S&P Global
Market Intelligence

# RLI Corp. NYSE:RLI

# FQ3 2007 Earnings Call Transcripts

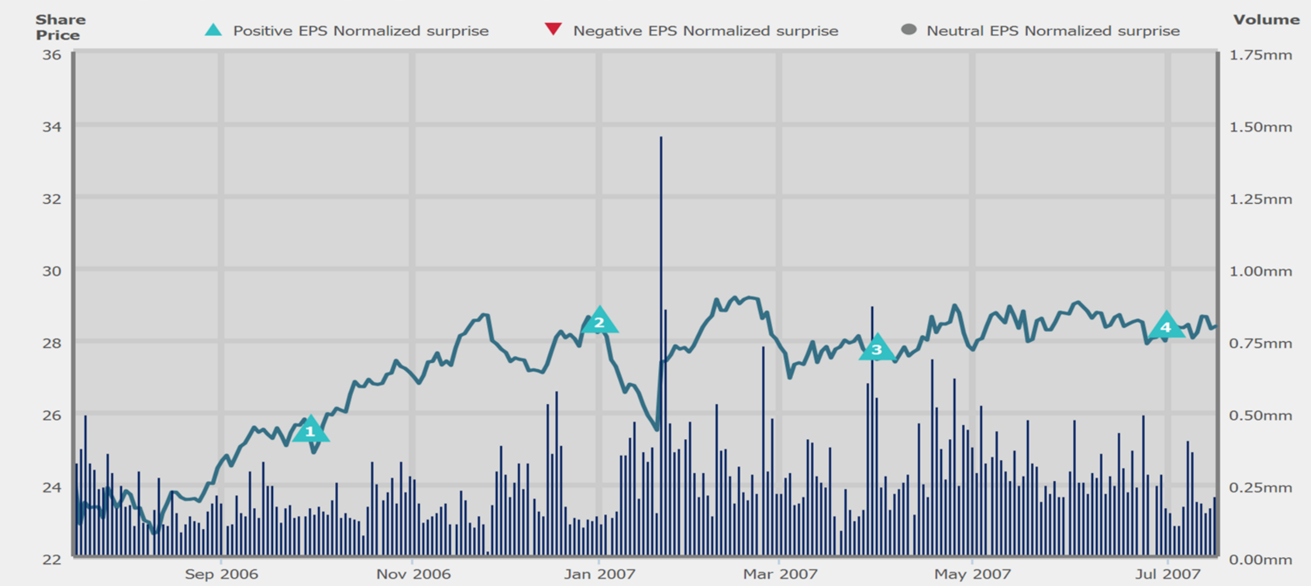
## Wednesday, October 17, 2007 3:00 PM GMT

## S&P Global Market Intelligence Estimates

| | -FQ3 2007- | | | -FQ4 2007- | -FY 2007- | -FY 2008- |
|---|---|---|---|---|---|---|
| | CONSENSUS | ACTUAL | SURPRISE | CONSENSUS | CONSENSUS | CONSENSUS |
| **EPS Normalized** | 0.53 | 1.23 | ▲132.08 | 0.52 | 2.77 | 2.12 |
| **Revenue** | - | - | ▲1.63 | - | - | - |
| **Revenue (mm)** | 155.82 | 158.37 | - | 155.93 | 634.76 | 621.21 |

Currency: USD
Consensus as of Oct-17-2007 2:45 PM GMT

**Stock Price [USD] vs. Volume [mm] with earnings surprise annotations**




**- EPS NORMALIZED -**

| | CONSENSUS | ACTUAL | SURPRISE |
|---|---|---|---|
| **FQ3 2006** | 0.44 | 0.57 | ▲1 32.56 % |
| **FQ4 2006** | 0.48 | 0.52 | ▲2 8.33 % |
| **FQ1 2007** | 0.50 | 0.60 | ▲3 20.00 % |
| **FQ2 2007** | 0.52 | 0.82 | ▲4 57.69 % |

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*Credit Suisse*

**Doug Mewhirter**

**Joe Dondanville**

**Jonathan Michael**

**Meyer Shields**
*Stifel Nicolaus*

**Michael Stone**

**Mike Grasher**

**Ron Bobbin**
*Capital Returns*

**Unidentified Company Representative**

# Presentation

**Operator**

Good morning and welcome ladies

and gentlemen to the RLI Corp third quarter earnings teleconference call. At this time we would like to inform you that

this conference is being recorded and that all participants are in listen only

mode. At the request of the company we will open the conference up for

questions and answers after the presentation.

