

ACE Limited

Provides 2010 EPS Guidance: Mildly Disappointing, but Not a Complete Surprise Given Challenging Environment

Management's Guidance for 2010 Below Our Estimate. Before the markets opened on January 5, ACE Limited provided its 2010 operating EPS guidance. The guidance was expected in mid-December, but management waited until the new year to release estimates. Management's 2010 operating EPS (excluding net realized losses/gains) guidance range is \$6.25 to \$6.75, which includes \$317 million of after-tax catastrophe losses (\$0.95 per share, according to our estimate). Management does not include in its estimate any provision for favorable or adverse loss reserve development, which is included in our estimate. Excluding catastrophe losses and favorable loss reserve development, our estimate was \$7.95, compared with management's EPS guidance range of \$7.20 to \$7.70. Guidance came in slightly lower than our expectations given continued pressure on industry pricing and profitability. The current consensus estimate is \$7.64, although we do not know the level of catastrophe losses or favorable development included in this number.

Lowering 2010 Estimates Given Pressure on Margins. We are lowering our 2010 EPS estimate to \$7.20 from \$7.60, assuming lower underwriting margins given continued pricing pressure. Our estimate includes \$0.96 per share of catastrophe losses and a \$0.61 per share benefit due to favorable loss reserve development, compared with about \$1.25 per share in 2008. Actual catastrophe losses in 2009 were a modest \$0.38 per share. We are also establishing a 2011 EPS estimate of \$7.90, presuming some modest reductions in underlying loss ratios by 2011.

Maintaining Outperform Rating; Stock Extremely Inexpensive, in Our View. We are maintaining our Outperform rating and continue to view ACE as core in the commercial property/casualty (P&C) space, a best-in-class underwriter globally, and an emerging franchise in the industry. But we remain selective in the space given the deterioration in underlying profitability we expect in 2010 as a result of continued pressure on pricing. Commercial P&C insurance is the only industry we cover where we expect fundamentals will be worse in 2010 than in 2009. That said, we view valuation as attractive on an absolute and relative basis, and we see an entry point below GAAP book value as very attractive over any reasonable period. The shares trade at roughly a 15% discount to GAAP book value per share of our year-end 2009 estimate. We view a normalized valuation level in a range of 1.30 to 1.50 times GAAP book value per share.

Financial | Commercial P/C Insurance

January 05, 2010

Stock Rating: **Outperform**
Company Profile: **Core Growth**

Symbol: ACE (NYSE)
Price: \$49.27 (52-Wk.: \$31-\$56)
Market Value (mil.): \$17,456
Fiscal Year End: December
Long-Term EPS Growth Rate: 14%
Dividend/Yield: \$1.15/2.3%

	2008A	2009E	2010E
Estimates			
EPS Q1	\$2.16	A\$1.99	NA
Q2	\$2.18	A\$2.09	NA
Q3	\$1.51	A\$2.07	NA
Q4	\$1.87	\$1.97	NA
FY	\$7.72	\$8.12	\$7.20
CY		\$8.12	\$7.20

Valuation			
FY P/E	6.4x	6.1x	6.8x
CY P/E		6.1x	6.8x

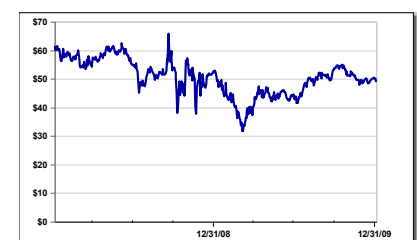
Trading Data (Thomson Financial)

Shares Outstanding (mil.)	336
Float (mil.)	NA
Average Daily Volume	1,837,021

Financial Data (Thomson Financial)

Long-Term Debt/Total Capital (MRQ)	19.9
Book Value Per Share (MRQ)	49.5
Enterprise Value (mil.)	19,663.3
EBITDA (TTM)	NA
Enterprise Value/EBITDA (TTM)	NA
Return on Equity (TTM)	8.6

Two-Year Price Performance Chart



Source: Thomson Financial, William Blair & Company estimates

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ACE Limited
Condensed Income Statement Comparison
(\$ in millions, except per share data)

