

Insurance Brokers

Second Quarter 2011 Broker Preview: Look for Gradual Improvement

Summary:

The second quarter should exhibit a gradually improving growth picture and build the case for a strong 2012. The core themes are continued improvement in organic revenue, materially higher acquisition revenue, and growing evidence of cost cutting at several of the brokers. On balance, we expect most brokers' results to be in line with estimates, with the potential for upside from one or two of the companies.

Expected Results:

We expect the quarter to produce divergence between the global brokers (Aon, Willis Group, Marsh & McLennan) and the mainly U.S. middle-market brokers (Brown & Brown, AJ Gallagher). A number of factors should disproportionately help the global brokers, including strong international growth, better reinsurance brokerage conditions, and improving healthcare consulting dynamics. While the middle-market brokers will be helped by increased acquisition revenue, U.S. organic growth will still lag the international component. We believe Aon or Marsh & McLennan have the best chance for beating expectations on revenues if not earnings, and Brown & Brown has the best chance of missing (again, this may be on revenues).

Recommendation:

We recommend buying Aon going into the quarter. Earnings performance should be solid. Aon should show early evidence of cost saving programs that are crucial to 2012 numbers—our estimates suggest a 25% earnings growth rate. In addition, non-U.S. segments should display strong growth levels.

Financial | Insurance Brokers

July 07, 2011

Aon Corporation

Stock Rating: **Outperform**
 Company Profile: **Established Growth**
 Symbol: AON (NYSE)
 Price: \$51.83 (52-Wk.: \$35-\$55)

Arthur J. Gallagher & Co.

Stock Rating: **Market Perform**
 Company Profile: **Established Growth**
 Symbol: AJG (NYSE)
 Price: 28.81 (52-Wk.: 24.3-31.92)

Brown & Brown, Inc.

Stock Rating: **Market Perform**
 Company Profile: **Established Growth**
 Symbol: BRO (NYSE)
 Price: 25.78 (52-Wk.: 18.85-27.07)

Marsh & McLennan Companies, Inc.

Stock Rating: **Market Perform**
 Company Profile: **Established Growth**
 Symbol: MMC (NYSE)
 Price: 31.32 (52-Wk.: 22.21-31.57)

Willis Group Holdings Public Limited Company

Stock Rating: **Outperform**
 Company Profile: **Established Growth**
 Symbol: WSH (NYSE)
 Price: 41.45 (52-Wk.: 28.91-42.42)

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**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	51.48	\$3.07	\$3.38	\$4.02	16.8x	15.2x	12.8x	15.6x	13.8x	10.4x	11.2x	8.2x	7.4x
AJG	M	28.81	\$1.36	\$1.36	\$1.65	21.1x	21.1x	17.4x	15.5x	16.2x	13.7x	11.0x	9.1x	7.8x
BRO	M	25.78	\$1.13	\$1.15	\$1.29	22.8x	22.5x	20.0x	17.3x	17.0x	15.4x	10.6x	10.2x	9.3x
MMC	M	31.32	\$1.65	\$1.87	\$2.17	19.0x	16.8x	14.5x	18.2x	15.9x	13.8x	9.8x	9.0x	8.3x
WSH	O	41.45	\$2.69	\$2.83	\$3.58	15.4x	14.6x	11.6x	13.6x	20.5x	10.6x	10.0x	9.7x	8.2x
Average						19.0x	18.0x	15.3x	16.0x	16.7x	12.8x	10.5x	9.2x	8.2x
Median						19.0x	16.8x	14.5x	15.6x	16.2x	13.7x	10.6x	9.1x	8.2x

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

Factors to Watch:

Organic Growth Moving; Gradual Uptick Expected

The organic growth rebound is continuing. The evidence of a continuing rebound was clear in the first quarter as overall organic growth was 2% compared with 0% for all of 2010. Growth has moved from negative to positive, with the U.S. middle-market being a laggard. Historically, there is a lag in the United States between economic growth and flow through to higher exposures and better growth rates. We expect overall organic revenue growth to accelerate to 3% in the second quarter.

The three major factors to watch in the near term are 1) U.S. organic growth, 2) reinsurance brokerage, and 3) emerging market growth. The United States should continue to rebound as the exposure headwind abates and rate pressure lessens. Reinsurance brokerage has the potential to add upside to current forecasts if the hardening of property catastrophe and related lines increases. Emerging markets should continue to be a driver of growth, particularly as we expect South America to produce double-digit increases. Our forecasts assume that organic revenues grow by 4% in 2012, but this could be conservative if certain events unfold.

U.S. organic growth has shown life in the last several quarters, but it is still holding down the overall average. U.S. organic growth has shifted from an average of -2% to -3% at the middle of 2010 to roughly 1% in the last two quarters. However, this still lags international organic growth, which is running closer to 5%, with some segments of the world generating higher growth rates.

We see signs that U.S. growth should gradually improve as exposure units go from negative 3% to 5% to flat and should eventually turn positive. We project overall organic revenues to increase throughout 2011 to 3%. Growth should improve on a sequential basis, with an average of 2% in the first half and 3% to 4% in the second half. Our forecasts assume U.S. organic growth will be flat to slightly up in the second quarter and at least improve to 2% by the end of 2012.

Insurance Brokers
Organic Revenue Growth Trends for Insurance Brokerage

Company	Ticker	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11E	3Q11E	4Q11E	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%	3.1%	3.2%	3.5%	3.8%	2.1%	-0.8%	-0.3%	3.0%	3.8%
Arthur J. Gallagher	AJG	-1.0%	-1.0%	-6.0%	-1.0%	-3.0%	-3.0%	0.0%	0.0%	1.6%	2.0%	3.0%	4.0%	1.5%	-1.5%	-2.2%	-1.5%	2.7%	4.0%
Brown & Brown	BRO	-2.2%	-4.7%	-5.2%	-8.3%	-8.5%	-4.0%	-2.6%	-3.3%	-2.3%	-1.5%	0.0%	1.0%	-3.4%	-5.5%	-5.1%	-4.6%	-0.7%	4.0%
Marsh & McLennan	MMC	1.3%	2.0%	-1.0%	-1.0%	0.0%	1.0%	2.0%	5.0%	4.0%	3.7%	3.8%	3.7%	0.0%	0.6%	0.3%	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%	5.0%	5.5%	6.0%	3.5%	3.5%	1.8%	3.8%	5.1%	6.3%
Median		1.0%	0.0%	-3.0%	-1.0%	-3.0%	-0.8%	0.0%	3.0%	2.0%	3.1%	3.2%	3.7%	1.5%	0.6%	-0.8%	-0.3%	3.0%	4.0%
Average		0.2%	-0.5%	-2.6%	-1.9%	-2.3%	-0.6%	0.6%	1.7%	1.9%	2.5%	3.1%	3.6%	1.1%	-0.2%	-1.2%	-0.1%	2.8%	4.4%

Source: Company reports

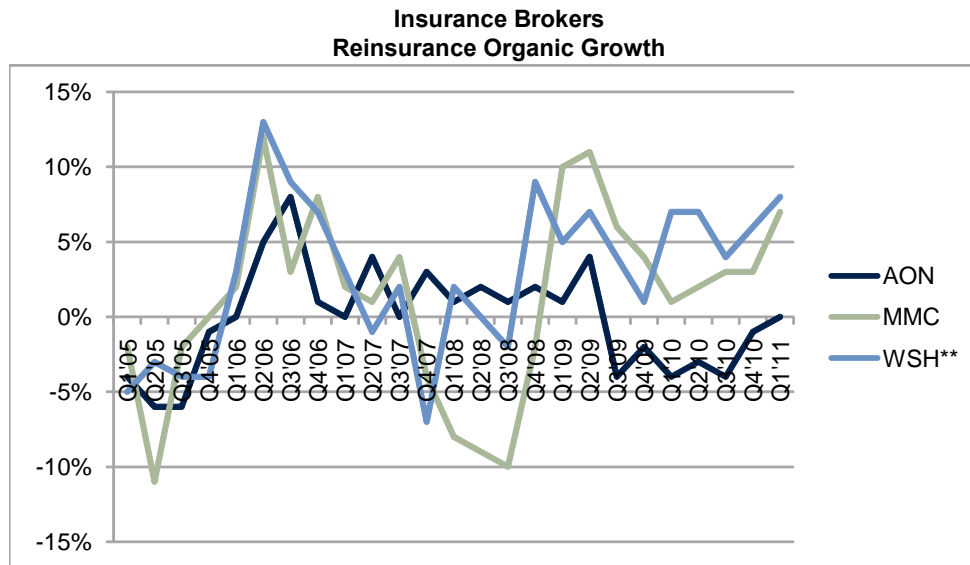
Higher Property Reinsurance Rates Should Be a Plus

The jury on the depth of reinsurance rate increases is still out. Even if rates are moderately positive, organic growth should get a small bump. However, if the market has changed and higher rates are sustainable into 2012, this could provide upside to earnings.

Significant loss activity and pressure from RMS is resulting in higher rates in a number of key property catastrophe markets. June 1 renewal rates for U.S. southeast wind went from a range of -5% to -10% in the previous renewal period to a range of -5% to +10%; rates in Japan, Australia, and New Zealand are up even more. Europe, which renews later, remains a question market. Lloyd’s property oriented markets, such as property, marine, and transportation, are also experiencing a better environment. In addition, several new programs were placed this year, which should generate additional fee and commission income for the brokers. Citizens (CIA \$6.98) and TWIA added over \$1 billion of limit into the market. One restraining factor is that although rates are going up, some cedents are choosing to purchase protection higher up to reduce premium spending. This means that commission/fee flow-through may be less than the percentage of price increases.

Under a favorable scenario, broker earnings could be materially affected by a sustained increase in higher rates. Aon and Marsh have 13% and 8% of overall revenues coming from reinsurance, respectively; Willis has 15%. Assuming a 15% rate increase, this should add 50 to 150 basis points to organic growth given that roughly half of the business is property oriented (i.e., casualty reinsurance prices are not going up). Given that reinsurance brokerage is a higher margin business and that a good portion of new revenue should drop to the bottom line, we assume that the brokerage margins would increase by 20 to 30 basis points. In total, a robust property reinsurance market (a bullish scenario) could add 3% to 5% additional bottom-line growth to 2012 for the respective brokers.

We have not changed our reinsurance brokerage estimates, as January 1 renewal should play a large role in determining if the current market can sustain or even gain momentum. January is the largest renewal not only for domestic, but also for international programs. Hurricane season will take on more importance than usual. A strong season could push rates even higher. However, a weak season could help reinsurer profitability for 2011 and potentially lessen the rush to firm the market. Early signals—hot weather and lack of El Niño—suggest an active season, but it is too early to tell.