Before we get started let me

remind you, 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 the annual form 10K which should be reviewed carefully.

The company has filed a form 8K

with the Securities and Exchange Commission that contains the press release

announcing third 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 operating earnings and earnings per

share from operations consist of net earnings after the elimination of after

tax realized investments, gains or losses. RLI's management believes that this

measure is useful in gauging core operating performance across reporting periods.

They may not be comparable to other companies' definitions of operating

earnings. The form 8K contains reconciliations between operating earnings and

net earnings.

The form 8K and press release are

available at the company's website at www. Rlicorp.com. Again, at the request

of the company we will open the conference up for questions and answers

following the presentation. I will now turn the conference over to RLI's

treasurer Mr. John Robison. Please go ahead sir.

**John Robison**

Thank you, good morning to

everyone. Welcome to the RLI earnings teleconference for the third quarter of 2007. Joining me for today's call are John Michael, President and CEO of RLI Corp., Joe Dondanville, Senior Vice President and Chief Financial Officer and Mike Stone, President and Chief Operating Officer of RLI Insurance Company.

We will conduct this call as we have in past quarters. I will give a brief review of the financial highlights and then Mike Stone will talk about the quarter's operations. We'll then open the call up for questions and John Michael will finish up with some closing comments.

I'm pleased to report record third quarter operating earnings of $59.1 million or $2.46 per share. The combined ratio for the third quarter was 50.6. Included in the results this quarter was favorable loss development on prior year's reserves of $48.5 million or $1.31 per share. The company periodically reviews its loss reserves estimates and underlying actuarial reserving methodologies in order to assess their accuracy and suitability and to benchmark its reserving practices against industry best practices.

As disclosed in last quarters 10Q and our 2006 10K annual report the company has performed in the current quarter a more detailed round up analysis of the actuarial estimation risks associated with each of its products and segments including consultation with external consultants and assessment of industry information.

Our analysis revealed that the company's quarterly actuarial reserve estimates over recent historical periods have shown a downward trend as a result of moderating loss trend environment, improvements in policy terms and conditions and a favorable underlying exposure mix that occurred during the hard market period from 2001 through 2004. The impact was most evident in our casualty and surety segments. Based on these factors and analysis including the current consideration of such underlying trends in the actuarial estimates, the result is $48.5 million pretax favorable development on prior year's loss reserves net of bonus and profit share in related expenses.

Whilst reserve estimates are

subject to a high degree of variability, due to the inherent uncertainty of ultimate settlement values, periodic adjustments to these settlements may occur as the actual emergence of losses reveals itself over time. The company believes its enhanced loss reserving processes reflect industry best practices and its methodologies continue to result in an appropriate best estimate of necessary reserve levels.

Turning to investments. Investment income grew 11.6% to $20.4 million this quarter. There were no significant changes to asset allocation from the previous quarter. Our fixed income portfolio has a duration of approximately 4.5 years and maintains a AAA overall quality rating. Our equity investment in Maui Jim contributed $2 millio9n of pretax income for the quarter. I'm pleased to report an update on the CMC litigation this quarter. We reached a (inaudible) with another bank. This settlement was within our expectations and the remaining exposure on litigation is approximately 17% of the original bond penalty.

Turning to our share repurchase program. During the quarter we repurchased 547,100 shares of RLI stock at an average cost of $58.52 or $32 million.

For the operations highlight, I will now turn the call over to Mike Stone. Mike.

**Mike Stone**

Thanks John. Good morning everyone, another excellent quarter. Our discipline underwriters produced superior results in a difficult environment. We're an underwriting company, we expect to thrive not just survive in this market as well as our own markets.

