S&P Capital IQ

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RLI Corp. NYSE:RLI

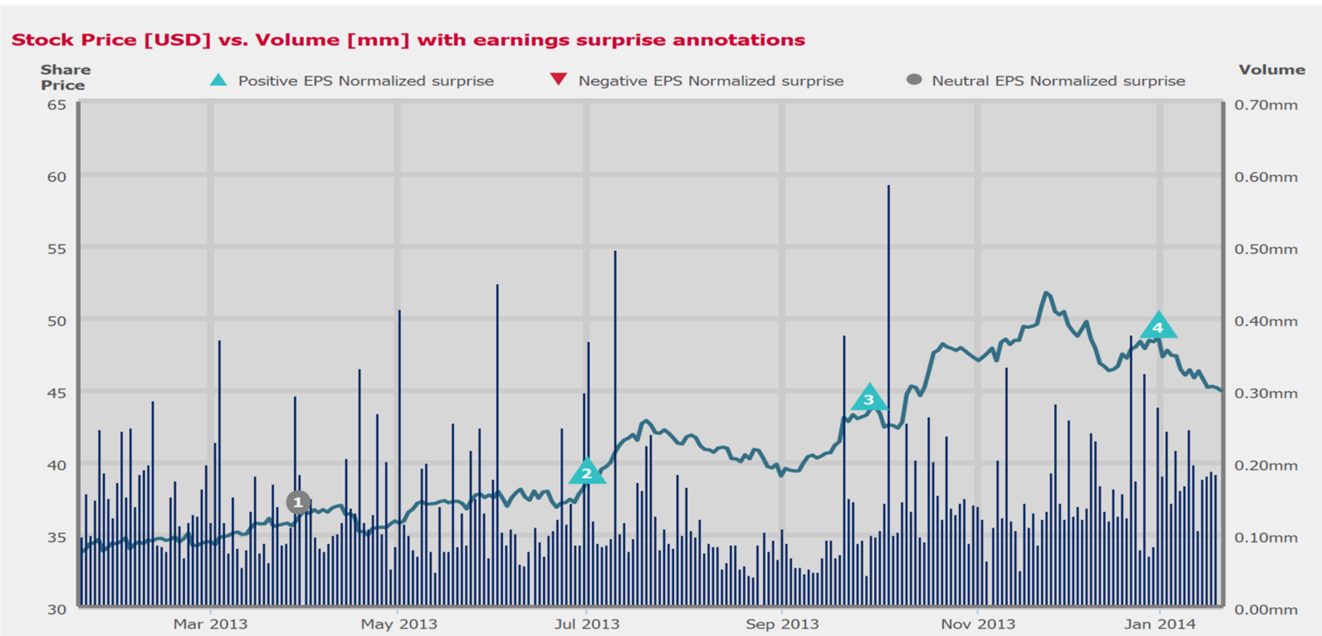
FQ1 2014 Earnings Call Transcripts

Thursday, April 17, 2014 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2014-			-FQ2 2014-	-FY 2014-	-FY 2015-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.52	0.57	▲9.62	0.63	2.30	2.30
Revenue (mm)	179.84	181.22	▲0.77	182.29	752.45	794.18

Currency: USD
Consensus as of Apr-17-2014 1:24 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2013	0.52	0.52	1 0.00 %
FQ2 2013	0.58	0.64	▲2 10.34 %
FQ3 2013	0.50	0.70	▲3 40.00 %
FQ4 2013	0.51	0.72	▲4 41.18 %

Call Participants

EXECUTIVES

Aaron H. Jacoby
Vice President of Corporate Development

Craig William Kliethermes
President and Chief Operating Officer

Jonathan E. Michael
Chairman and Chief Executive Officer

Michael J. Stone
Director

Thomas L. Brown
Chief Financial Officer and Senior Vice President

ANALYSTS

Jason Matthew Oetting
FBR Capital Markets & Co., Research Division

Kenneth G. Billingsley
Compass Point Research & Trading, LLC, Research Division

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Presentation

Operator

Good morning, and welcome, ladies and gentlemen, to the RLI First Quarter Earnings Teleconference. At this time, I would like to inform you that this conference is being recorded. [Operator Instructions].

