

Commercial Property/Casualty Insurance Update

Fundamentals Remain Under Some Pressure, But Washed Out Valuation Requires Some Exposure

We have prepared a presentation titled, "Commercial P/C Insurance: Update Following First Quarter 2009 Earnings Results." Highlights from the presentation are given below.

Please see R*Docs or your William Blair & Company, L.L.C. sales representative for a copy of the presentation.

Highlights From Presentation

Position on Stocks—See Significant Value, but Near-Term Visibility Lacking

- We remain selective in the space given expectations of further earnings pressure and potential underperformance in an economic recovery scenario; that said, we would definitely have some exposure to this space given current valuation levels.
- Although we expect earnings to come under further pressure in the near term, we see significant value in the space, largely unprecedented. The group has lagged badly in the market recovery since early March, as we would expect given its defensive characteristics. Pricing improvements have also been slower to develop, in our opinion.
- Without regard to the near-term fundamental outlook, buying the group under GAAP book value per share (currently at 0.94 times according to our estimates) has proved to be a good investment over any reasonable period of time.
- Valuation is 15% cheaper than levels in March 2000, a period in which investors were convinced the group was no longer an investable space. The group appreciated by about 90% between March 3, 2000, and December 31, 2000.
- More defensive investors may be more open to this investment position. While this group does not have as much leverage to an improvement in the environment as other financial areas including commercial banks, the relative visibility for commercial property-casualty underwriters is better, in our opinion.
- Primary near-term concerns remain an underlying pressure on pricing; 2009 will be a tough year, with the potential for the stocks to underperform in a sharp equity rally.

Financial | Commercial P/C
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Fundamental Outlook for Balance of 2009—More Pain Before Stronger Recovery

- We expect a continued deterioration in underlying profitability given the compound impact of more than four years of lower prices, lower investment yields, and a lack of meaningful improvement in pricing to date. We see some risk of earnings disappointment given the pressure on near-term results.
- Our position since September 2008 has been one of caution relative to consensus regarding the potential for pricing improvements given our belief that underwriting margins were too high for aggressive pricing changes, particularly in the face of a weak economy creating additional resistance.
- Pressure on underlying profitability should lead to further improvement in pricing for the balance of the year, but the financial benefits will not be seen until 2010. More positive pricing movement should only be driven by greater-than-expected earnings deterioration.
- Credit losses will remain above average, although continuing to moderate from the heightened levels in late 2008.
- We expect the continued movement of business away from AIG (AIG \$1.56) (12% market share of U.S. commercial lines market) and would expect increasing pricing discipline from the company over time.

Top Two Ideas:

ACE Limited (ACE \$45.50)—Outperform/Core Growth

- Best-in-class commercial underwriter globally with strong and credible management team, and superior execution over the past few years. We believe ACE is a better-managed company with a superior growth, diversity, and profitability profile versus the other two large-cap names in the space—Chubb (CB \$41.03) and Travelers (TRV \$42.98).
- Earnings results have been strong the past several quarters, reflecting the company's superior execution and assistance from prior-period favorable loss reserve development (reduction in loss estimates from prior periods). The company's life reinsurance business has contributed to some recent volatility, but the recovery in equity markets mitigates concerns about the life reinsurance business.
- The investment portfolio, as expected, experienced moderate losses and minimal negative ratings migration in the quarter. The company has less exposure to municipal bonds compared with peers given its non-U.S. domicile. We expect continued losses in the portfolio through the balance of the year.
- Stabilization in pricing has yet to gain sustained broad momentum, but ACE is experiencing meaningful rate improvements within its global P&C reinsurance business (only 12% of P&C net written premiums). The company is also benefiting from a flight to quality and remains a prime beneficiary of the imminent competitive degradation of AIG, in our opinion.
- We view ACE as core in the space and defensive among financial services companies. The company is undervalued on an absolute basis, in our opinion, and we believe an entry point below GAAP book value excluding OCI of \$50.17 per share as of March 31, 2009, is attractive from a longer-term perspective. In a more normalized environment, ACE should trade for at least 1.2 to 1.5 times book value per share, in our opinion.
- Primary near-term concerns remain underlying pressure on pricing and the potential for the stock to underperform in a sharp equity rally.

First Mercury Financial Corporation (FMR \$14.19)—Outperform/Aggressive Growth

- Specialty property/casualty insurance underwriter with a highly profitable core specialty franchise (greater than 90% liability business).
- We believe growth will be driven by the company's new specialty business unit, FM Emerald, and the benefits from recent opportunistic hiring initiatives—three underwriters from AIG and

XL Capital (XL \$10.31) to staff a new professional liability unit, and a former head underwriter of North Pointe for the launch of a new hospitality and indoor recreational platform. American Management Corporation (AMC) (long haul trucking) could also be a major driver of growth for the balance of the year and into 2010 if pricing improves more than anticipated. First Mercury only acts as an agent on AMC's current business, which could be at a \$100 million run-rate by late 2010.

- The company continues to experience pricing pressures in its core markets, while First Mercury's franchise continues to gain traction, as evidenced by strong submission flow, increasing 50% in March compared with the year-ago period.
- We continue to view First Mercury as a legitimate takeover candidate at some point that would complement an onshore or offshore company with a broad specialty-lines platform.
- The shares trade at roughly a 6% discount to March 31, 2009, diluted book value of \$15.15, and we believe the shares should trade at a minimum of book value per share today and closer to 1.5 times book value over time given the company's profitability and growth profile.
- Primary concerns remain underlying profitability in the face of above-average growth the past few years and a limited operating history outside core specialty lines.

Additional information is available upon request.

Current Rating Distribution (as of 05/31/09)

Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	57	Outperform (Buy)	3
Market Perform (Hold)	42	Market Perform (Hold)	1
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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