

ACE Limited

Quick First Look at Better-Than-Expected Third-Quarter Results

- Solid results, outperformance driven by favorable development; could have been better.** Third-quarter operating EPS increased 38%, to \$2.07, \$0.02 above our estimate and \$0.10 ahead of consensus. The outperformance relative to our estimate was principally driven by greater-than-expected favorable loss reserve development during the quarter (roughly \$0.27 per share benefit relative to our estimate), offset by a higher loss ratio excluding favorable loss reserve development (accident-year loss ratio), which limited upside relative to our estimate. We increased our estimate significantly after the end of the quarter following a modest quarter for catastrophe losses.
- Decline in premium not a surprise.** Net property-casualty written premiums decreased 5%, below our 2% growth estimate, but flat on a constant-currency basis. The retention rate in third quarter 2008 (net written as a percentage of gross) was unusually low, which was why our estimate was positive. Gross written premium was down 4%, versus our 2% decline estimate. Management stated that the company chose to forgo select growth opportunities in favor of better pricing, achieving a positive rate change of 2% during the third quarter. Recessionary pressures and heightened competitive pressures continue to serve as significant headwinds for the company. Price increases have not developed as strongly as expected year-to-date, given continued economic pressures and less pressure on capital given a recovery in credit and equity markets. We believe earnings results for the overall industry need to deteriorate more meaningfully before prices move appreciably higher.
- Underwriting profitability remains strong; favorable development continues to drive results.** Favorable loss reserve development continues to drive strong underwriting margins, while the accident-year loss ratio increased compared with last quarter. The accident-year loss ratio for the first nine months was about 62.2%, in line with the accident-year loss ratio for full year 2008. The combined ratio excluding the life insurance segment was 88.2%, compared with 98.0% in third quarter 2008 and slightly below our estimate of 88.5%. Favorable loss reserve development reduced the combined ratio by 6.7 percentage points this quarter, compared with 5.4 percentage points last quarter, and more than offset a higher accident-year loss ratio. The higher loss ratio could simply be product-mix-driven or normal quarterly variability, versus real deterioration. We believe favorable loss reserve development is likely to continue over the next few quarters at a minimum, albeit at a more measured pace.

Financial | Commercial P/C Insurance

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

Symbol: ACE (NYSE)
Price: \$53.27 (52-Wk.: \$31-\$59)
Market Value (mil.): \$18,462
Fiscal Year End: December
Long-Term EPS Growth Rate: 14%
Dividend/Yield: \$1.14/2.1%

	2008A	2009E	2010E
Estimates			
EPS Q1	\$2.16	A\$1.99	NA
Q2	\$2.18	A\$2.09	NA
Q3	\$1.51	\$2.05	NA
Q4	\$1.87	\$2.06	NA
FY	\$7.72	\$8.19	\$7.90
CY		\$8.19	\$7.90

Valuation			
FY P/E	6.9x	6.5x	6.7x
CY P/E		6.5x	6.7x

Trading Data (Thomson Financial)

Shares Outstanding (mil.)	336
Float (mil.)	NA
Average Daily Volume	1,613,570

Financial Data (Thomson Financial)

Long-Term Debt/Total Capital (MRQ)	19.9
Book Value Per Share (MRQ)	49.5
Enterprise Value (mil.)	21,100.3
EBITDA (TTM)	2,095.0
Enterprise Value/EBITDA (TTM)	10.1x
Return on Equity (TTM)	7.1

Two-Year Price Performance Chart



Source: Thomson Financial, William Blair & Company estimates

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- **Book value continues double-digit growth.** The investment portfolio incurred realized/unrealized investment gains of \$1.6 billion (\$3.94 per share), up from a \$1.2 billion gain (\$2.96 per share) last quarter, and GAAP book value per share increased 13.1% sequentially given the rally in credit spreads, well above our mid- to high-single-digit percentage increase estimate, and compared with a 12.4% increase last quarter. GAAP book value per share excluding other comprehensive income increased only 2% sequentially, as realized losses remain elevated, although were driven by mark-to-market losses on derivatives including certain equity market hedges.
- **Maintaining Outperform rating; reviewing estimates after conference call with management.** Our rating remains Outperform and we will review our estimates after the conference call with management scheduled for Wednesday at 8:30 a.m. ET. We remain selective in the space given what we view as an imminent deterioration in industrywide profitability. However, we believe investors should definitely have some exposure to the group given near-trough valuation levels. We believe ACE should be core in the space and it is defensive among financial services companies, with limited credit exposure and no business model risk. We view ACE as undervalued on an absolute basis and we view an entry point below GAAP book value excluding other comprehensive income (\$53.04 as of September 30, 2009) as very attractive over any reasonable period.

William Blair & Company, L.L.C. is a market maker in the security of ACE Limited and may have a long or short position.

Additional information is available upon request.



Current Rating Distribution (as of 09/30/09)

Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	63	Outperform (Buy)	2
Market Perform (Hold)	37	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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