Before we get started, let me remind everyone that through the course of the teleconference, RLI management may make comments that reflect their intentions, beliefs and expectations for the future. As always, these forward-looking statements are subject to certain risk factors, which could cause actual results to differ materially.

These risk factors are listed in the company's various SEC filings, including in the annual Form 10-K, which should be reviewed carefully. The company has filed a Form 8-K with the Securities and Exchange Commission that contains the press release announcing the first quarter results. RLI management may make reference during the call to operating earnings and earnings per share from operations, which are non-GAAP measures of financial results. RLI's operating earnings and earnings per share from operations consists of net earnings after the elimination of after-tax realized investment gains or losses.

RLI's management believes this measure is useful in gauging core operating performance across reporting periods, but may not be comparable to other companies' definitions of operating earnings. The Form 8-K contains reconciliation between operating earnings and net earnings. The Form 8-K and press release are available at the company's website at www.rlicorp.com.

I will now turn the conference over to RLI's Vice President, Corporate Development, Mr. Aaron Jacoby. Please go ahead, sir.

Aaron H. Jacoby
Vice President of Corporate Development

Thank you. Good morning to everyone. Welcome to the RLI earnings call for the first quarter of 2014. Joining me on today's call are Jon Michael, Chairman and CEO; Mike Stone, President and Chief Operating Officer; Tom Brown, Vice President and Chief Financial Officer; and Craig Kliethermes, Executive Vice President, Operations.

I'm going to turn the call over to Tom first to get some brief opening comments on the quarter's financial results. Then, Mike and Craig will talk about operations and market conditions. Next, we'll open the call to questions and Jon will finish up with some closing comments. Tom?

Thomas L. Brown
Chief Financial Officer and Senior Vice President

Thanks, Aaron. Good morning, everyone. We are pleased to announce yet another positive underwriting quarter and a solid start to the year. Starting with our most important metric, the combined ratio. We posted 86 in the quarter, which is consistent with the ratio achieved in the first quarter of last year. Profits are strong in each segment with Casualty at a 93, Property at a 78 and Surety at a 75. Reserve releases benefited each segment but most notably in the Casualty segment.

We continued for good not only about these calendar results but also the underlying accident year figures as a result of our core underwriting discipline. Meanwhile, premium was up 2% on a gross basis in the quarter and 6% on a net basis. The higher net growth rate was a function of both reduced reinsurance costs, as well as mix changes within the portfolio.

For segments, Casualty grew 8% on the quarter, which represents a deceleration from 2013. Surety is up 4%, which we consider strong given the competitive surety market environment, Mike, has spoken about in previous quarters. Property gross premium was down 9% although significant parts of this can be attributed to particular lines such as marine, crop and our assumed reinsurance business.

Moving on to investments. There were several positive trends in the quarter, not the least of which was the 5.4% growth in investment income. In addition, both the fixed income and equity portfolios turned in positive total returns enabling a combined portfolio return of 2.7% for the quarter. Margins contribution in the quarter was roughly in line with last year. I would point out that new to this quarter, we have a second investment that has included both the income statement and balance sheet in a similar manner as Maui Jim. As we pointed out in the press release, in February of this year, we took a minority stake in Prime Holdings Insurance Services, a specialty E&S company. While we believe that Prime will be additive, we expect Maui to be the relative driver over investee line item for some time in the future. I'll also note in addition to the ownership stake in our -- ownership stake, RLI is a quarter share reinsurer of Prime. The incremental premium from this quarter share was modest in the quarter and likely to be somewhere between $8 million and $10 million of premium for the full year. We believe Prime is a terrific company with an outstanding track record and we're pleased to have this new relationship. Ultimately, the combination of underwriting and investment results improved operating EPS of $0.57 per share, up 10% from last year. Meanwhile, book value per share was up 4.9% in the quarter, a strong start to the year.

And now I'll turn it over to Mike Stone for further comments.

Michael J. Stone
Director

Thanks, Tom. Good morning, everybody. Another impressive underwriting quarter even with the competition, particularly in the property space beginning to intensify. And it should be no surprise given all the attention to the alternative capital coming into the property space, the lack of the U.S. catastrophe in '13 and the favorable reinsurance removals of 1/1. I might remind you that we have 9 straight years of combined ratios under 90, and 18 straight years under 100, and this first quarter of 2014 continues that trend at 86.