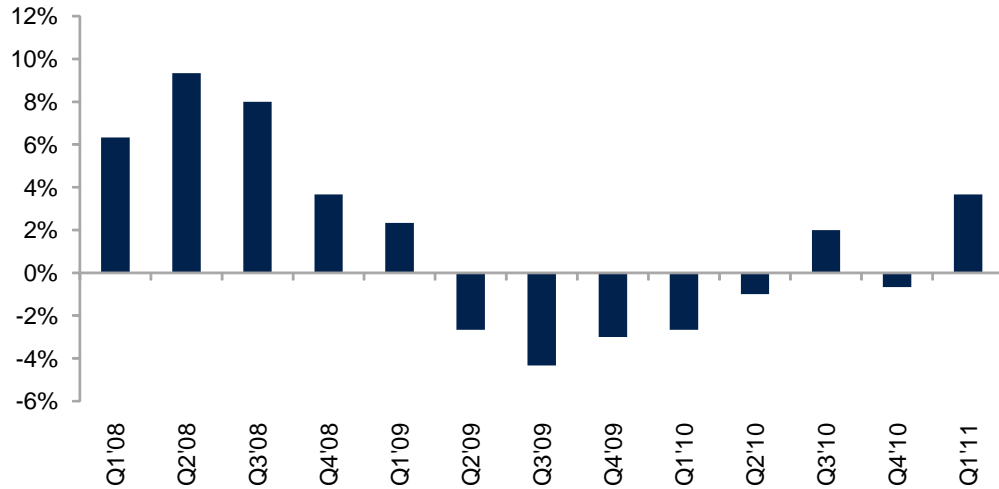
** WSH Global
Source: Company Reports

Consulting Should Be a Growth Driver Going Forward

Demand for human resource consulting and outsourcing had been relatively weak in 2009 and 2010. Organic growth has been moderately negative as corporations cut back on discretionary projects and U.S. healthcare legislation put a near-term hold on related consulting projects. The drastic increase in the unemployment rate and drop in non-farm payrolls during the recession also severely hampered demand.

However, we believe the strong organic growth exhibited during the first quarter of 2011 is a sign of more positive demand trends emerging in the industry. Part of the increase can be attributed to rising prices in the sector as a result of healthcare reform, but we believe that as unemployment slowly moderates and corporations begin hiring again, companies will need to reassess and expand their benefits programs.

Insurance Brokers
Organic Growth in HR Benefits Consulting Industry*

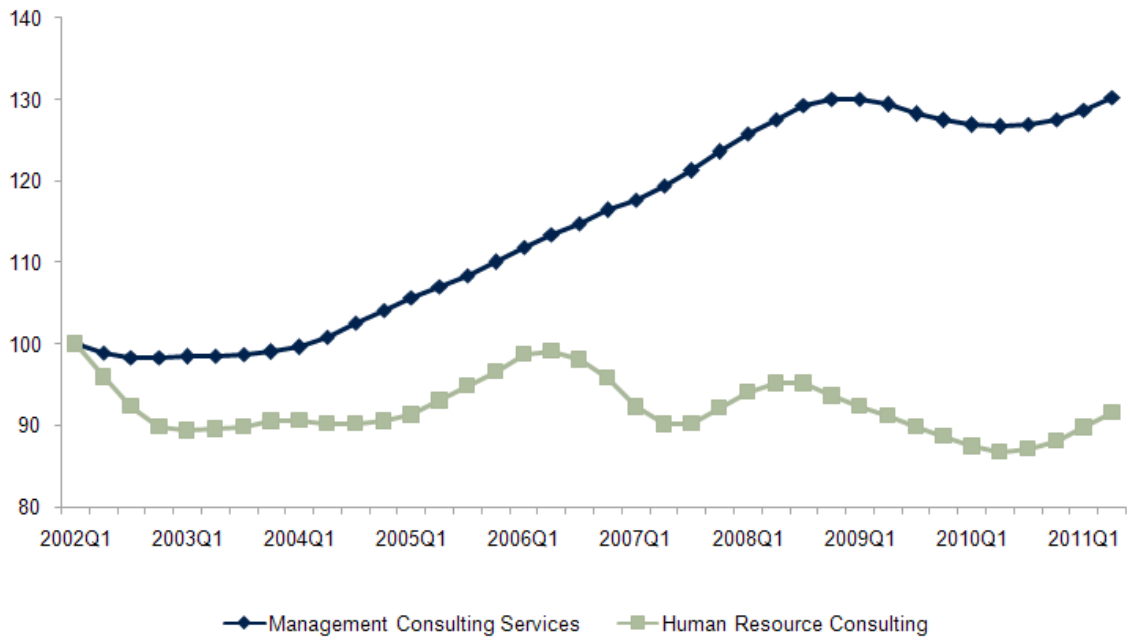


Note*: Includes data for TW, AON, MMC

Source: Company Reports, and William Blair & Company, L.L.C.

On the supply side, it appears that companies in both human resource consulting and the overall management consulting category are beginning to reinvest in their business. Total employment levels in consulting services are starting to recover from the prolonged slump during the last several years. As illustrated in the chart on the following page, HR consulting has not seen as much growth over the last several years as management consulting in general, but the downward trend appears to be reversing over the last several quarters. We believe that firms' hiring of new staff is a great forward indicator for future demand trends, as companies tend to invest only when they anticipate significant business in the pipeline.

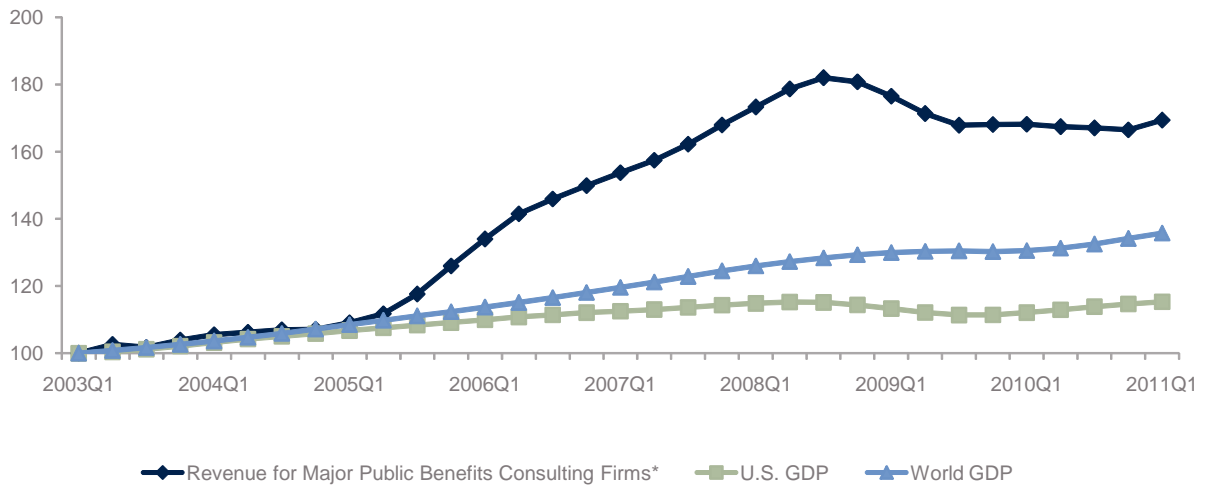
Insurance Brokers
Employment in HR and Management Consulting
 (Rolling 12 month periods indexed to Q1 2002)



Source: BLS

During the past 5 to 10 years, the major human resource benefit consulting firms have grown revenue far faster than the economy as a whole. As firms have looked to decrease costs and run more efficiently, hiring external consultants for advisory services or even outsourcing their entire human resources department has become commonplace among many corporations. Though revenue growth has pulled back somewhat over the last two years because of the recession, there are signs that the pattern is beginning to change, and continued growth in U.S. and world GDP will only help to hasten the pace of recovery. In a recent survey conducted by Forrester Research at the end of 2010, business decision-makers were asked for which service they were most likely to hire third-party consultants. Human resource and talent consulting came out as the top choice, beating out nine other common consulting fields like tax and auditing, CRM, corporate strategy, risk management, and supply chain management.

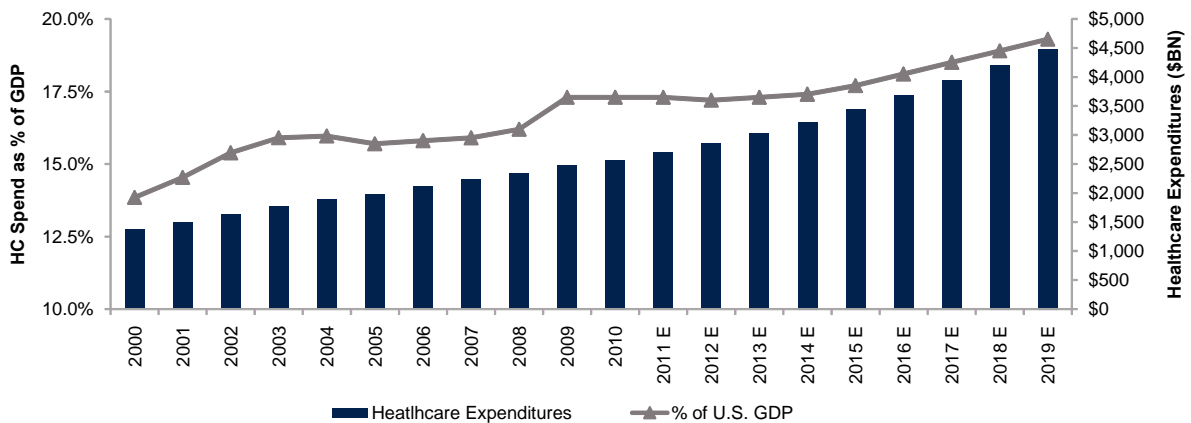
Insurance Brokers
Growth in Benefits Consulting Index vs. Overall GDP
 (Rolling 12 month periods indexed to Q1 2003)



Note*: Includes data for TW, AON, MMC and Hewitt and Towers Perrin pre-merger
 Source: Company Reports, BEA, William Blair & Company, L.L.C.

Clearly, corporations still recognize and value the importance that human resource consulting and outsourcing firms can provide, and much of that has to do with cost savings. One of the largest drivers of costs for employers has been the steady increase of healthcare costs, and the complexities added with the recent healthcare reform. Healthcare expenditures are projected to nearly double by 2020, driven by increasing costs that will further drive up the costs of health insurance. Much of this burden will fall onto corporations, and as many of the uncertainties surrounding the current healthcare legislation become resolved, we expect corporate spending on healthcare and benefits-related consulting to quickly pick up.

Insurance Brokers
Absolute Health Care Spending in the US and as % of U.S. GDP



Source: Centers for Medicare & Medicaid Services, Office of the Actuary, National Health Statistics Group; U.S. Department of Commerce, Bureau of Economic Analysis; and U.S. Bureau of the Census.

On a long-term basis, global consulting demand is forecast to grow at 5% annually through 2014. According to International Data Corporation (IDC), the global human resources market is expected to expand to more than \$125 billion. The firm expects both business process outsourcing (BPO) and consulting services to grow at a healthy rate, although BPO should be the faster of the two, particularly with the new healthcare legislation.