The market is soft, casualty rates down 12-15%, property rates off 15-20%. However we are coming off a very robust pricing in prior years, still nice margins though they are now under some pressure. Our model rewards profits, our underwriters will continue to select risks on the basis of profitability opportunity and not on volume because we don't have any volume targets here. While gross premium is down you would expect, especially a company with significant ENS presence, to be off in this kind of marketplace.

I’ll talk a little bit about the segments. In the casualty, I'll talk about a few products here. Our general liability product, our primary liability exposures which have been our growth engine in the recent past, gross written premiums are off 8% for the year and 9% for the quarter with rates off 11% in the year and 13% for the quarter. Still producing solidly profitable results. We would expect this area to stabilize in the coming quarters but it has been under pressure for the last couple of quarters.

Our executive products group, D&O and E&O gross written premiums off 16% year-to-date, 25% for the quarter and rates under pressure at 14% down for the year and 15% down for the quarter. Much more competition here. And you’ll see that we will give up share where rates don’t allow adequate returns.

Our personal umbrella product, the bright lights in this marketplace are standalone personal umbrella. Post written premiums are up 5% and we also had a rate increase of about 4%. It continues to grow this product as we foster our relationship with the big IBA, the big trade association for agents and provide umbrella for other companies who don’t have this expertise. We will expect to see this product continue to grow in coming quarters.

Transportation, our truck and bus operation, post written premiums are off 16% for the year and 25% for the quarter. Rates down 5% on the quarter, 3% year-to-date. Again we are sacrificing share here as this market softens significantly. We also expect this marketplace to be the first to firm, the earliest to firm as it’s a fairly short tail for a casualty line.

Overall casualty, markets are tough. We’ll remain disciplined as we continue to select on the basis of profit and we’ll look for new opportunities as they come forward.

On the property segment, gross written premiums off 14% for the quarter 11% for the year. Talk about the CAT business first. Price levels off 30% from 1/1 where roughly reached their peak. Wind peaked a little bit earlier in probably September of last year and year-over-year when renewals were off about 25% on a rate basis. Earthquake peaked around January 1st and year-over-year rate levels are basically flat because we are not yet to the peak. The pricing has stabilized over the last couple of months and probably because we're in the hurricane season, given however it has been a benign hurricane season I don't expect rates to recover to prior levels any time to soon.

Our EMS fire business rates off about 15%, gross written premium off 30%. Remember that we underwrote our habitational business that was providing a number of losses in prior quarters and that's driven our gross written premium down but it's also driven our loss activity down.

We lost RLI RE, a facultative property operation in the third quarter. We're up and running and expect production to accelerate in the fourth quarter.

Our marine business continuing to build this out. Gross written premium up 40% in the quarter. We've written about $30 million plus year-to-date. They're executing on their business plan. We're expecting this to be a profitable $75-100 million worth of gross written premium business in the next few years.

Surety. Goods Stores gross written premiums up 6% for the year. Our energy, miscellaneous and commercial products continue to grow nicely. Our contract business lags but we've added underwriters during 07 and expect to begin growing this in the coming quarters. Surety combined ratio 33 in the quarter, 60 year-to-date. I would say very significant improvement from just a couple of years ago.

Overall, a tough marketplace. All products where disciplined underwriters will find new opportunities, new products and find ways to continue to outperform in our current businesses. That's basically our commentary on the market. Back to you John.

**John Robison**

Thank you Mike. We will now open the call up to questions.

**Question**

Thank you sir. The

question-and-answer session will begin at this time. (Operator Instructions).

And our first question comes from Bijan Moazami.

<TAG>Bijan Moazami - Friedman,

Billings, Ramsey & Co.</TAG>

Good morning everyone. A number

of questions. When you say 12-15% rate decline on casualty is that new or

renewal business?

**Mike Stone**

That's on renewal business but we

don't see much better rate activity on new business.

<TAG>Bijan Moazami - Friedman,

Billings, Ramsey & Co.</TAG>

Are you concerned that (inaudible)

wants to expand their market share in the US because obviously as the

reinsurance capacity will become more available do you believe that there is

going to be more rating pressure going forward?

**Mike Stone**

Its Mike Stone again. Obviously

they were a competitor to begin with now they are tied with a partner of ours

and I think that's just another signal that the market's anything but firm

right now. You know they paid a fairly rich price for this asset so we'll see.