As Tom indicated, our gross written premiums increased 2% while net was up 6% due to increased retentions and better reinsurance terms. As we continue to lead up 8% and 11% respectively, we continue to see modest rate improvement in most casualty products. Craig will elaborate on and elucidate this point.

In our E&S casualty space, we are growing our excess in an umbrella business as we continue to see opportunities in select geographies for buffer and first layer excess. Our primary liability business was relatively flat with gross written premiums down about 1%. But we continue to exit underperforming habitational OL&P business and we're able to replace it with better performing classes of business. We did experience some $5 million worth of favorable reserve development in this space. And as a point of reference, this business had its zenith was full $200 million in gross written premium in '06. And last year, we wrote less than $100 million. As rates improved and the economy begins to expand, we hope, we have the capacity to greatly increase our writings in this area.

Transportation was up 4% as we continue to benefit from more submissions due to the demise of several writers in this space. However, we begin to see a reentry into this space by new, might I say, naïve capacity in those fruition of to run out their pens. This product rewards disciplined, knowledgeable, committed underwriters and better states all others. We have successfully that is under 100 combined ratio underwritten transportation business for 15-plus years in both soft and hard markets.

In our professional and package business, we continue to invest. Gross written premium was up 29% in our professional business, which are architects and engineers, miscellaneous tech professionals, as we continue to build this business to scale and add product in customer segments. Now our package business, which is really our CBIC business that we acquired a few years back and our professional package business was up 4% again as we continue to invest in this space and gain scale.

Property. Gross written premium down 9%. But our combined ratio was a nice 78. As I said earlier, we see increased competition for Property business given the new entrants and the alternative capital coming into this space.

While our E&S property was down just 2% and we continue to get adequate expected returns in our Catastrophe business when and earthquake. Our Marine business was down some 20% as we continue to reunderwrite our Marine business. We did achieve a combined ratio under 100. So the hard work is starting to pay off but there's still work to do.

Surety. Gross written premiums up 4% with our commercial account-driven surety up some 14% and contract up 10% as we continue our underwriting discipline even with increase -- increasing competition in the space. Our contract segment is back to performing well as the loss experience we saw the past few years is starting to subside. And as I think I've remarked before, in surety and contract surety it's all about avoiding loss. It's only takes a few for this line to go south.

Our reiterate, what I've said in the last number of quarters as we continue to see new entrants into the surety space, it's not that easy. We've taken our lumps and we now have a well performing, well recognized surety platform. It takes good experienced underwriters, specialists in their particular segment with good relationships with producers and good systems and we have them all. All in all, again, a very good underwriting quarter.

Craig will now discuss in more detail the rate environment in our reinsurance positions.

Craig William Kliethermes
President and Chief Operating Officer

Thanks, Mike, and good morning, everyone. I would describe the pricing environment as, there has been some moderate loss of rate momentum. Although we're still seeing generally positive to flat increases across most of our products. The reminder that price is still generally more adequate than it has been before we've seen increases over the last several years. So with a slight drop off not really that surprising. We would describe it as generally a rational environment. People are still competitive where results have been very good and they still are taking rate where they've seen some problems. I think as Mike alluded to, there have been some exceptions. Particularly in low-frequency high severity lines of business like Catastrophe, some D&O businesses, large surety accounts are particularly competitive. Products where the memories are particularly short. People lose sight of the facts and the risks that their taking due to some resentency[ph] bias. Overall, in our Casualty business, we're still seeing some increases particularly in our commercial umbrella states where, I think we talked about growing a bit. Transportation still positive momentum there. In the property side, the cat is particularly competitive. You're seeing 5% to 10% rate decreases pretty much across-the-board. I think you have some tripled-down impact of some of those 1/1 renewals. We're still seeing very good pricing on our Marine business where we continue to reunderwrite and we've had, knock on wood, 2 consecutive quarters of positive underwriting results. As our underwriters will continue to pick their spots, and we're going to let them differentiate to themselves as they have in the past.

In regards to ceded reinsurance. I think we talked about our net written premium growth exceeding our gross written premium, that's -- that was a conscious effort and you've seen that trend over the last 18 months. That's a direct result of market prices in our continued evaluation of our underlying retentions. Again, over the last 18 months, we've taken more risk in the working layers on our mature products and our new products as they've matured, we've elected to take a little more net.