Insurance Brokers
Worldwide HR Management Services Spending by Service Type, 2009-2014
(dollars in millions)

	2009	2010E	2011E	2012E	2013E	2014E	2009-2014E CAGR
Processing Services	\$48,621.9	\$50,216.8	\$52,335.5	\$54,810.7	\$57,479.3	\$60,277.2	4.4%
BPO Services	\$17,576.2	\$18,335.1	\$19,343.6	\$20,550.4	\$22,017.9	\$23,705.9	6.2%
Subtotal	\$66,198.1	\$68,551.9	\$71,679.1	\$75,361.1	\$79,497.2	\$83,983.1	4.9%
Consulting Services	\$36,098.8	\$37,073.1	\$38,380.5	\$40,239.1	\$42,182.1	\$44,158.2	4.1%
Total	\$102,296.9	\$105,625.0	\$110,059.6	\$115,600.2	\$121,679.3	\$128,141.3	4.6%

Source: IDC Market Report

Acquisitions Activity Picks Up

Deal activity moved back to normalized levels in 2010 after a slow 2009. In addition to the typical small deals, Aon purchased Hewitt for \$4.9 billion. It seems that 2011 is off to an even faster start than 2010 in terms of deal-making activity, particularly for A.J. Gallagher and Brown & Brown. For Brown & Brown, there have been 11 transactions year-to-date worth an estimated \$45 million of incremental annualized revenue, versus 6 transactions worth \$23 million in annualized revenue in the year-ago period. Similarly, Gallagher has announced 13 transactions year-to-date versus 8 in the year-ago period, including a huge acquisition of UK P&C and Benefits Broker Heath Lambert, which is expected to add \$158 million in annualized revenue.

One factor driving the increase in deals appears to be less economic uncertainty. The other major contributor to deal activity is that brokers' cash levels have been increasing, mainly because of successful expense management. Both of these factors combined with relatively low deal multiples have created a very attractive environment for acquisitions. Recent conversations with management at many of the firms continue to suggest strong pipelines going forward, indicating that observed activity levels are unlikely to abate soon. Given the significant jump in activity, acquisitions should continue to be a meaningful driver of earnings growth over the next 18 months. Organic revenue growth should also be stronger in the back half of 2011, ranging from 3% to 4%. Our forecast assumes that acquisitions will drive at least two-thirds of top-line growth over the next 18 months.

Insurance Brokers
Revenue and Earnings Estimates

	Rating	No. of 2010 Deals	2011E Revenue Growth by Acquisition	2011E Organic Revenue Growth	2011E Total Revenue Growth	2011E Acquisition Growth as % of Total	2010-2012 EPS Growth Estimate	2011 William Blair EPS Estimate	2011 Consensus EPS Estimate	William Blair EPS Estimate Versus Consensus
AON	Outperform	2	1%	3%	4%	27%	14%	\$3.38	\$3.42	-1.1%
AJG	Market Perform	18	17%	3%	20%	87%	10%	\$1.36	\$1.37	-0.2%
BRO	Market Perform	26	6%	-1%	5%	114%	7%	\$1.15	\$1.19	-3.8%
MMC	Market Perform	7	3%	4%	7%	48%	15%	\$1.87	\$1.87	0.1%
WSH	Outperform	0	0%	5%	5%	0%	15%	\$2.83	\$2.88	-1.6%
Average	NA	11	5%	3%	8%	66%	12.3%	NA	NA	-1.3%

Note: Excludes Financial Services for Arthur J. Gallagher, and Consulting for MMC and AON
Sources: Company reports, William Blair & Company, L.L.C.

Second-Quarter Forecasts:

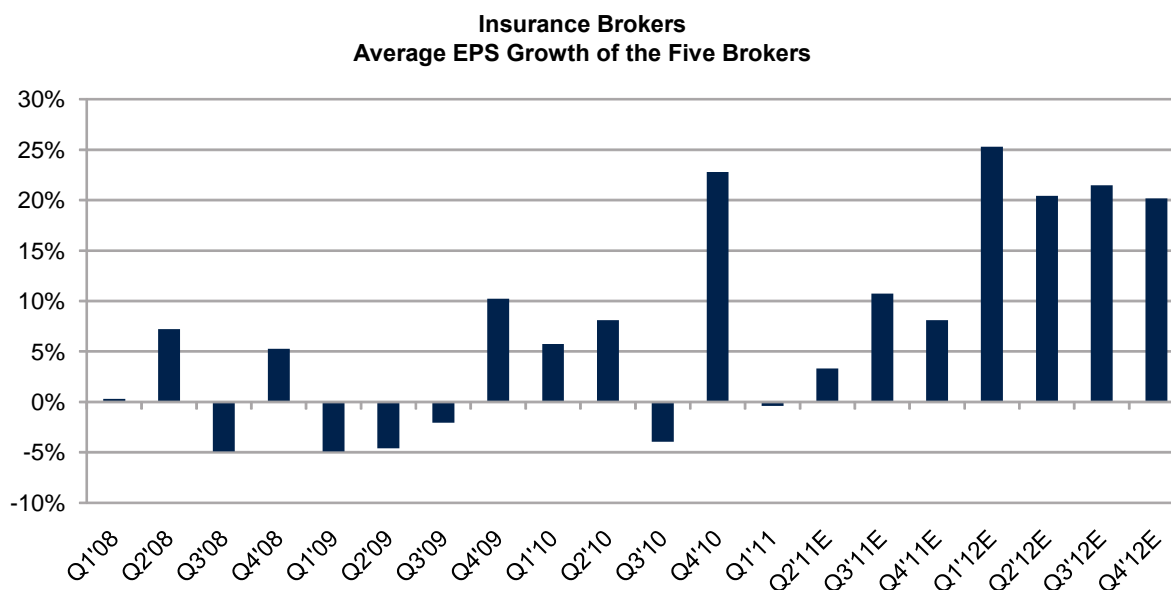
Earnings Remain Solid

We are expecting a decent earnings period in the second quarter, in line with the second quarter of 2010 with some variation by stock. Organic growth and revenue from acquisitions should be better than the year-ago period, offset somewhat by a continued decline in pricing. Aon, Marsh & McLennan, and Willis in particular will benefit from increased exposure to international markets, where organic growth has been stronger, pricing declines have been less severe, and dollar weakness has provided some exchange rate benefits to reported results.

Insurance Brokers EPS Comparison			
Ticker	GAAP EPS		
	2Q2011E	2Q2010	1Q2011
AON	\$0.81	\$0.81	\$0.80
AJG	\$0.43	\$0.44	\$0.16
BRO	\$0.31	\$0.29	\$0.31
MMC	\$0.49	\$0.46	\$0.56
WSH	\$0.55	\$0.54	\$1.28

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

Earnings growth has been depressed in recent quarters by a struggling economy and weak industry pricing. Industry pricing continues to remain stuck in a negative trend, and we continue to forecast prices to be down 2% to 4% for the whole of 2011. However, we have seen a pickup in acquisitions and stronger organic growth, which should offset some of those negative trends. We are forecasting earnings to show moderate year-over-year growth through the remainder of 2011, and then far stronger growth moving into 2012.



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

**Insurance Brokers
WB EPS Estimates vs. Consensus**

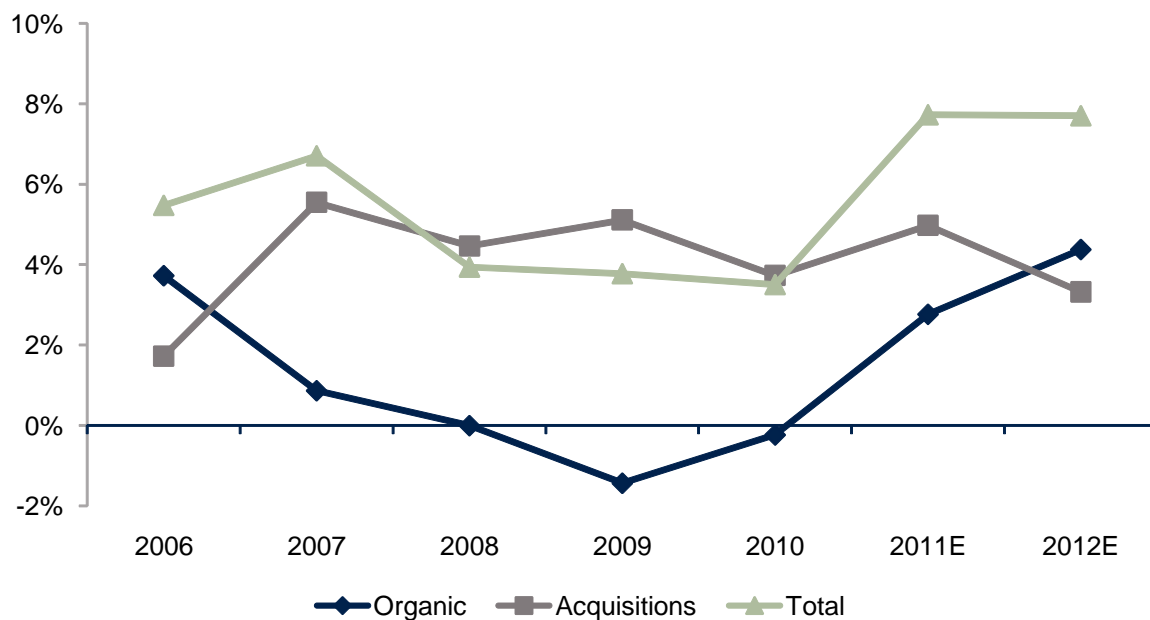
Ticker Symbol	Rating	WB Estimates			Consensus Estimates			WB vs Consensus		
		2Q'11	2011	2012	2Q'11	2011	2012	2Q'11	2011	2012
AON	O	\$0.81	\$3.38	\$4.02	\$0.83	\$3.42	\$3.90	(\$0.02)	(\$0.04)	\$0.12
AJG	M	\$0.43	\$1.36	\$1.65	\$0.42	\$1.37	\$1.76	\$0.01	(\$0.00)	(\$0.10)
BRO	M	\$0.31	\$1.15	\$1.29	\$0.31	\$1.19	\$1.35	\$0.01	(\$0.05)	(\$0.06)
MMC	M	\$0.49	\$1.87	\$2.17	\$0.48	\$1.87	\$2.14	\$0.01	\$0.00	\$0.02
WSH	O	\$0.55	\$2.83	\$3.58	\$0.58	\$2.88	\$3.35	(\$0.03)	(\$0.05)	\$0.23
Estimates Above Consensus								3	1	3
Estimates Below Consensus								2	4	2
Estimates in Line With Consensus								0	0	0

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

Revenue: Gradual Uptick

We expect sector revenues to rebound in 2011. Organic growth, related to a better economy and the expectation of higher levels of acquisitions, should overcome a likely depressed pricing environment. The chart below shows that our forecast for sector revenue growth is 8% in 2011, compared with historical revenue growth of 4% in 2009 and 2010. The 8% figure is derived from 5% acquisition growth and a turnaround in organic growth from an estimated 0% in 2010 to +3% in 2011.