<TAG>Bijan Moazami - Friedman,

Billings, Ramsey & Co.</TAG>

Mike finally, are you seeing any

kind of totally irrational behaviour? Is there any of your products lines

that's just not having the appropriate rates of return at this point?

**Mike Stone**

Bijan I think that some of the

property businesses is getting pretty difficult and we still think we're making

a profit in all of our products but certainly the property segment seems to be

dropping quickly.

Transportation is also fairly

difficult. Again I think that these are two that will firm back up quickly as

people recognize that where their pricing their product.

<TAG>Bijan Moazami - Friedman,

Billings, Ramsey & Co.</TAG>

Is there anything in particular

that happened in the quarter that led to the prices dropping so much more now

as compared to the quarter (inaudible)?

**Mike Stone**

Bijan it's been a decline, a decay

over the last number of quarters. It seemed to be accelerated a bit last

quarter and it didn't improve this quarter.

<TAG>Bijan Moazami - Friedman,

Billings, Ramsey & Co.</TAG>
Thank you so much Mike.

# Question and Answer

**Operator**

And taking the next question from

Charlie Gates with Credit Suisse.

<TAG>Charles B. Gates - Credit

Suisse</TAG>

Hi, good morning. What do you

think contributed Mike to the acceleration that you witnessed in this

competition in the last two quarters?

**Mike Stone**

Well Charlie again I mean there's

an awful lot of capacity out there, an awful lot of capital and there hasn't

been a major event in a while. People have come off fairly profitable years in the casualty lines

so maybe that's some of the tort environment improving but overall I believe

it's a capital issue. There's an awful lot of capital chasing return.

<TAG>Charles B. Gates - Credit

Suisse</TAG>

My second question, maybe I

misheard you but I thought you said that during the period transportation

pricing was down only 5%. Did I get that right? And to what extent does that

show a diminution in competition?

**Mike Stone**

Charlie, you did get that right.

That's our renewal rate decrease. Also, our gross written premium was off 20%

plus. So we're pricing off market share and the market is off significantly

more than 5%. Every large renewal that we have, something gin excess of

$100,000 is under very significant pressure in the transportation arena.

**Charles B. Gates**
*Credit Suisse*

I believe (inaudible) ratings

only rose on a net basis 0.1%. To what extent does that reflect increased

competition and to what extent do you have an issue there with a slowing

realistic construction market?

**Mike Stone**

We were off, we were up just

about a percent in the quarter, but really a lot of that was our contract business was off more than that so certainly as there is a slowing construction market place you will see a diminution on writings on the contract segment. Our other segments were up fairly nice year-to-date, so we would expect to see our small transactional license and permit bond business and also our account-driven business to grow and our energy business has grown nicely year-to-date. So, it's a really a function of in the contract segment. We're going to be careful. We've been through that before and we're going to be slow to move quickly on the contract side.

**Charles B. Gates**
*Credit Suisse*

To what extent do you witness a

change in the players writing excess and surplus client coverage? And what I mean by that is to what extent do you see the standard market companies coming to this market? To what extent do you see the new Bermudians?

**Jonathan Michael**

This is John, Charlie. The

standardized company, that's probably the biggest reason anecdotally (ph. Circle science) business is eroding is that the standard lines companies are moving down into that territory and making more of that business lot business and standard alliance business.

The new Bermuda

capital certainly is getting their share of business. There's no question about that. That's happening as well. The other thing that is happening that Mike did not talk about is that carriers look at their, and I'm not talking about RLI, but I'm talking about in general, markets look at their forecasts and underwriters are looking to make bonus and that sort of thing and so what typically happens ion the fourth quarter of the year is they get more aggressive in pricing the business in order to try to achieve their premium forecasts.

We don't do that, but others do.

And we're seeing some of that too.

**Charles B. Gates**
*Credit Suisse*

My final question at this time;

if you guys were to go back in history, what period in time would this current

market environment be similar to?

**Jonathan Michael**

I think I'll let Mike answer that;

he's a little older than I am.