On every treaty we place, we evaluate the risk reward trade-off in an attempt to make decisions that are in our favor. Over the quarter, we did place 2 treaties both our surety treaty and our professional liability treaty and both of those results have been some savings, 10% to 20% savings overall in premium.

With that, I'll turn it back to Aaron.

Aaron H. Jacoby
Vice President of Corporate Development
Thanks, Craig. We can now open the call up for questions?

Question and Answer

Operator

[Operator Instructions] We'll take our first question from Randy Binner.

Jason Matthew Oetting
FBR Capital Markets & Co., Research Division

This is Jason Oetting for Randy Binner this morning. First question is on like Casualty segment. We're seeing some underlying loss ratio versus first half of 2013, 2012. Is this primarily due to the business mix shift that was mentioned later last year or how should I be thinking of that? And as a follow-up, can you provide any color on initial 2014 loss bits more broadly?

Thomas L. Brown
Chief Financial Officer and Senior Vice President

Yes. This is Tom. I think I got your question. I think it's really, we're getting a better rate and it's mixed.

Jason Matthew Oetting
FBR Capital Markets & Co., Research Division

And what are you thinking for initial 2014 loss bits going forward?

Thomas L. Brown
Chief Financial Officer and Senior Vice President

Sorry, I didn't hear that. I'm sorry.

Jonathan E. Michael
Chairman and Chief Executive Officer

I think we generally look at it. Randy, can you speak up. It's hard for us to hear you.

Jason Matthew Oetting
FBR Capital Markets & Co., Research Division

Yes, sorry, I was just asking about initial 2014 loss bits, thoughts there?

Thomas L. Brown
Chief Financial Officer and Senior Vice President

I mean for casualty, they're generally flat. We've got enough prices to offset trend. So there's a mix obviously, differences. So some are improving. Some are more flat. Some maybe slightly increasing where we haven't gotten any increases. So about 2 points better overall. But I believe it's about 2 points better overall for casualty.

Jason Matthew Oetting
FBR Capital Markets & Co., Research Division

Okay. And I appreciate the commentary on the pricing update. Can you speak a little more broadly to E&S, especially relative to what it was for last quarter?

Michael J. Stone
Director

This is Mike Stone. I think E&S continues to perform pretty well. We are starting to see probably little bit more the standard lines companies. We still have to compete with the MGAs that are a little less disciplined. Therefore a while, a couple of years ago, we saw them pulling back but they're coming back. So we think it's still good. But it's probably a little less good than it was a year ago. But still, they're still getting some rate where we need it and in some spaces, what we're seeing quite a bit of opportunity. So all in all, I think it's still pretty good times.

Operator

And our next question comes from Ken Billingsley.

Kenneth G. Billingsley
Compass Point Research & Trading, LLC, Research Division

First question was -- let me, the reserve releases for the quarter, I was looking at 2013 year-end. Look like you had a lot coming out of 2012, so kind of recent years that your releasing reserves. Where the reserves coming out of releases for the Casualty business that you've just had in the first quarter?

Thomas L. Brown
Chief Financial Officer and Senior Vice President

Kenneth, it's Tom Brown. You're right. It's the more recent years but really for casualty, it does come across fairly consistently over the last several years including back about '08 or '09.

Kenneth G. Billingsley
Compass Point Research & Trading, LLC, Research Division

Is it, was that '08 and '09, you said?

Thomas L. Brown
Chief Financial Officer and Senior Vice President

Yes, sorry, it was not '08 through the current year. We thought it's a little bit skewed more to the recent accident years.

Kenneth G. Billingsley
Compass Point Research & Trading, LLC, Research Division

And is that something you kind of expected in the current trend that we're likely to see that you're going to see -- we're going to see more, a heavier release from more recent accident years than maybe we've seen in the past?

Thomas L. Brown
Chief Financial Officer and Senior Vice President

Yes, I think, Ken, it's hard to predict. We think, we really feel our reserves are adequate at this point in time.

Kenneth G. Billingsley
Compass Point Research & Trading, LLC, Research Division

Or how about, given the pricing trends if they continued on their current path and where they were in the last few years, would that be something that we could extrapolate from the numbers?

