. The largest of the four deals, announced in December, was the purchase of London-based HSBC Insurance Brokers. As part of the deal, Marsh & McLennan will form a strategic partnership with HSBC Bank to provide insurance brokering and risk management services to HSBC's clients. The deal is scheduled to close during the second quarter.

The remaining three deals are part of Marsh & McLennan Agency, which was established in late 2008 to focus on middle-market commercial property/insurance business. In November, Marsh & McLennan acquired Houston-based Insurance Alliance, one of the largest insurance agencies in Texas, with \$15 million in annual revenue. In December the company acquired New Jersey-based NIA Group, with annual revenue of \$60 million, and in February Marsh & McLennan acquired Kansas-based Haake Companies, which has \$11 million in annual revenue. A key focus in 2010, according to management, is to drive top- and bottom-line growth through strategic acquisitions, and we anticipate several additional deals to be announced during the year.

Maintaining rating; 2010 EPS estimate lowered, 2011 EPS estimate established. Our rating remains Market Perform, and we are lowering our 2010 EPS estimate to \$1.75 from \$1.80 given continued pressure on organic growth. We are also establishing a 2011 EPS estimate of \$ 1.95. We are pleased with the progress of the new management team and believe it is taking the company in the right direction. Marsh & McLennan has very valuable assets, limited balance-sheet risk, and no business model risk. Risks for the company are industry-related, with pricing expected to remain soft and economic challenges continuing to restrain top-line growth, especially in the consulting business. That said, we continue to 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 is trading at 12.6 times our 2010 EPS estimate, and we view 10 to 12 times in the current environment as a more attractive entry point.

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Additional information is available upon request.



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Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	66	Outperform (Buy)	5
Market Perform (Hold)	34	Market Perform (Hold)	1
Underperform (Sell)	0	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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