**Mike Stone**

I'm old but I'm wise. I think

that we're, we've reached probably the nadir of the marketplace in about

'99-'00. So we're not there. I'd say we're probably around 2002 as we started

to move up, we started to move down, but we're still in a fairly good

market.

**Charles B. Gates**
*Credit Suisse*

Thank you.

**Operator**

And moving on to our next

question from Doug Mewhirter from Ferris, Baker, Watts.

**Doug Mewhirter**

Hi, good morning. A question

about your reserve adjustment; did you make any of the adjustments to anything

written in the current accident year as well as prior accident years? And also

if you could provide any detail at all about what the main accident years the

adjustments came out of.

**Joe Dondanville**

Doug, this is Joe Dondanville.

Primarily the reserve releases came out of the 2004, 2005 and 2006 years. We

did have some increase in losses in 2007, which is more up trending of

price-driven and we have some reserve strengthening in the years of 2001 and

prior. So, net there was some movement through all of it, but the true releases

were '04, '05 and '06.

**Doug Mewhirter**

Ok, just to make sure I heard you correctly. You said that there is actually some reserve increases for 2007 written business?

**Joe Dondanville**

Well, in looking at where the loss pick for 2007, they were increased slightly. So by picking that up in the third quarter for the first two quarters effect had an impact on moving a little bit up, but that certainly was not even significant compared to the activities compared to ’04, ’05 and ’06.

**Doug Mewhirter**

Ok. Thanks for that. And I had a question about your premium retention. I know that it has gone up. How much of that is just the changing business mix, where you would write more in lines that you would naturally assume is risk and how much of it is general interest company-wide to retain more premiums, because of your capital positions or what have you?

**Joe Dondanville**

Doug, I would say it’s about half of each. Certainly lines like general liability where we are holding our ground a little bit is a high-retained line, surety is a highly retained line where we saw growth and then some of the big decline areas on our EPG is a high area for reinsurance for us.

**Doug Mewhirter**

Ok, thanks a lot. That’s all my questions.

**Operator**

And the next question comes from Meyer Shields from Stifel Nicolaus.

**Meyer Shields**
*Stifel Nicolaus*

Thanks. Good morning everybody. To start off with the surety reserve release, is there any way to find how much of that was changed methodology and how much of that was the CMC settlement?

**Unidentified Company Representative**

Actually, you're description is

probably incorrect on both. The CMC, we're settled out at about the reserves

that we had. So there was no significant impact on CMC in the quarter and it's

really kind of incorporating the trends. There was no change in methodology in

what we're doing; it's relying, putting more reliance on the trends that we've

seen.

**Meyer Shields**
*Stifel Nicolaus*

Ok, and does the same accident

year split that you talked about for (inaudible)?

**Unidentified Company Representative**

Yes, I believe there is still

that concentration in the four, five and six years for surety.

**Meyer Shields**
*Stifel Nicolaus*

Ok, if I can turn to

transportation, I guess, what are the implications of the fact that Munich is apparently not interested in Midlands

transportation book? Is that a factor at all in your strategy?

**Mike Stone**

It's Mike Stone. I don't think

so. Munich has

been a fairly significant competitor in transportation business for the last

year or so. So they've been in it. We've competed with them. We like the

transportation business, so we'll stay. It will just be, if it's not Munich it's someone else,

so we'll find our spots.

**Meyer Shields**
*Stifel Nicolaus*

That's helpful. I guess, with the

recent changes in the housing market and all the sub-prime issues, have you seen

any infliction points at all, I'm asking I guess both with regard to surety and

with regard to property loss comp?

**Mike Stone**

It's Mike Stone. Not really. We

haven't seen any impact there.

**Meyer Shields**
*Stifel Nicolaus*

Ok, and I guess the last

question; Maui Jim earnings were down on a year-to-year basis. Is there

anything going on there that we should know about?

**Mike Stone**

Yeah, the big impact on the cause

of the change is in the 2006 number Maui Jim had a sale of a discontinued operation,

which there was a $1 million gain recognized and that is not repeated in the

third quarter, so there is a special item in 2006.

**Meyer Shields**
*Stifel Nicolaus*

Would you use this quarter as a

decent basis for projection?