Michael J. Stone
Director

That's Mike Stone. Well I think that, it's not -- trouble with those questions are we don't [ph] know the reserves that are on. Obviously, with better than initially expected and we tend to be a bit conservative early on. But loss trends have been more benign than unexpected. We continue to believe that the long-term trend is what it is and it's been -- like I said it's been more benign. I think you hear that from most of the markets and will that continue forever? No. So we certainly don't want to get behind. So I think that's how we see it.

Craig William Kliethermes
President and Chief Operating Officer

Well, Ken, this is Craig. The only color I would add to that is demand, just as a reminder as we do use long-term trends in our projections and in our estimates for current accident year as well as past. And obviously, if things come in better than that. That will have a good fortune of having favorable development but we really aren't in the business of trying to predict what short term trends are and we don't think it’s wise to try to lower those estimates just because we think we've observed some short-term favorable trends.

Kenneth G. Billingsley
Compass Point Research & Trading, LLC, Research Division

Very good. The other question I have is on the reinsurance market. And you did mention that you guys have been taking more risk in the working layers. With pricing in general coming down and more competition from reinsurers even on the casualty side, do you see yourself utilizing that market a little bit more, opportunity maybe to place some more business and pass it off to the reinsurers or how do you feel that you guys are going to participate in the pricing market over the next say 2 years with reinsurance rates coming down?

Jonathan E. Michael
Chairman and Chief Executive Officer

Reinsurance purchase, this is Jon Michael, reinsurance purchasing is a little bit like real estate. The most important thing in real estate is location, location, like location. In reinsurance purchasing, the most important thing is the first 3 most important things are, that, that reinsurer is going to pay the loss when it comes time to pay the loss. And that goes for the second thing and the third thing. Way down the line, is reinsurance pricing in my opinion and we don't participate on too much on -- or change our purchasing habits by the pricing of reinsurance. That's not the way we do business. So the answer is, no.

Operator

[Operator Instructions] We'll take our next question from Meyer Shields.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Can I get a little more color on habitational. The reason I'm asking is because we've had sort of really strong reserve development for last couple of years and I'm wondering whether in retrospect, there's more profits or less unprofitability than you originally thought in terms of how you're planning forward?

Michael J. Stone
Director

Yes, Meyer, it's Mike Stone. I think when we look at our E&S business both property and casualty, and I know you're talking about casualty now, but that habitational business is very significantly underperformed. And did we swing the pendulum too far is basically, your question? Who knows the answer to that. Who knows? I hope we did but I can assure you when we’re looking at this a few years back, it didn't look very pretty. And it really -- it hasn't improved much. We've exited quite a bit of that business and kept the better performing. And in the E&S casualty space, quite a bit of that business is habitational. So which you guys have to be very careful, either large premium items, the E&S companies seem to pass them around and the habitational -- the real estate companies tend to be a little bit brighter than we are at times when they take certain locations out of their schedules and then put them back in and it's tough business what we discovered. And -- but we still, like I said, it's still a big part of that E&S casualty space. So we're always trying to find the right recipe. And we think we have it now but we know we didn't have it in the recent past. Now I'll also tell you on the property areas, its tough business in the property area as well. And a lot of business, a lot of our businesses is habitational in the E&S space. So the answer to your question is, I hope so.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Yes, understood. That's very helpful. Is the quarter share deal with Prime, is that new business for you?

Thomas L. Brown
Chief Financial Officer and Senior Vice President

Yes, this is Tom, Meyer. That was effective 1/1 of this year. It's a 25% quarter share.

Operator

[Operator Instructions] We'll go next to Mark Dwelle.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Couple of questions. First while on the topic of Prime. Can you just give a little bit of background on what type of business their writing or is yours really just a unit to help lay off some of your own risk. Can you maybe just throw little bit more color there, what Prime does and what you might hope it would be?

