

Equity Research

FINANCIAL
Insurance

February 12, 2008
Research Note

Ticker: MMC
Market: NYSE
Price: \$25.79
52-week: (\$23-\$34)

Stock Rating:
Market Perform

Company Profile:
Core Growth

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Marsh & McLennan Companies, Inc.

Fourth-Quarter Results Sluggish; a Lot of Heavy Lifting to Be Done

FINANCIAL SUMMARY

Fiscal Year Ends:	December	Dividend/Yield:	\$0.76/2.9%
Long-term EPS Growth Rate:	14%	Market Value (mil.):	\$13,633

FISCAL YEAR	2007A	2008E	2009E
ESTIMATES *			
Earnings Per Share	\$1.18	\$1.65	\$2.15
VALUATION			
Price/Earnings Ratio	21.9x	15.6x	12.0x

* Estimates reflect the adoption of FAS 123R.

Highlights

> Marsh's fourth-quarter results were mixed and overall fell short of expectations. Adjusted EPS, excluding restructuring charges and other nonrecurring expenses, amounted to \$0.26 per share compared with the consensus estimate of \$0.31 per share. The shortfall was driven by a lower operating margin within the risk and insurance services segment, which included unrealized losses within the investment portfolio held in subsidiary Risk Capital Holdings.

> Organic revenue growth within insurance brokerage (about 85% of risk and insurance services) was 1%, relatively in line with peers, and a reflection of continued pricing pressure within commercial property-casualty insurance, from which we see no relief over the next several quarters. Management stated that new business growth was strong and client retention better, although from depressed levels. The adjusted operating margin within insurance brokerage was 7.6%, or about 11.5% excluding the unrealized loss at Risk Capital Holdings. The adjusted operating margin for the year was a disappointing 11.3%. This business when run optimally should have margins around 20%—at least.

> Organic revenue growth within consulting was particularly strong, with 13% organic growth and an improvement in the adjusted operating margin to 12.3% from 11.4%. The core Mercer business increased 8% and Oliver Wyman, which includes the specialty consulting businesses, increased 22% given strong growth among many specialty practices. Management stated that it has seen some softening in these businesses to start the year given a weaker economy, but the impact has not been material and management implied any adverse impact could be made up in other areas. Organic revenue growth was 10% for the year and the adjusted operating margin was 12.6%. This business should be able to produce midteen percentage operating margins, in our view.

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

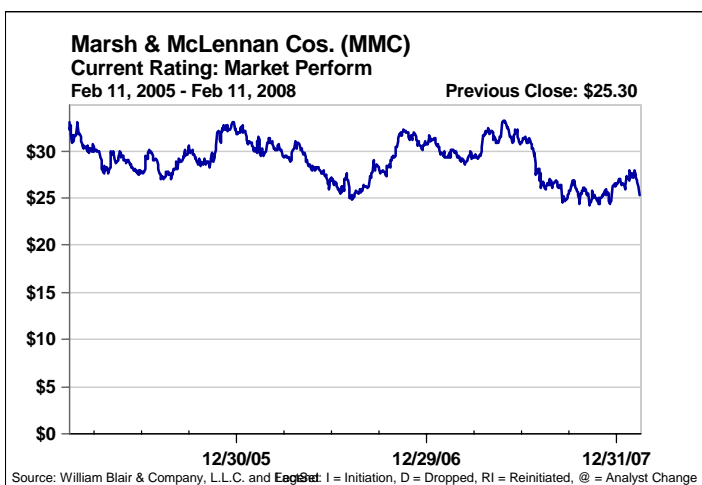
> Kroll continues to struggle, particularly on the corporate restructuring side, and new CEO Brian Duperreault has established an assessment of Kroll as one his key near-term priorities. We believe the business makes sense to keep—improving performance would be more accretive to Marsh & McLennan than a sale—although either way Kroll is not a major driver of value for the company overall, in our view.

> We expect capital management to remain more aggressive. The company has some short-term obligations, including some debt paydown and further funding of the "bid rigging" fund, but financial flexibility has improved a lot with the sale of Putnam. Total net debt to total EBITDA over the last 12 months is less than 1.5 times, and we expect most of the excess cash to be directed at share repurchase.

> We are reestablishing a 2008 EPS estimate of \$1.65 and establishing a 2009 EPS estimate of \$2.15.

> Our rating remains Market Perform. We estimate normalized EPS in 2009 of \$2.50 to \$2.60 per share—including a 20% risk and insurance services operating margin and a 15% consulting and Kroll operating margin. Aon (AOC \$41.79) trades at about 12 times the consensus EPS of 2009 and Willis (WSH \$31.13) trades at less than 10 times the consensus EPS estimate of 2009. A best case scenario of 13 times a \$2.55 normalized EPS number would put the stock at \$33 per share. While we do not see much downside risk and we are big fans of Brian Duperreault, given the cyclical pressures in the space and the execution risk associated with any turnaround we do not find the near-term potential upside compelling enough to be aggressive on the stock.

Additional information is available upon request.



Current Rating Distribution (as of 2/1/2008)

Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	59	Outperform (Buy)	13
Market Perform (Hold)	40	Market Perform (Hold)	6
Underperform (Sell)	1	Underperform (Sell)	1

*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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