**Mike Stone**

Yes.

**Meyer Shields**
*Stifel Nicolaus*

Ok, thanks so much.

**Mike Stone**

And I say yes on a somewhat

seasonable basis.

**Meyer Shields**
*Stifel Nicolaus*

Right, I understand.

**Operator**

Moving on to Mr. Mike Grasher

with Piper Jaffray.

**Mike Grasher**

Good morning gentlemen. Just Mike

and John; a question around capital position. You laid out a scenario where

there is excess capital in the market place net. What about your own position

and how would you go about raising that capital position with a risk to capital? What would be your target ratio? Could we expect some acquisition? More share repurchase, dividend? If we look back, acquisition probably isn't the way you've tended to go, it's been more building of book and going from there. But has you attitude changed to that? Maybe you could give us some commentary around that.

**Jonathan Michael**

We continue to, you know as you've stated, Mike, we continue to grow our capital relative to the amount of business that we're writing. At the same time we are looking for opportunities, both potential acquisition opportunities, hiring people, lift-outs of teams of people, the RLI RE is an example of that. And we'll continue to look for ways to utilize our capital. In the meantime, I'm we will continue with our buyback and once that buyback is completed we'll have to reassess where we are and then go from there. But in terms of target, we're obviously below our target and we are over-capitalized. We'd like to get it to someplace around one to one. But we're going to continue to look at all of those things in the future and it's a good problem to have that we continue to make a lot of earning and are far outstripping our ability to grow. So, we'll continue to look at that.

**Mike Grasher**

Ok, and just a follow-up, you made a statement about lifting out the teams or bring teams on, that would seem to me to imply new or differentiated product. What areas might you be looking at? I don't necessarily think you have any holes that you're looking to fill but certainly opportunities that look intriguing out in the market place to you now?

**Jonathan Michael**

I don't want to say which areas of business, but I will say they will be specialty, niche areas. That's what we're good at. We're not going to be all things to all people. And those are the things we're looking for. We look at ourselves where we're good at and where we have hole and we go from there. But we won't be in the standard lines markets any time soon, that's for sure.

**Mike Grasher**

Thank you and congratulations on

the quarter.

**Operator**

And moving on to Ron Bobbin with

Capital Returns.

**Ron Bobbin**
*Capital Returns*

Hi. Congrats on another great

quarter. Underwriting is really impressive and also great discipline on

limiting the top line where it's not meant to be. I had a question; I think

it's a follow-up to Charlie's question. In the transportation area, you

mentioned rates were down 5% on your renewal this quarter but your volumes were

up 25%. I was wondering whether a particular large account or something that, I

recognize no one wants a 5% decline, but the 25 was obviously a pretty

significant drop in writings for the quarter. Was it just an ordinary situation

of competition pulling business or was there something concentrated there?

Thanks.

**Mike Stone**

We're off 16% for the year.

Again, we lost a number of renewals in the quarter and any renewal that comes

up with sizeable premium in six figures is under quite a bit of pressure. We're

very disciplined in that business. The margins in that business are top so we

will let that business go and expect it will be back in a couple years.

**Ron Bobbin**
*Capital Returns*

Ok, I guess another question.

Thanks for that. I was just curious; does Munich

provide you any reinsurance? Are they under any of your programs?

**Mike Stone**

They're our largest

re-insurer.

**Ron Bobbin**
*Capital Returns*

Oh, and do you have any sort of

differing view about they increasing insurance initiatives in growing, I would think that you would, given an availability of reinsurance, you would surely

consider (inaudible) provider, or am I wrong?

**Michael Stone**

That's hard to say. I think

maybe, really, the first reaction might be that, but the reality is all the

reinsurers are competing with us, so you can go, you look at those Bermuda reinsurers and they're all competing with us, and

we seek out their capacity for some of our covers as well. If we took that

attitude we wouldn't place reinsurance.

Ron Bobbin - Capital Returns

So.

**Michael Stone**

Probably no change, we'll have a

talk with Munich

about it, but probably no change.

**Ron Bobbin**
*Capital Returns*

Thanks a lot, and continued good

luck and success.

<TAG>Unidentified Company Representative

</TAG>

Thank you.