**Insurance Brokers
Average Insurance Brokerage Revenue Growth**

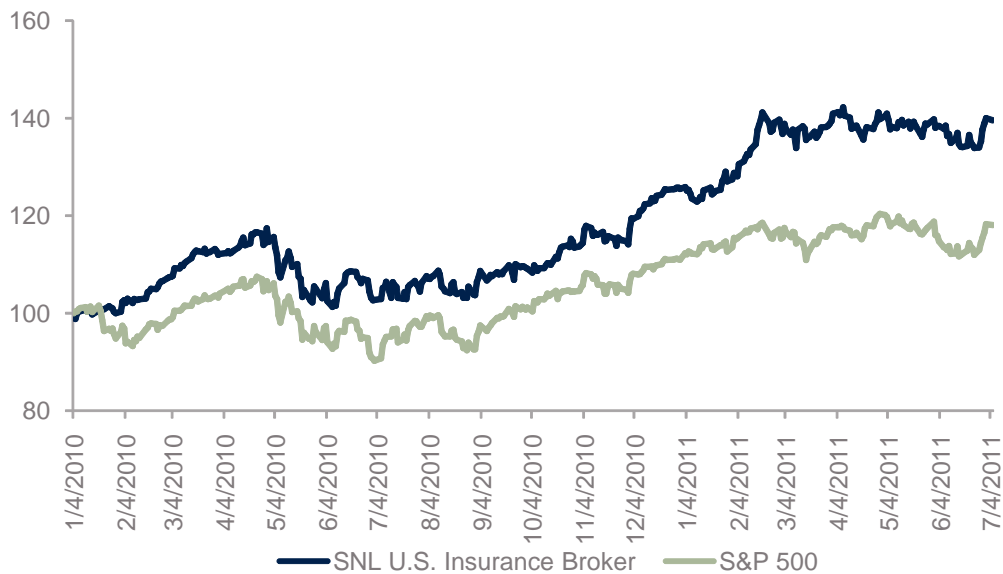


Note: Excludes Financial Services for Arthur J. Gallagher, and Consulting for MMC and AON
Source: Company reports

Performance

The brokerage sector is having a good year. On average, the sector is up by 11% year-to-date in 2011 versus 5% for the S&P 500. These stocks have historically shown the ability to perform in soft cycles due to acquisition-related growth. Recent data points, along with a strong pickup in acquisitions, suggest that the strong performance could continue through 2011. Willis is leading at 20% and A.J. Gallagher is lagging at -1%.

**Insurance Brokers
Composite Broker Stock Performance (Indexed)**



Source: Thomson One, SNL

Valuation

Valuations have moved off trough levels based on the prospect of improved earnings. Earnings growth should begin to come off low levels. The combination of weak industry pricing, a contracting economy, and lower acquisition levels resulted in revenue growth one-third of historical levels for the last three years. EPS growth declined from a 20-year average of 11% to an average of 3% in the last three years (excluding the last five years, which included the Spitzer-led investigations and the recent recession, historical revenue and EPS growth would have averaged 13% and 15%, respectively). P/E multiples moved to historical lows (13.9 times forward earnings) in 2009, reflecting the lower growth rate, but have recently popped back up, based on signs of higher growth. The current average forward P/E multiple is 18.0 times 2011 earnings; the average EV-to-EBITDA ratio is 9.2 times.

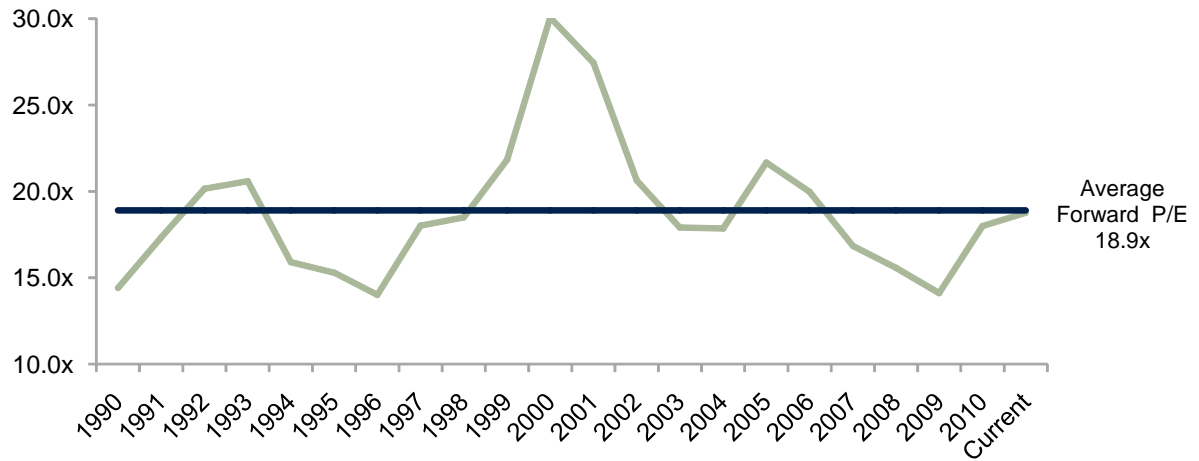
The average P/E multiple for the insurance broker group mainly ranged between 100% and 120% of the S&P 500 multiple over the last 10 years. It dropped down to 80% in 2009 as the lagging impact of the recession reduced earnings growth. It has recently recovered to near 120% as signs of a sector rebound have begun to emerge.

In the near term, we expect multiples to stay relatively stable, with potential for moderate improvement. Both P/E and EV-to-EBITDA ratios are already trading at the higher end of the nonpeak range based on an expected recovery in earnings. The potential for faster-than-expected earnings acceleration, however, could push the multiples higher. Over the long term, multiples have significant upside when the P&C pricing cycle experiences a positive inflection. Our cash flow analysis shows a good probability of an upward turn in pricing in 2013. The brokers tend to be early leaders in cycle turns and therefore multiple expansion could occur in 2012 (i.e., 6 to 12 months before pricing increases).

On a relative basis, we expect the group to keep pace with the overall market but not outperform. However, we specifically like Aon and Willis, which are trading at 11 times and 10 times 2012 cash earnings, respectively, due to their attractive valuations versus the group and above-average growth prospects. We believe both stocks have the chance to trade closer to the 12 to 14 times range, and thus significantly outperform the group and the broader market.

As discussed above, revenue and earnings have significant leverage to GDP. Therefore, earnings should continue to respond, assuming the economy continues on its path toward a gradual recovery. The sector has some resiliency to a downside economic scenario, as acquisitions can maintain at least a base growth rate. However, a reversal of the current economic recovery would result in downside to our current estimates.

**Insurance Brokers
One-Year Forward P/E Multiple**



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

Aon Corporation

Quarterly View:

The quarter should be highlighted by strong international brokerage growth and improved reinsurance and consulting growth rates. Our second quarter 2011 estimate is \$0.81 compared with consensus of \$0.83. One drawback is that consulting is seasonally weaker in the second quarter, thus results will be down sequentially even with additional cost savings. We expect them to go from \$26 million to \$45 million. In addition, we are conservative on brokerage margin at 21.3% compared with 21.1% given recent lackluster recent history. If margin expands by 100 basis points, this would result in an additional \$0.03 of earnings per share.

Key Factors to Watch:

- **Potential cost savings:** The major factors driving the outcome will be cost savings and revenue growth levels. Management initially projected a 2012 cost savings of \$318 million to \$335 million. This represents roughly 8% of the cost base of the combined organization. Cost savings should come from several areas, including back office/administration, management overlap, moving Aon benefit outsourcing onto the Hewitt platform, and general corporate costs. The most interesting factor should be potential savings from moving Aon's benefit outsourcing onto Hewitt's platform. Our high/low range for 2012 is \$300 million to \$375 million, with our current estimate (base case) assuming \$320 million. Our second-quarter estimate assumes that \$45 million of cost savings are realized compared with \$24 million in the first quarter.
- **Brokerage organic growth:** Our forecast calls for brokerage organic revenue growth to be 3.1%, which would be the third positive quarter in a row and compares with -0.8% for the second quarter of 2010. Aon averaged organic growth of -1.5% through the first nine months of 2010, but then turned to a positive 3% in the fourth quarter of 2010 and followed that up with 2% in first quarter 2011. The largest improvement has been in the U.K. segment, which averaged -5% for the first three quarters of 2010 compared with 6% in fourth quarter 2010 and 3% in the first quarter of 2011. The reinsurance segment had -3% organic growth in 2010 and 0% in the first quarter of 2011. The catastrophes in New Zealand, Australia, Japan, and the United States should affect reinsurance pricing in the second quarter; we expect 2% organic growth. The hardening of the reinsurance market is a big plus for Aon, as 23% of Aon's brokerage revenues in 2010 came from reinsurance.
- **Hewitt business trends:** We expect moderately better revenue performance and increased cost savings. We expect organic revenue, which was flat during the first quarter, to be up by 1% to 2% as outsourcing revenue has the potential to stabilize. Our forecast assumes core margins (excluding cost savings and goodwill charges) come down from 18% to 16% on a sequential basis, as the second quarter is seasonally weak. Our margin forecast may be too conservative.

Recommended Action:

We are reaffirming our Outperform rating on Aon. The stock has the potential for significant long-term upside. The ability to make roughly \$5.00 of cash earnings in 2012 highlights the strong underlying core earnings power. Brokerage stocks average a 13- to 15-times multiple of cash earnings, which suggest significant upside, assuming that Aon can hit its targets.

Aon Corporation
Earnings Model
(dollars in millions)