Michael J. Stone
Director

Yes, it's Mike Stone. I'll give you a little bit. Prime is a -- it's a standalone insurance company, headquartered in Salt Lake City and we purchased an interest in them February of this year. And they've had very, very good performance during their tenure. They write that they're deep E&S player. They write very difficult place risks. For example, helicopter bungee jumps, white-water rafting, the Bartman ball where they insured the Bartman ball out of the local Chicago restaurant. In other words, fairly deep E&S. I mean, we're in the E&S space but we don't write the Bartman ball. We don't write helicopter bungee jumping, and some very, very unique risks. I think if you think of the Old Lloyds. And people think of Lloyds in London and the stuff they used to place, I kind of get a sense that these guys are like that. They're very careful underwriters in very difficult space. And while it limits higher rates, I can assure you there, that they get their pound of flesh and they don't expect to keep the business for a very long period of time. They expect to keep it at most a couple of renewals and many of the business won't renew at all. So they're -- and they're very good underwriters, quality people. We spent quite a bit of time with them over the last 6 months or so and we like their business and we like their operation.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Any general sense for the overall kind of premium volume. I'm just trying to get a sense of scope of the business, and size generally?

Thomas L. Brown
Chief Financial Officer and Senior Vice President

Yes, Mark, it's Tom Brown. I said in my comments, we think for the full year it's going to be somewhere between $8 million to $10 million.

Jonathan E. Michael
Chairman and Chief Executive Officer

Well, $8-plus million.

Thomas L. Brown
Chief Financial Officer and Senior Vice President

Yes, I'm sorry, not their writing, that would be our percentage of their book.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Got it, right, yes, I got that, okay. Okay, the second question I had was just on the investment portfolio where there's any particular changes there. I know you've shifted in and out of munis and at various points we've added or subtracted from the equity portfolio. Just trying to get a sense for, is there any you're contemplating there or not?

Thomas L. Brown
Chief Financial Officer and Senior Vice President

Mark, it's Tom Brown again. I think, it may be on the margins but by and large, if you look at it over the last couple of years, we stayed pretty true to the 80%, 20% allocation between fixed income and equities. But we do work on the margins there. You're right. I think with some previous quarters, perhaps a little larger allocation to munis. We kind of like that part of the markets. It's at about 35% as we speak but again when we say the margins by comparison that was around 31% of little over a year ago. Not a lot of movement with respect to the allocations.

Operator

[Operator Instructions] And we have a follow-up from Ken Billingsley.

Kenneth G. Billingsley
Compass Point Research & Trading, LLC, Research Division

Yes, just a follow-up question on the Prime. The 25% quarter share that you guys put in place at the beginning of the year. Did you replace someone or was this capacity added so they can grow their book?

Thomas L. Brown
Chief Financial Officer and Senior Vice President

Yes, we replaced an existing reinsurer.

Kenneth G. Billingsley
Compass Point Research & Trading, LLC, Research Division

Okay, and is there an expectation that they're going to be growing their book significantly at this point with you involved or is the expectation with your replacement could be similar to year-over-year?

Thomas L. Brown
Chief Financial Officer and Senior Vice President

I'd say it's too early to really tell. One thing that I will note that the -- with the financial investment that they did get upgraded from B++ to A-. Which gives them little access to me perhaps to different markets but too early to tell.

Operator

And we have a follow-up from Meyer Shields.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Yes, I was just hoping you could talk about the how many opportunities like Prime exists in terms of both the investments and a quarter share side?

Jonathan E. Michael
Chairman and Chief Executive Officer

This is Jon Michael. We do like to do this with the -- some types of investments where we see opportunities and we try to call the great relationships with specialty carriers particularly those that are private and with this one, we saw an opportunity to get this quarter[ph] share and to make the small investment and they help out Prime. We think there are a lot of those kinds of opportunities across the country.

Operator

And at this time, with no further questions in queue, I will turn the conference back to Mr. Jonathan Michael.

Jonathan E. Michael

Chairman and Chief Executive Officer

Thank you, all, for joining us. It was another strong quarter. 86 combined ratio. Premiums were up slightly. We had $0.57 per share, which was a nice increase from last year's first quarter. We talked a little bit about the markets and the new capacity entering the market. We're the type of company that perseveres in this type of environment. We'll maintain our discipline while continuing to seek opportunities like Prime and others. And thanks to our underwriters and to all our associates for another good quarter and we'll talk to you again this second quarter. Thanks.

Operator

Ladies and gentlemen, if you wish to access the replay for this call, you may do so by dialing 1 (888) 203-1112 with an ID number of 9677966. This concludes our conference for today. Thank you, all, for participating and have a nice day. All parties may now disconnect.