**Operator**

Moving on to our next question

from Tom Cholnoky with Goldman Sachs.

<TAG>Thomas Cholnoky - Goldman

Sachs </TAG>

Good morning. I guess I have a

question that may or may not be related to RLI, but in your commentary I was

focusing on your obviously commentary on rates and decline in rates, and I

guess one of the things that I struggle with in looking at either you or other

companies in the industry is that in an environment where rates are going down

double digit, why aren't we seeing accident year loss ratios reflect what are

double digit declines? I mean, put simplistically, if lost cost trends are essentially flat, and you've got 10 or 15% less rate, it would imply that your loss ratio picks probably should go up by 10%, and I'm not picking on RLI by any means, but I'm just thinking in general, what is wrong with my view of where a margin should be in a declining rate environment?

**Joe Dondanville**

This is Joe Dondanville. I think
part of the phenomenon that you're seeing today is that as loss costs are relatively stable, our emergence of losses, of what we expect the losses to be, have been more favorable than what we've expected, so that has offset some of that price decline that you're seeing, and so when we're looking at our overall reserves and booking ratios, that has had a more favorable impact historically then the price declines, and I think for us as I mentioned we are seeing a little bit higher loss picks going forward in 2007 and I would assume other companies are going to run in to that same phenomenon.

**Michael Stone**

Yea Tom, our estimated loss
ratios for the current accent year begin with when we're looking at that formula, they begin with what's the price change, what price change are we seeing across the book, and that's the starting point, but then you have to bring in, as Joe said, the emergence from prior year's development to the extent that that's been positive it more or less has offset some of that.

<TAG>Thomas Cholnoky - Goldman
Sachs </TAG>

So, when you get to a point where
you don't have any more favorable development, let's say, you’ve come to a point where your reserves are at adequate levels, at that point one would expect either yourselves or other companies in the industry, if they're true to what's going on with pricing, to see much more significant increases and loss ratio picks. Is that fair?

**Michael Stone**

That's fair.

<TAG>Thomas Cholnoky - Goldman
Sachs </TAG>

Ok, alright, that's great. Thank
you.

**Operator**

Moving on to Kenneth Billingsley,
with Signal Hill.

<TAG>Kenneth Billingsley - Signal
Hill Capital Group LLC</TAG>

Good morning. This is kind of
taking Tom's question in a little bit different direction. He commented that
rates are down pretty significantly, but it looks like the core loss ratio is
still improving. From a reserve standpoint, what changes were made? For
example, are you booking more to your own experience then industry experience,
as compared to prior quarters?

**Joe Dondanville**

Again, this is Joe. Yes, that's
part of the factor, but we did have an increase in the current accent year
during the quarter, so, but that still might be masked by the large decreases
for prior years.

<TAG>Kenneth Billingsley - Signal
Hill Capital Group LLC</TAG>

And what I'm looking is the core
adjusting out the reserve adjustment of the whole compared to prior year’s loss
ratios backing out reserve releases. It still looks like quarter over quarter
you're still having improvements.

**Joe Dondanville**

I think it's mixed again. Are you
looking at, it depends on which segment you're looking at. Are you looking at
overall?

<TAG>Kenneth Billingsley - Signal
Hill Capital Group LLC</TAG>

Blended right now.

**Joe Dondanville**

I think if you look at the

property results for example you'll see significant improvement in the property results, quarter over quarter.

<TAG>Kenneth Billingsley - Signal Hill Capital Group LLC</TAG>

And what drove the change to focus more on your own experience over industry experience, and can you give me an idea of how much of the waiting changed?

**Joe Dondanville**

We can’t really give you what the waiting change is, but if you look at our trend of favorable development over the last several quarters, at this point we’ve incorporated more of that into our reserve analysis, as more of a continuing trend as opposed to an anomaly.

<TAG>Kenneth Billingsley - Signal Hill Capital Group LLC</TAG>

Great. Great quarter. Thank you.

**Operator**

We'll take a follow-up question from Charlie Gates.

<TAG>Charles B. Gates - Credit Suisse</TAG>

Hi. My first question. I think one of you said that 17% of the commercial money center bond exposure remained. The initial commercial center bond exposure remained. Could you tell us what that number is, or what the initial number was?