	2009	2010	Q1'11	Q2'11E	Q3'11E	Q4'11E	2011E	Q1'12E	Q2'12E	Q3'12E	Q4'12E	2012E
INCOME STATEMENT												
Brokerage comm. & fees	\$7,503.0	\$8,493.2	\$2,755.0	\$2,747.9	\$2,632.0	\$3,016.4	\$11,151.3	\$2,873.7	\$2,876.4	\$2,760.7	\$3,167.5	\$11,678.2
% Change	0.8%	13.2%	43.3%	45.9%	47.5%	3.9%	31.3%	4.3%	4.7%	4.9%	5.0%	4.7%
Net investment income	\$142.0	\$58.0	\$34.0	\$14.0	\$15.0	\$15.0	\$78.0	\$16.0	\$17.0	\$19.0	\$19.0	\$71.0
% Change	(46.2%)	(59.2%)	11.0%	11.0%	11.0%	11.0%	34.5%	11.0%	11.0%	11.0%	11.0%	(9.0%)
Total Revenue	\$7,645.0	\$8,551.2	\$2,789.0	\$2,761.9	\$2,647.0	\$3,031.4	\$11,229.3	\$2,889.7	\$2,893.4	\$2,779.7	\$3,186.5	\$11,749.2
% Change	(0.9%)	11.9%	44.1%	45.3%	47.1%	4.0%	31.3%	3.6%	4.8%	5.0%	5.1%	4.6%
Compensation Benefits & G&A	\$5,975.0	\$6,733.0	\$2,202.0	\$2,227.7	\$2,158.8	\$2,383.2	\$8,971.7	\$2,215.6	\$2,226.2	\$2,176.1	\$2,411.7	\$9,029.7
% Change	(5.5%)	12.7%	43.1%	49.0%	52.4%	4.4%	33.2%	0.6%	(0.1%)	0.8%	1.2%	0.6%
Benefits to Policyholders												
Interest expense	\$124.0	\$182.0	\$63.0	\$63.0	\$63.0	\$62.0	\$251.0	\$59.0	\$59.0	\$59.0	\$59.0	\$236.0
AON Amortization & Depreciation	\$242.0	\$238.0	\$62.0	\$61.0	\$62.0	\$62.0	\$247.0	\$62.0	\$62.0	\$62.0	\$62.0	\$248.0
Deal Amortization		65	\$61.0	\$60.0	\$60.0	\$60.0	\$241.0	\$77.5	\$77.5	\$77.5	\$77.5	\$310.0
Hewitt Depreciation		40	\$21.0	\$22.0	\$21.5	\$21.0	\$85.5	\$20.5	\$20.0	\$19.5	\$19.0	\$79.0
Total Amortization & Depreciation		\$343.0	\$144.0	\$143.0	\$143.5	\$143.0	\$573.5	\$160.0	\$159.5	\$159.0	\$158.5	\$637.0
Total Operating Expenses	\$6,341.0	\$7,233.0	\$2,388.0	\$2,350.7	\$2,281.8	\$2,505.2	\$9,525.7	\$2,414.1	\$2,424.7	\$2,374.6	\$2,610.2	\$9,823.7
% Change	(2.3%)	14.1%	46.4%	48.0%	48.0%	1.3%	31.7%	1.1%	3.1%	4.1%	4.2%	3.1%
Pretax Operating Income	\$1,304.0	\$1,318.2	\$401.0	\$411.2	\$365.2	\$526.2	\$1,703.6	\$475.6	\$468.6	\$405.1	\$576.2	\$1,925.5
% Change	7.1%	1.1%	31.8%	31.4%	42.1%	18.5%	29.2%	18.6%	14.0%	10.9%	9.5%	13.0%
Pretax Operating Margin	17.1%	15.4%	14.4%	14.9%	13.8%	17.4%	15.2%	16.5%	16.2%	14.6%	18.1%	16.4%
Special Charges	\$0.0	\$187.0	\$45.0	\$30.0	\$0.0	\$75.0	\$150.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Adj. P-T Income	\$1,304.0	\$1,131.2	\$356.0	\$381.2	\$365.2	\$451.2	\$1,553.6	\$475.6	\$468.6	\$405.1	\$576.2	\$1,925.5
Income Taxes	\$354.0	\$326.3	\$103.0	\$123.4	\$109.6	\$157.9	\$493.8	\$140.3	\$138.3	\$119.5	\$170.0	\$568.0
Tax rate	27%	25%	29%	30%	30%	30%	29%	30%	30%	30%	30%	30%
Adj. A-T Income from cont. ops.	\$950.0	\$804.9	\$253.0	\$257.8	\$255.6	\$293.3	\$1,059.8	\$335.3	\$330.4	\$285.6	\$406.3	\$1,357.5
A-T Income from disc. ops./charges												
A-T Net Income	\$950.0	\$804.9	\$253.0	\$257.8	\$255.6	\$293.3	\$1,059.8	\$335.3	\$330.4	\$285.6	\$406.3	\$1,357.5
% Change												
Minority Interest	(\$45.0)	(\$26.0)	(\$9.0)	(\$9.0)	(\$9.0)	(\$9.0)	(\$36.0)	(\$9.0)	(\$9.0)	(\$9.0)	(\$9.0)	(\$36.0)
Preferred dividends	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Adjusted Income	\$905.0	\$778.9	\$244.0	\$248.8	\$246.6	\$284.3	\$1,023.8	\$326.3	\$321.4	\$276.6	\$397.3	\$1,321.5
Net Income Per Share	\$3.12	\$2.61	\$0.71	\$0.72	\$0.72	\$0.84	\$2.98	\$0.97	\$0.97	\$0.85	\$1.23	\$4.02
Extraordinary Items Per Share, Net	\$0.00	\$0.46	\$0.09	\$0.09	\$0.00	\$0.22	\$0.40	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Capital Gains (losses) Per Share	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Operating Income Per Share	\$3.12	\$3.07	\$0.80	\$0.81	\$0.72	\$1.06	\$3.38	\$0.97	\$0.97	\$0.85	\$1.23	\$4.02
% Change	10.3%	(1.6%)	(4.0%)	(0.1%)	18.5%	26.2%	10.1%	21.9%	19.8%	18.0%	16.9%	18.8%
Cash Earnings Per Share	\$3.32	\$3.30	\$0.89	\$0.91	\$0.90	\$1.02	\$3.72	\$1.19	\$1.20	\$1.08	\$1.47	\$4.94
Currency Impact	(\$0.03)	(0.5%)	0.1%	3.5%	34.0%	17.9%	12.6%	34.1%	32.1%	19.5%	43.8%	32.7%
Avg. shares outstanding	290.3	298.7	345.4	344.5	343.0	340.5	343.3	336.2	331.6	326.0	322.0	328.9
Dividends Per Share	\$0.60	\$0.60	\$0.17	\$0.17	\$0.17	\$0.17	\$1.22	\$0.17	\$0.17	\$0.17	\$0.17	\$1.24
Dividend Payout Ratio	19.2%	19.5%	21.3%	21.0%	23.6%	16.1%	36.1%	17.5%	17.5%	20.0%	13.8%	30.9%

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

Arthur J. Gallagher & Co.

Quarterly View:

Our estimate for second quarter 2011 is \$0.43, versus \$0.42 for consensus and compared with \$0.44 a year ago. The quarter will be affected by an estimated \$0.06 higher loss in the corporate segment compared with last year related to a slower ramp-up of the clean energy business. Aside from the corporate segment, earnings from the core brokerage and risk management areas should grow in the high single digits reflecting momentum from recent deals.

Key Factors to Watch:

- **Recent deal activity:** AJG has made or signed agreements for 8 acquisitions during the last three months and 18 deals in the last nine months. The activity has been spread across product and geographic sectors. The largest deal was the Heath Lambert acquisition in May, which is expected to generate \$158 million in annualized revenue. This will spur significant growth in AJG's international brokerage, although only a portion will flow through in the second quarter due to the May 12 acquisition date. Although not as recent, the acquisition of GAB TPA deal last October with expected annualized revenues of \$50 million will provide continued momentum to the Gallagher Basset subsidiary. We expect acquisitions to add 13% to revenue growth in the quarter.
- **Brokerage organic:** Organic revenue growth increased from -3% in the first half of 2010 to 0% in the second half of 2010. Organic in the first quarter of 2011 was 2% and we expect 2% this quarter as well. The company's growth will still likely come from the international segment. Upside is possible if the United States begins to show growth during the quarter.
- **Heath Lambert acquisition:** The deal will be the biggest driver of earnings in 2012. Original guidance is that it should break even in the near term and then potentially add more than 20% to brokerage earnings in the long term. We expect management to provide more details in the second quarter on how profitability will improve.

Recommended Action:

We are reaffirming our Market Perform rating. AJG has strong long-term potential as the company has significant leverage to an improving U.S. economy. If property-and-casualty pricing improves in 2013, AJG will be one of the prime beneficiaries. However, with the stock currently trading above 21 times our 2011 EPS estimate, we believe near-term upside will be limited.

Arthur J. Gallagher & Co.

Earnings Model

(dollars in millions)

	2009	2010	Q1'11	Q2'11E	Q3'11E	Q4'11E	2011E	Q1'12E	Q2'12E	Q3'12E	Q4'12E	2012E
TOTAL COMPANY												
Commissions	\$1,003.7	\$1,040.2	\$256.0	\$327.0	\$340.4	\$326.3	\$1,249.6	\$317.2	\$371.4	\$368.1	\$353.5	\$1,410.2
% change	9%	4%	10%	18%	25%	26%	20%	24%	14%	8%	8%	13%
Fees	\$708.0	\$735.0	\$189.0	\$200.1	\$206.8	\$224.9	\$820.9	\$201.6	\$213.4	\$220.5	\$241.3	\$876.8
% change	3%	4%	15%	12%	11%	10%	12%	7%	7%	7%	7%	7%
Investment Income - Fiduciary	\$17.7	\$6.9	\$1.9	\$2.7	\$2.7	\$2.7	\$10.0	\$2.7	\$2.7	\$2.8	\$2.8	\$11.0
% change	-57%	-61%	36%	29%	69%	50%	45%	42%	0%	4%	4%	10%
Investment Income - All Other	\$0.5	\$64.9	\$0.0	\$1.0	\$3.0	\$5.0	\$9.0	\$5.0	\$6.0	\$7.0	\$7.0	\$25.0
% change	-38%	12880%					-86%					178%
Investment Gains (Losses)	(\$0.6)	(\$3.4)	(\$0.6)	(\$0.6)	(\$0.6)	(\$0.6)	(\$2.4)	(\$0.6)	(\$0.6)	(\$0.6)	(\$0.6)	(\$2.4)
% change												
Gross Revenues	\$1,729.3	\$1,843.6	\$446.3	\$530.2	\$552.3	\$558.3	\$2,087.1	\$525.9	\$593.0	\$597.8	\$603.9	\$2,320.6
% change	5%	7%	-4%	16%	20%	22%	13%	18%	12%	8%	8%	11%
Less Brokerage	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
% change												
Revenues	\$1,729.3	\$1,843.6	\$446.3	\$530.2	\$552.3	\$558.3	\$2,087.1	\$525.9	\$593.0	\$597.8	\$603.9	\$2,320.6
% change	5%	7%	-4%	16%	20%	22%	13%	18%	12%	8%	8%	11%
Compensation	\$1,061.0	\$1,092.1	\$289.6	\$315.5	\$332.9	\$352.0	\$1,290.0	\$335.8	\$350.3	\$354.9	\$379.3	\$1,420.3
% change	7%	3%	12%	17%	22%	21%	18%	16%	11%	7%	8%	10%
Other Operating	\$327.9	\$334.5	\$92.7	\$95.5	\$96.3	\$104.2	\$388.7	\$99.8	\$104.1	\$106.5	\$113.9	\$424.3
% change	-12%	2%	18%	16%	14%	17%	16%	8%	9%	11%	9%	9%
Investment Expenses	\$11.1	\$98.3	\$2.0	\$6.7	\$6.7	\$6.7	\$22.1	\$6.7	\$6.7	\$6.7	\$6.7	\$26.8
% change	-	-	-97%	46%	16%	-61%		235%	0%	0%	0%	
Interest	\$28.5	\$34.6	\$9.5	\$9.5	\$9.5	\$9.5	\$38.0	\$9.5	\$9.5	\$9.5	\$9.5	\$38.0
% change			nm	nm	10%	9%		nm	nm	0%	0%	
Depreciation	\$30.6	\$32.3	\$8.1	\$8.4	\$8.6	\$8.6	\$33.7	\$8.5	\$8.5	\$8.5	\$8.5	\$34.0
% change	2%	6%	5%	4%	4%	4%		5%	2%	-1%	-1%	
Amortization	\$57.9	\$58.5	\$16.4	\$17.4	\$18.4	\$18.7	\$70.9	\$18.9	\$19.2	\$19.4	\$19.7	\$77.1
% change	32%	1%	18%	22%	27%	18%		15%	10%	5%	5%	
One-Time Items												
Expenses	\$1,517.0	\$1,650.3	\$418.3	\$452.9	\$472.4	\$499.6	\$1,843.3	\$479.3	\$498.2	\$505.4	\$537.6	\$2,020.5
% change	2%	9%	-5%	17%	20%	16%		15%	10%	7%	8%	
Earnings Before Income Taxes	\$212.3	\$193.3	\$28.0	\$77.3	\$79.9	\$58.7	\$243.8	\$46.7	\$94.7	\$92.4	\$66.4	\$300.2
% change	30%	-9%	-1%	9%	23%	101%		67%	23%	16%	13%	
Tax benefit related to Litigation/One-timers												
Provision For Income Taxes	\$78.0	\$35.8	\$10.1	\$29.8	\$30.0	\$21.8	\$91.7	\$17.0	\$36.3	\$35.4	\$25.0	\$113.7
Effective Tax Rate	36.7%	18.5%	36%	39%	38%	37%	37.6%	36%	38%	38%	38%	37.9%
Net Earnings	\$134.3	\$157.5	\$17.9	\$47.5	\$49.8	\$36.9	\$152.1	\$29.7	\$58.4	\$57.0	\$41.4	\$186.5
% change	21%	17%	-13%	3%	16%	-23%	-3%	66%	23%	14%	12%	23%
Discontinued ops												
Earnings Per Share	\$1.32	\$1.36	\$0.16	\$0.43	\$0.45	\$0.33	\$1.36	\$0.26	\$0.52	\$0.51	\$0.37	\$1.65
% change	12%	3%	-18%	-3%	10%	3%	0%	63%	22%	13%	11%	21%
Cash EPS	\$1.70	\$1.86	\$0.26	\$0.53	\$0.55	\$0.44	\$1.78	\$0.38	\$0.63	\$0.62	\$0.48	\$2.11
% change	14%	9%	-10%	0%	12%	-19%	-4%	44%	19%	12%	9%	18%
Average Diluted Shares	100,622	105,099	110,315	111,365	111,765	112,065	111,378	112,315	112,565	112,815	113,015	112,678

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

Brown & Brown, Inc.