	1Q08	2Q08	3Q08	4Q08	2008 Actual	1Q09	2Q09	3Q09	4Q09E	2009 Estimate	2010 Estimate
Property-Casualty Insurance											
Gross premiums written	\$4,304	\$4,866	\$4,839	\$3,906	\$17,915	\$4,150	\$4,733	\$4,622	\$3,996	\$17,501	\$17,915
% change annual	-2%	7%	11%	-3%	3%	-4%	-3%	-4%	2%	-2%	2%
Net premiums written	\$3,049	\$3,224	\$2,928	\$2,681	\$11,882	\$3,078	\$3,048	\$2,783	\$2,737	\$11,646	\$11,905
% change annual	-4%	8%	8%	-1%	2%	1%	-5%	-5%	2%	-2%	2%
% gross premiums written	70.8%	66.3%	60.5%	68.6%	66.3%	74.2%	64.4%	60.2%	68.5%	66.5%	66.5%
Net premiums earned	\$2,840	\$3,061	\$3,265	\$2,867	\$12,033	\$2,859	\$2,902	\$3,031	\$2,909	\$11,701	\$11,775
% change annual	-5%	5%	7%	-3%	1%	1%	-5%	-7%	1%	-3%	1%
Loss and loss expense	\$1,579	\$1,785	\$2,265	\$1,654	\$7,283	\$1,704	\$1,688	\$1,764	\$1,737	\$6,893	\$7,341
% premiums earned	55.6%	58.3%	69.4%	57.7%	60.5%	59.6%	58.2%	58.2%	59.7%	58.9%	62.3%
Adverse loss reserve development	(\$137)	(\$104)	(\$277)	(\$252)	(\$770)	(\$68)	(\$158)	(\$203)	(\$98)	(\$527)	(\$260)
Catastrophe losses	\$31	\$58	\$411	\$67	\$567	\$38	\$31	\$45	\$44	\$158	\$400
Loss ratio—ex cats and development	59.3%	59.8%	65.3%	64.1%	62.2%	60.7%	62.5%	63.4%	61.6%	62.1%	61.2%
Underwriting expense	\$783	\$864	\$901	\$796	\$3,344	\$763	\$820	\$873	\$814	\$3,270	\$3,327
% premiums earned	27.6%	28.2%	27.6%	27.8%	27.8%	26.7%	28.3%	28.8%	28.0%	27.9%	28.3%
Corporate administrative expense	\$39	\$39	\$33	\$42	\$153	\$35	\$39	\$35	\$38	\$147	\$150
% premiums earned	1.4%	1.3%	1.0%	1.5%	1.3%	1.2%	1.3%	1.2%	1.3%	1.3%	1.3%
Underwriting income	\$439	\$373	\$66	\$375	\$1,253	\$357	\$355	\$359	\$320	\$1,391	\$957
% change annual	15%	4%	-81%	7%	-13%	-18%	-4%	444%	-15%	11%	-31%
Combined ratio	84.5%	87.8%	98.0%	86.9%	89.6%	87.5%	87.8%	88.2%	89.0%	88.1%	91.9%
Net investment income—P/C	\$474	\$492	\$480	\$474	\$1,920	\$456	\$463	\$468	\$469	\$1,856	\$1,945
% change annual	8%	8%	0%	-3%	3%	-4%	-3%	-1%	-1%	-3%	5%
Pretax operating income	\$913	\$865	\$546	\$849	\$3,173	\$813	\$818	\$827	\$789	\$3,247	\$2,902
% change annual	11%	6%	-34%	1%	-4%	-11%	-5%	51%	-7%	2%	-11%
Life Insurance											
Pretax operating income	\$31	\$81	\$85	\$21	\$218	\$67	\$78	\$95	\$75	\$315	\$290
% change annual	-24%	84%	93%	-32%	36%	116%	-4%	12%	256%	44%	-8%
Interest expense	\$46	\$62	\$68	\$54	\$230	\$53	\$56	\$60	\$54	\$223	\$220
Other income	\$13	\$5	\$17	(\$17)	\$18	(\$17)	\$13	(\$8)	\$3	(\$10)	\$10
Pretax income	\$911	\$889	\$580	\$799	\$3,179	\$810	\$853	\$854	\$812	\$3,329	\$2,982
% change annual	12%	8%	-30%	-4%	-4%	-11%	-4%	47%	2%	5%	-10%
% total revenue	26.6%	22.4%	14.0%	21.3%	20.8%	21.9%	22.6%	21.9%	21.3%	21.9%	19.4%
Income tax expense	\$186	\$151	\$76	\$175	\$588	\$141	\$147	\$153	\$146	\$587	\$540
Effective tax rate	20.4%	17.0%	13.1%	21.9%	18.5%	17.4%	17.2%	17.9%	18.0%	17.6%	18.1%
Income excluding realized gains	\$725	\$738	\$504	\$624	\$2,591	\$669	\$706	\$701	\$666	\$2,742	\$2,442
% change annual	9%	11%	-27%	-10%	-4%	-8%	-4%	39%	7%	6%	-11%
Net realized investment gains/(losses)	(\$348)	\$8	(\$450)	(\$604)	(\$1,394)	(\$102)	(\$171)	(\$207)	\$0	(\$480)	\$0
Net income	\$377	\$746	\$54	\$20	\$1,197	\$567	\$535	\$494	\$666	\$2,262	\$2,442
% change annual	-46%	15%	-92%	-97%	-54%	50%	-28%	815%	3229%	89%	8%
Preferred dividends	(\$11)	(\$13)	\$0	\$0	(\$24)	\$0	\$0	\$0	\$0	\$0	\$0
Operating income available to common shareholders ¹	\$714	\$725	\$504	\$624	\$2,567	\$669	\$706	\$701	\$666	\$2,742	\$2,442
% change annual	10%	11%	-26%	-8%	-4%	-6%	-3%	39%	7%	7%	-11%
Diluted operating EPS	\$2.16	\$2.18	\$1.50	\$1.87	\$7.71	\$1.99	\$2.09	\$2.07	\$1.97	\$8.12	\$7.20
% change annual	9%	10%	-27%	-9%	-5%	-8%	-4%	38%	5%	5%	-11%
Average diluted shares	331	333	335	333	333	336	338	338	339	338	339
Operating return on equity—diluted	17.7%	17.8%	12.7%	16.8%	16.3%	18.4%	18.1%	15.9%	14.0%	16.4%	12.0%
Book value per share—diluted	\$48.87	\$49.00	\$45.80	\$43.40	\$43.40	\$43.79	\$49.07	\$55.36	\$57.00	\$57.00	\$62.82

¹Excludes net realized investment gains/(losses).

Source: Company reports and William Blair & Company estimates

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Additional information is available upon request.



Current Rating Distribution (as of 12/31/09)

Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	64	Outperform (Buy)	4
Market Perform (Hold)	36	Market Perform (Hold)	0
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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