Quarterly View:

Our second quarter 2011 estimate of \$0.31 is equal with consensus. The company has been battling softness in key markets, including Florida, West Coast, and wholesale. Signs of bottoming in these core markets would be a significant positive for 2011; however, in management presentations, it did not seem as upbeat about a rebound in the economy or a hardening in insurance pricing. Given these soft markets, the company has elevated acquisition activity in the last 12 months.

Key Factors to Watch:

- **Acquisitions:** A recent pickup in deal activity is a good sign. We expect acquisitions to add roughly 10% to growth in the second quarter, which is driven by the September acquisition of Crowe Paradis (\$23 million annualized) and the recent First Horizon acquisition (\$14.8 million annualized).
- **Expense restraint is crucial:** Our estimate assumes that the EBITDA margin will increase from 36% to 37% based on the expectation of a 4% increases in expenses. This is in line with the first quarter and represents growth in the cost base related to acquisitions. Inability to hold the line on expenses could lead to downside to our current estimates.
- **Retail organic still negative:** We expect retail organic in the second quarter to be -2%, and overall organic to be -1.5%. The company's retail organic has not shown the same improvement as the other brokers due to the depressed economies in Florida and California. One positive was the western retail segment stabilized in the first quarter, at -3.0%, compared with -10.8% for 2010.

Recommended Action:

We are reaffirming our Market Perform rating on Brown & Brown. After a challenging period, growth is exhibiting a gradual turnaround. However, given the higher-than-average price-to-earnings multiple of 23 times, we believe that there are better values in the sector.

Brown & Brown, Inc.
Earnings Model
(dollars in millions)

	2009	2010	Q1'11	Q2'11E	Q3'11E	Q4'11E	2011E	Q1'12E	Q2'12E	Q3'12E	Q4'12E	2012E
INCOME STATEMENT												
Commissions & Fees	\$964.9	\$966.9	\$261.5	\$256.1	\$257.4	\$241.9	\$1,016.9	\$281.5	\$276.1	\$276.4	\$266.8	\$1,100.9
% change	0%	0%	4%	6%	5%	6%	5%	8%	8%	7%	10%	8%
Investment Income	\$1.2	\$1.3	\$0.2	\$0.5	\$0.5	\$0.5	\$1.7	\$0.5	\$0.5	\$0.5	\$0.5	\$2.0
% change	-81%	13%	-28%	45%	43%	64%	32%	123%	0%	0%	0%	16%
Other Income	\$1.9	\$5.3	\$0.6	\$0.7	\$0.7	\$0.7	\$2.7	\$0.7	\$0.7	\$0.7	\$0.7	\$2.8
% change	-66%	185%	-56%	-69%	-42%	28%	-50%	27%	0%	0%	0%	6%
Total Revenues	\$967.9	\$973.5	\$262.2	\$257.3	\$258.6	\$243.1	\$1,021.2	\$282.7	\$277.3	\$277.6	\$268.0	\$1,105.7
% Change	-1%	1%	4%	6%	4%	6%	5%	8%	8%	7%	10%	8%
Compensation & Benefits	\$484.7	\$487.8	\$126.6	\$127.2	\$127.8	\$127.9	\$509.5	\$135.2	\$136.7	\$137.5	\$138.1	\$547.4
% change	0%	1%	4%	5%	5%	5%	4%	7%	7%	8%	8%	7%
Non-cash stock compensation	\$7.4	\$6.9	\$2.8	\$3.0	\$3.0	\$3.0	\$11.8	\$3.0	\$3.0	\$3.0	\$3.0	\$12.0
% change	1%	-7%	42%	69%	100%	86%	72%	8%	0%	0%	0%	2%
Other Operating Expenses	\$143.4	\$134.4	\$36.0	\$32.8	\$32.6	\$40.7	\$142.0	\$37.7	\$35.5	\$37.9	\$40.0	\$151.1
% change	4%	-6%	1%	-1%	3%	20%	6%	5%	8%	16%	-2%	6%
Amortization	\$49.9	\$51.5	\$13.5	\$13.5	\$13.5	\$13.6	\$54.2	\$13.9	\$14.1	\$14.4	\$14.7	\$57.1
% change	7%	3%	8%	7%	5%	2%	5%	3%	5%	7%	8%	5%
Depreciation	\$13.2	\$12.6	\$3.1	\$3.2	\$3.2	\$3.2	\$12.7	\$3.2	\$3.2	\$3.2	\$3.2	\$12.8
% change	0%	-5%	-4%	2%	3%	2%	1%	2%	0%	0%	0%	1%
Interest	\$14.6	\$14.5	\$3.6	\$3.6	\$3.2	\$3.2	\$13.6	\$3.0	\$3.0	\$3.0	\$3.0	\$12.0
% change	-1%	-1%	0%	-1%	-12%	-12%	-6%	-17%	-17%	-6%	-6%	-12%
Total Expenses	\$713.1	\$707.6	\$185.6	\$183.3	\$183.3	\$191.6	\$743.7	\$195.9	\$195.5	\$199.0	\$202.0	\$792.4
% change	1%	-1%	4%	4%	5%	8%	5%	6%	7%	9%	5%	7%
PT Income	\$254.8	\$265.9	\$76.7	\$74.0	\$75.3	\$51.6	\$277.5	\$86.8	\$81.8	\$78.6	\$66.0	\$313.3
% change	-7%	4%	5%	9%	3%	-1%	4%	13%	11%	4%	28%	13%
Tax	\$101.5	\$104.3	\$30.4	\$29.6	\$30.1	\$20.6	\$110.7	\$34.7	\$32.7	\$31.4	\$26.4	\$125.3
Tax Rate	39.8%	39.2%	39.6%	40.0%	40.0%	40.0%	39.9%	40.0%	40.0%	40.0%	40.0%	40.0%
Minority Interest	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Net Income	\$153.3	\$161.6	\$46.3	\$44.4	\$45.2	\$30.9	\$166.8	\$52.1	\$49.1	\$47.2	\$39.6	\$188.0
% change	-8%	5%	5%	8%	2%	-4%	3%	13%	11%	4%	28%	13%
Cash Income	\$203.2	\$213.0	\$59.8	\$57.9	\$58.7	\$44.5	\$221.0	\$65.9	\$63.2	\$61.6	\$54.3	\$245.1
Reported EPS	\$1.06	\$1.13	\$0.32	\$0.31	\$0.31	\$0.21	\$1.15	\$0.36	\$0.34	\$0.32	\$0.27	\$1.29
% change	-10%	7%	3%	6%	0%	-4%	1%	12%	10%	4%	28%	12%
Operating EPS	\$1.06	\$1.13	\$0.32	\$0.31	\$0.31	\$0.21	\$1.15	\$0.36	\$0.34	\$0.32	\$0.27	\$1.29
% change	-10%	7%	3%	6%	0%	-4%	1%	12%	10%	4%	28%	12%
Cash EPS	\$1.40	\$1.49	\$0.41	\$0.40	\$0.40	\$0.31	\$1.52	\$0.45	\$0.43	\$0.42	\$0.37	\$1.68
% change	-7%	6%	3%	5%	1%	-3%	2%	10%	9%	4%	22%	11%
Operating EPS excl contingents	\$0.87	\$0.90	\$0.20	\$0.28	\$0.28	\$0.20	\$0.95	\$0.23	\$0.32	\$0.29	\$0.25	\$1.09
% change	-6%	3%	15%	9%	3%	0%	6%	18%	12%	6%	28%	15%
Cash EPS excluding contingents	\$1.22	\$1.26	\$0.29	\$0.38	\$0.37	\$0.29	\$1.33	\$0.33	\$0.42	\$0.39	\$0.35	\$1.49
% change	-3%	3%	12%	8%	3%	0%	6%	13%	10%	6%	21%	12%
Average Diluted Shares	142.3	143.0	145.7	145.4	145.5	145.7	145.6	145.9	146.0	146.1	146.3	146.0
Actual Shares	142.5	143.2	143.5	143.5	143.8	143.8	143.8	144.1	144.1	144.4	144.4	144.4
Dividends Per Share	\$0.29	\$0.31	\$0.08	\$0.05	\$0.05	\$0.05	\$0.32	\$0.06	\$0.06	\$0.06	\$0.06	\$0.32
Dividend Payout Ratio	27.4%	27.7%	25.2%	16.4%	16.1%	23.5%	27.9%	16.8%	17.8%	18.6%	22.1%	24.9%
Reported Book Value	\$9.61	\$10.19	\$10.41	\$10.67	\$10.91	\$11.08	\$11.08	\$11.36	\$11.63	\$11.88	\$12.09	\$12.09
Return on Average Equity (ROE)	11.7%	11.4%	12.5%	11.7%	11.7%	7.8%	10.9%	12.9%	11.9%	11.1%	9.2%	11.3%

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

Marsh & McLennan Companies, Inc.

Quarterly View:

Marsh should have a solid second quarter. We project top-line growth of 7%, driven by risk and insurance services and consulting segments. Our \$0.49 second quarter 2011 estimate is slightly above the current consensus of \$0.48 and is up 7% compared with \$0.46 in first quarter of 2010. We expect near-term results to show modest progress in both the risk and insurance services and consulting segments. However, the company lacks a near-term catalyst. More aggressive deployment of cash is a possibility.

Key Factors to Watch:

- ***Use of cash is the question mark:*** We estimate that Marsh has close to \$1 billion of excess cash and plenty of leverage flexibility. The company has indicated a preference for acquisitions, although higher dividends and a recently announced share-buyback program are also on the table.
- ***Organic growth:*** Insurance brokerage organic of 4% was the highest in the group for the first quarter. We project 4% for the second quarter as well, driven by strong performance in Latin America and Asia. We are keeping a close eye on U.S. organic to make sure it continues its string of three quarters with positive organic. Consulting organic is showing accelerating growth in the first half of 2011. Total consulting organic has gone from 3% in 2010 to 5% in first quarter 2011, and we expect it to remain at those levels given the demand we have seen in the marketplace for benefits and health consulting.
- ***Risk and insurance services margins:*** The brokerage margin moved up from 15.5% in 2006 to 18.6% in 2009. However, the margin showed only a moderate increase in 2010, and is down slightly for year-to-date 2011. The ability to expand the margin in 2011 as the business environment improves would be a significant positive for the stock. Our current forecast assumes a flat margin in 2011.

Recommended Action:

We are reaffirming our Market Perform rating on Marsh. Marsh has significant buying power and is showing the willingness to use it. However, we believe other brokers will have a higher level of near-term growth. Given a higher-than-average trading multiple, upside will likely be limited in the near term.

Marsh & McLennan Companies, Inc.
Earnings Model
(dollars in millions)

	2009	Q1'10	Q2'10	Q3'10	Q4'10	2010	Q1'11	Q2'11E	Q3'11E	Q4'11E	2011E	2012E
INCOME STATEMENT												
Insurance Services Revenues	\$5,284.0	\$1,492.0	\$1,459.0	\$1,327.0	\$1,486.0	\$5,764.0	\$1,634.0	\$1,562.3	\$1,416.6	\$1,570.4	\$6,183.2	\$6,593.9
% Change	-3%	9%	9%	8%	11%	9%	10%	7%	7%	6%	7%	7%
Risk Consulting and Technology	\$687.0	\$162.0	\$0.0	\$0.0	\$0.0	\$162.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
% Change	-31%	-13%	-100%	-100%	-100%	-76%	-100%	#DIV/0!	#DIV/0!	#DIV/0!	-100%	0%
Consulting Services Revenues	\$4,609.0	\$1,155.0	\$1,168.0	\$1,203.0	\$1,309.0	\$4,835.0	\$1,261.0	\$1,241.4	\$1,284.4	\$1,402.6	\$5,189.4	\$5,565.7
% Change	-11%	7%	2%	5%	6%	5%	9%	6%	7%	7%	7%	7%
Interest Income	\$17.0	\$4.0	\$3.0	\$6.0	\$7.0	\$20.0	\$7.0	\$7.0	\$7.0	\$7.0	\$28.0	\$24.0
Investment Income	(\$2.0)	\$8.0	\$18.0	(\$2.0)	\$19.0	\$43.0	\$19.0	\$12.0	\$12.0	\$12.0	\$55.0	\$48.0
Corporate Eliminations	(\$68.0)	(\$14.0)	(\$21.0)	(\$6.0)	(\$10.0)	(\$51.0)	(\$11.0)	(\$15.0)	(\$15.0)	(\$15.0)	(\$56.0)	(\$60.0)
Corporate Eliminations % Revenue	-0.6%	-0.5%	-0.8%	-0.2%	-0.4%	-0.5%	-0.4%	-0.5%	-0.6%	-0.5%	-0.5%	-0.5%
Total Revenues	\$10,527.0	\$2,807.0	\$2,627.0	\$2,528.0	\$2,811.0	\$10,773.0	\$2,910.0	\$2,807.7	\$2,705.0	\$2,977.0	\$11,399.7	\$12,171.5
% Change	-9%	7%	1%	-1%	2%	2%	4%	7%	7%	6%	6%	7%
Salaries & Benefits	\$6,240.0	\$1,650.0	\$1,614.0	\$1,586.0	\$1,690.0	\$6,540.0	\$1,721.0	\$1,685.5	\$1,698.1	\$1,806.3	\$6,910.9	\$7,313.5
% Change	-10%	7%	5%	2%	5%	9%	4%	4%	7%	9%	6%	6%
Amortization of Intangibles	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
% Change												
Operating Expenses	\$2,941.0	\$706.0	\$1,042.0	\$699.0	\$770.0	\$3,217.0	\$691.0	\$782.5	\$788.3	\$838.5	\$3,100.4	\$3,395.2
% Change	-14%	1%	38%	0%	-2%	9%	-2%	-25%	13%	9%	-4%	10%
Interest Expense	\$241.0	\$60.0	\$60.0	\$60.0	\$53.0	\$233.0	\$51.0	\$51.0	\$52.0	\$52.0	\$206.0	\$204.0
Total Operating Expenses	\$9,422.0	\$2,416.0	\$2,273.0	\$2,315.0	\$2,459.0	\$9,463.0	\$2,462.0	\$2,417.0	\$2,434.4	\$2,592.8	\$9,906.2	\$10,504.7
% Change	-11%	5%	-3%	0%	0%	0%	2%	6%	5%	5%		
PT Operating Income	\$1,105.0	\$391.0	\$354.0	\$213.0	\$352.0	\$1,310.0	\$448.0	\$390.7	\$270.6	\$384.2	\$1,493.4	\$1,666.8
Pretax Operating Margin	10.5%	13.9%	13.5%	8.4%	12.5%	12.2%	15.4%	13.9%	10.0%	12.9%	13.1%	13.7%
Special Items	(\$791.0)	\$0.0	\$443.0	\$0.0	\$0.0	\$443.0	\$0.0	\$0.0	\$0.0	\$0.0	\$886.0	\$886.0
Other Income	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Pretax Income	\$314.0	\$391.0	\$797.0	\$213.0	\$352.0	\$1,753.0	\$448.0	\$390.7	\$270.6	\$384.2	\$1,493.4	\$1,666.8
% Change	297%	47%	-805%	18%	-1860%	458%	15%	-51%	27%	9%	-15%	12%
Taxes	\$53.0	\$117.0	(\$60.0)	\$55.0	\$106.0	\$218.0	\$128.0	\$117.2	\$81.2	\$115.2	\$447.0	\$909.9
Tax Rate	16.9%	29.9%	-7.5%	25.8%	30.1%	12.4%	28.6%	30.0%	30.0%	30.0%	29.9%	54.6%
Taxes Adj	\$241.0	\$117.0	\$95.1	\$55.0	\$122.0	\$389.1	\$128.0	\$117.2	\$81.2	\$115.2	\$441.6	\$500.0
Tax Rate Adj	21.8%	29.9%	26.9%	25.8%	34.7%	29.7%	28.6%	30.0%	30.0%	30.0%	29.6%	30.0%
Minority Interest (net of tax)	\$15.0	\$4.0	\$6.0	\$3.0	\$3.0	\$16.0	\$6.0	\$6.0	\$6.0	\$6.0	\$24.0	\$12.0
Participating securities adj.	\$19.0	\$0.0	\$3.0	\$0.0	\$0.0	\$3.0	\$0.0	\$0.0	\$0.0	\$0.0	\$6.0	\$6.0
A-T Adjusted Income	\$830.0	\$270.0	\$250.0	\$155.0	\$227.0	\$902.0	\$314.0	\$267.5	\$183.4	\$262.9	\$1,027.8	\$1,154.7
% Change	10%	31%	45%	-38%	13%	9%	16%	7%	18%	16%	14%	12%
Adjustments Net	(\$444.0)	(\$22.0)	\$271.0	\$43.0	\$0.0	\$292.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
A-T Net Income Con. Ops	\$386.0	\$248.0	\$521.0	\$198.0	\$227.0	\$1,194.0	\$314.0	\$267.5	\$183.4	\$262.9	\$1,027.8	\$1,154.7
A-T Net Income Without Minority		\$252.0	\$527.0	\$201.0	\$230.0		\$320.0	\$273.5	\$189.4	\$268.9		
Operating Earnings	\$830.0	\$270.0	\$241.8	\$146.1	\$243.4	\$901.3	\$307.6	\$267.5	\$183.4	\$262.9	\$1,021.4	\$1,154.7
Net EPS - Cont Ops	\$0.74	\$0.46	\$0.96	\$0.36	\$0.41	\$2.19	\$0.57	\$0.49	\$0.34	\$0.49	\$1.88	\$2.17
% Change	-656%	36%	-406%	-10%	36%	197%	23%	-49%	-7%	17%	-14%	15%
Adjusted Operating EPS	\$1.59	\$0.50	\$0.46	\$0.28	\$0.41	\$1.66	\$0.57	\$0.49	\$0.34	\$0.49	\$1.88	\$2.17
% Change	9%	26%	39%	-41%	9%	4%	13%	7%	19%	17%	14%	15%
Adjusted Cash EPS	\$1.49	\$0.48	\$0.97	\$0.38	\$0.43	\$1.72	\$0.59	\$0.51	\$0.36	\$0.51	\$1.97	\$2.27
% Change	0%	9%	192%	19%	9%	15%	23%	-47%	-5%	18%	15%	15%
Average Shares	523.5	536.0	545.0	548.0	549.0	544.5	552.0	547.5	544.5	541.5	546.4	533.0
Dividend/Share	\$0.81	\$0.22	\$0.22	\$0.22	\$0.22	\$0.88	\$0.23	\$0.23	\$0.23	\$0.23	\$0.92	\$0.96
Amortization Expense	\$64.0	\$16.0	\$16.0	\$16.0	\$16.0	\$64.0	\$22.0	\$22.0	\$22.0	\$22.0	\$88.0	\$88.0
Depreciation	\$307.0	\$81.0	\$61.0	\$61.0	\$61.0	\$264.0	\$61.0	\$61.0	\$61.0	\$61.0	\$244.0	\$244.0
EBITDA	\$1,717.0	\$548.0	\$491.0	\$350.0	\$482.0	\$1,871.0	\$582.0	\$524.7	\$405.6	\$519.2	\$2,031.4	\$2,202.8

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

Willis Group Holdings Public Limited Company

Quarterly View:

Our forecast operating EPS of \$0.55 are \$0.03 below consensus, but 3% higher than second quarter 2010 EPS of \$0.54. Willis will have challenging comparisons with a year ago, including \$0.03 of favorable foreign currency that will likely go the other way due to strengthening, \$0.02 gain from acquisition revenue, and a large capital market transaction that added roughly \$10 million to revenues. Helping to offset these challenges should be an \$8 million decline in interest cost. In addition, compensation costs are expected to be materially higher, as cost savings are not yet expected to mitigate higher salary, 401(k), and amortization costs. This burden should begin to ease in the third and fourth quarters.

Key Factors to Watch:

- **Organic growth:** Organic should remain above peer levels. We expect organic of 5% in the second quarter, which would be the strongest result since fourth quarter 2008. Organic has been benefiting from continued strength internationally. However, in the first quarter, North American posted disappointing organic growth of -1%, particularly since several competitors posted 3% for the quarter. North America should improve from these levels and we would like to see it remain above zero for the remainder of the year to feel comfortable with longer-term prospects. We expect the international and global segments to continue to grow in the 6% to 8% range as these are helped by growth in emerging and developing markets and less pricing pressure than in domestic markets.
- **Compensation costs:** The key for the quarter is that the restricting of the compensation line is on track. We expect 8% growth and a compensation ratio of 58.6%; this assumes higher amortization, salary, and 401(k) costs will result in \$23 million of higher costs on an annual basis. Mitigating cost savings are only expected to reach \$5 million, although this may be conservative.
- **Expense initiative:** The company announced an expense restructuring plan with a target of \$90 million to \$100 million of savings by 2012. Our 2012 estimate, which assumes a 2% growth rate in compensation costs, is conservative in that we assume cost savings reach a \$50 million run-rate by the end of 2012. We also forecast only a \$20 million reduction in deferred cash amortization costs, although it could be double that level. Lower compensation costs could drive materially higher earnings.

Recommended Action:

We would continue to buy shares of Willis. While the second quarter should face several headwinds, we expect progress is building for an earnings rebound in 2012. Signs of strong international growth and the beginnings of cost savings should be positives for the stock.

Willis Group Holdings Public Limited Company
Earnings Model
(dollars in millions)

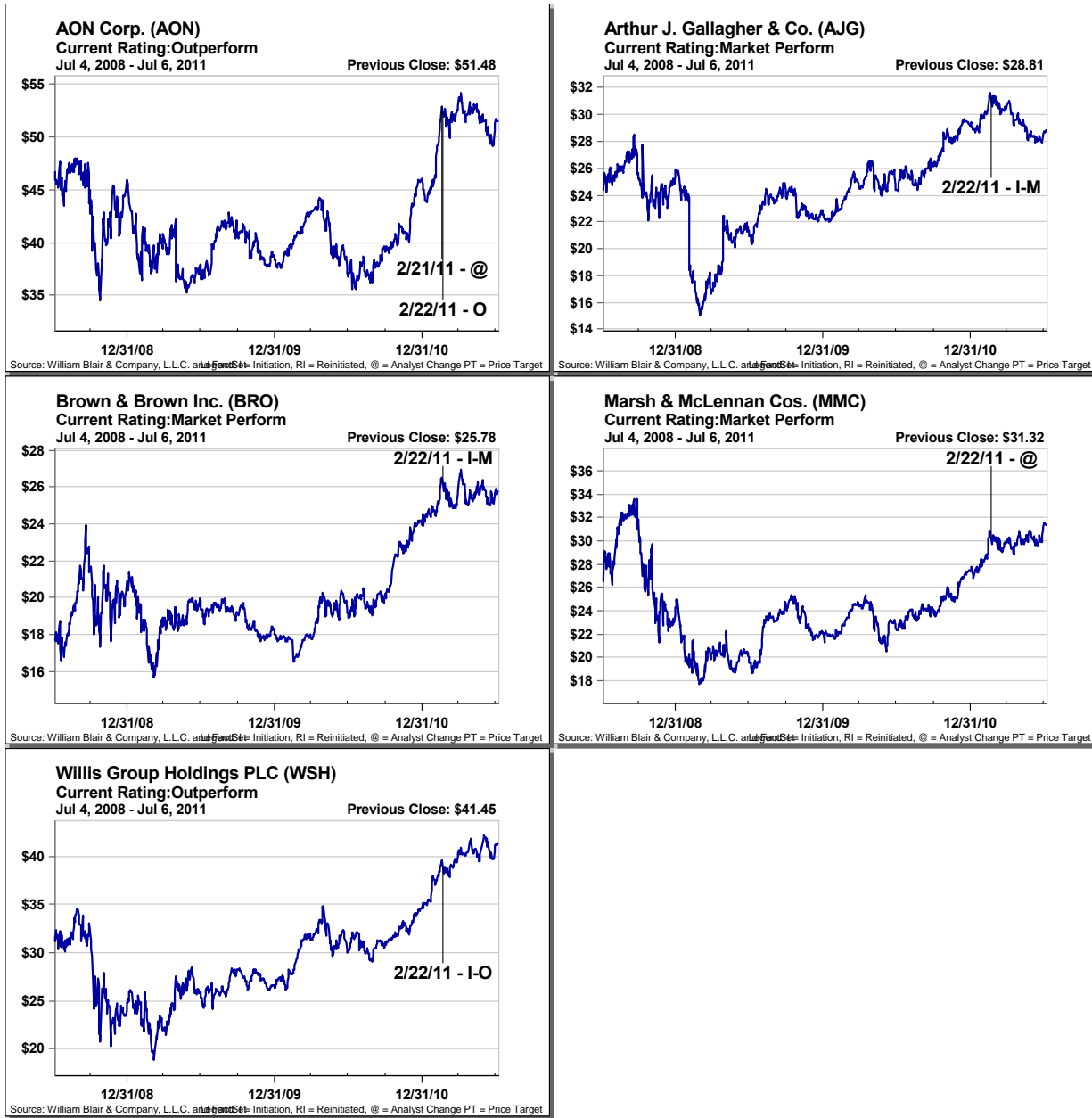
	2009	Q1'10	Q2'10	Q3'10	Q4'10	2010	Q1'11	Q2'11E	Q3'11E	Q4'11E	2011E	2012E
INCOME STATEMENT												
Commissions & Fees	\$3,210.0	\$963.0	\$789.0	\$723.0	\$825.0	\$3,300.0	\$1,000.0	\$824.5	\$762.8	\$874.5	\$3,461.7	\$3,697.6
% Change	16.7%	5.2%	2.2%	1.3%	2.0%	2.8%	3.8%	4.5%	5.5%	6.0%	4.9%	6.8%
Other Fees	\$1.0	\$0.0	\$0.0	\$0.0	\$1.0	\$1.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
% Change	na	na	na	na	na	na	na	na	na	na	na	na
Interest Income	\$52.0	\$9.0	\$10.0	\$10.0	\$9.0	\$38.0	\$8.0	\$8.0	\$8.0	\$8.5	\$32.5	\$36.0
% change	-37%	-40%	-17%	0%	-40%	-27%	-11%	-20%	-20%	-6%	-14%	10.8%
Total Revenues	\$3,263.0	\$972.0	\$799.0	\$733.0	\$835.0	\$3,339.0	\$1,008.0	\$832.5	\$770.8	\$883.0	\$3,494.2	\$3,733.6
% Change	15%	5%	2%	1%	1%	2%	4%	4%	5%	6%	5%	6.9%
Compensation Costs	\$1,820.0	\$486.0	\$453.0	\$462.0	\$469.0	\$1,870.0	\$502.0	\$488.0	\$495.3	\$499.6	\$1,985.0	\$2,019.2
% Change	16%	1%	2%	5%	3%	3%	3%	8%	7%	7%	6%	1.7%
Other Costs	\$579.0	\$149.0	\$135.0	\$129.0	\$153.0	\$566.0	\$142.0	\$144.0	\$131.0	\$158.9	\$576.0	\$601.1
% Change	0%	10%	-2%	-15%	-1%	-2%	-5%	7%	2%	4%	2%	4.4%
Total General and Admin. Expenses	\$2,399.0	\$635.0	\$588.0	\$591.0	\$622.0	\$2,436.0	\$644.0	\$632.1	\$626.4	\$658.6	\$2,561.0	\$2,620.4
% Change	12%	3%	1%	0%	2%	2%	1%	7%	6%	6%	5%	2.3%
Depreciation Expense	\$60.0	\$15.0	\$16.0	\$14.0	\$18.0	\$63.0	\$16.0	\$16.0	\$18.5	\$18.5	\$69.0	\$80.0
% Change	18%	7%	14%	-7%	6%	5%	7%	0%	32%	3%	10%	15.9%
Amortization Expense	\$93.0	\$21.0	\$21.0	\$22.0	\$18.0	\$82.0	\$17.0	\$17.0	\$17.0	\$17.0	\$68.0	\$72.0
% Change	138%	-13%	-9%	0%	-25%	-12%	-19%	-19%	-23%	-6%	-17%	5.9%
Interest Expense	\$169.0	\$43.0	\$41.0	\$40.0	\$42.0	\$166.0	\$40.0	\$33.0	\$33.0	\$32.0	\$138.0	\$118.0
% change	78%	13%	-5%	-5%	-9%	-2%	-7%	-20%	-18%	-24%	-17%	-14.5%
Other Expense	\$0.0	\$0.0	\$2.0	\$0.0	\$0.0	\$2.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Total Operating Expenses	\$2,721.0	\$714.0	\$668.0	\$667.0	\$700.0	\$2,749.0	\$717.0	\$698.1	\$694.9	\$726.1	\$2,836.0	\$2,890.4
% Change	16%	3%	1%	-1%	0%	1%	0%	5%	4%	4%	3%	2%
Operating Income	\$542.0	\$258.0	\$131.0	\$66.0	\$135.0	\$590.0	\$291.0	\$134.4	\$75.9	\$156.9	\$658.2	\$843.2
% change	9%	8%	7%	25%	6%	9%	13%	3%	15%	16%	12%	28.1%
Operating Pre-Tax Margin	16.6%	26.5%	16.4%	9.0%	16.2%	17.7%	28.9%	16.1%	9.8%	17.8%	18.8%	22.6%
Other Unusual/Non-Recurring Items	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Reported Pre-Tax Margin	16.6%	26.5%	16.4%	9.0%	16.2%	17.7%	28.9%	16.1%	9.8%	17.8%	18.8%	22.6%
Tax	\$103.0	\$67.0	\$35.0	\$10.0	\$28.0	\$140.0	\$76.0	\$35.1	\$19.8	\$41.0	\$171.9	\$227.7
Tax Rate	19%	26%	27%	15%	21%	24%	26%	26%	26%	26%	26%	27%
A- T Net Income	\$439.0	\$191.0	\$96.0	\$56.0	\$107.0	\$450.0	\$215.0	\$99.3	\$56.1	\$116.0	\$486.3	\$615.6
% Change	16%	9%	4%	-26%	13%	3%	13%	3%	0%	8%	8%	27%
Equity Earnings in Associates	\$33.0	\$20.0	(\$2.0)	\$9.0	(\$5.0)	\$22.0	\$16.0	(\$2.0)	\$9.0	(\$5.0)	\$18.0	\$18.0
Minority Interest	(\$21.0)	(\$7.0)	(\$2.0)	(\$1.0)	(\$3.0)	(\$13.0)	(\$8.0)	(\$2.0)	(\$1.0)	(\$5.0)	(\$16.0)	(\$16.0)
Adjusted Reported Net Income	\$451.0	\$204.0	\$92.0	\$64.0	\$99.0	\$459.0	\$223.0	\$95.3	\$64.1	\$106.0	\$488.3	\$617.6
% change	19%	5%	5%	-29%	25%	2%	9%	4%	0%	7%	6%	26%
Operating Earnings Per Share	\$2.68	\$1.20	\$0.54	\$0.37	\$0.58	\$2.69	\$1.28	\$0.55	\$0.37	\$0.61	\$2.83	\$3.58
% Change	5%	3%	3%	-30%	24%	0%	7%	3%	-1%	6%	5%	27%
Cash Operating EPS (New GAAP)	\$2.88	\$1.29	\$0.63	\$0.47	\$0.66	\$3.04	\$0.27	\$0.62	\$0.44	\$0.69	\$2.02	\$3.89
% Change	6%	2%	1%	12%	15%	6%	-79%	-1%	-5%	4%	-34%	93%
Average Shares	168.3	170.0	171.0	171.0	171.0	170.8	174.0	172.8	172.8	172.8	173.1	172.8
Dividends Per Share	\$1.04	\$0.26	\$0.26	\$0.26	\$0.26	\$1.04	\$0.26	\$0.26	\$0.26	\$0.26	\$1.04	\$1.04

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

A principal or employee of William Blair & Company, L.L.C. is a member of the board of directors or advisory board of Aon Corporation.

William Blair & Company, L.L.C. is a market maker in the security of Aon Corporation and Arthur J. Gallagher & Co. and Brown & Brown, Inc. and Marsh & McLennan Companies, Inc. and Willis Group Holdings Public Limited Company and may have a long or short position.

Additional information is available upon request.



Current Rating Distribution (as of 06/30/11)

Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	61	Outperform (Buy)	8
Market Perform (Hold)	29	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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