**Michael Stone**

Yea Charlie, it's Mike Stone. We had roughly $15 million worth of bond penalty, and it depends on how you look at this, and I think there's about $7 million left. I don't know if that answers 17% or not, but thereabouts. When you look at that out of pockets, that's roughly a little bit less than half of that, so there's about 7 million left, roughly, out of pockets, I mean, excuse me, bond penalty. We would expect it to be immaterial, going forward. We will, we expect to resolve this in the coming quarters, hopefully by year-end, but I'm not sending any signals to anybody, but it's really going to be a non-event.

<TAG>Charles B. Gates - Credit
Suisse</TAG>

Do you mean the future exposure is specific to that is probably a non-event?

**Michael Stone**

The future exposures related to that is a non-event.

<TAG>Charles B. Gates - Credit
Suisse</TAG>

Ok, there was my first question.

My second question. If you were an analyst, following multi-line insurance companies, and you were trying to ascertain to what extent those companies were growing their exposure in excess and surplus lines, today, how would you do that?

**Michael Stone**

Right Charlie, I'm glad I'm not an analyst. I think I'd talk to the managements of those companies, and that's how I would do it.

<TAG>Charles B. Gates - Credit
Suisse</TAG>

I think some of those managements would say oh, we don't even know how to spell excess and surplus lines. Thank you.

**Joe Dondanville**

Charlie, for our company we write a lot of it on a non-admitted basis in our Maui Jim company, but when you see the standard lines going down there's no differentiation with an admitted business in the types of surplus lines they would still record with the other more typical standard lines that they write, so it is something that you'd have to ask and drill down through management questions.

<TAG>Charles B. Gates - Credit
Suisse</TAG>

Is the specific area, if you re

to step back, and you're to say, what area of our business is the worst. Is

that basically commercial auto liability? Because you were saying

transportation, and I translated that into commercial auto liability.

<TAG>Unidentified Company Representative

</TAG>

Charlie, that's a little

different. Our transportation business consists of trucks and basically that's

fleet business, for hire, by and large, and busses, that is public

transportation. We have a small segment of what we commonly refer to as commercial

auto which is basically private, small, five, to 25 units of a particular

business, but by and large our business is large fleets, trucks, over the road,

and buses.

<TAG>Charles B. Gates - Credit

Suisse</TAG>

But on statutory basis, if an

analyst was to look and say, a multi-line insurance company writing these

risks, that would show up in commercial auto liability and commercial auto

physical damage?

<TAG>Unidentified Company

Representative </TAG>

Yes, that's correct, Yes Charlie.

**Charles B. Gates**
*Credit Suisse*

Thank you Guys. A nice conference

call. Thank you.

**Operator**

The next question comes from

Meyer Shields, with Stifel Nicolaus

<TAG>Meyer Shields - Stifel

Nicolaus </TAG>

Thanks, just a few nit-picky

questions, if I can. Is there any reason that short-term debt went up in the

quarter?

**Joe Dondanville**

We like the carry trait that we

have with the short-term debt that we have right now, and it's attractive to

us.

<TAG>Meyer Shields - Stifel

Nicolaus </TAG>

Ok. Was there anything unusual in

the tax rate? It came in a little lower than I would have thought.

**Joseph Dondanville**

Yea, we had some benefits that

came through in the quarter related to some items that were outstanding with

the settlement of our tax audit from last year.

**Meyer Shields**
*Stifel Nicolaus*

Ok, and I don't know if this is

the right way of doing it, but when we look at the general expenses and the

ratio of total revenues, that went up a little bit from 1.3 % to 2.1. Is there

anything unusual in terms of that?

**Michael Stone**

There are two things, Part of it

is because of the terrific quarter, bonus compensation went up, and part of

that goes through that line item, part of it, and then second we had a one time

charitable contribution increase of $1million for the quarter.

<TAG>Meyer Shields - Stifel

Nicolaus </TAG>

Ok, that's it for me. Thanks so

much.

**Operator**

We'll take our next question from

Mike Grasher, Piper Jaffray

**Mike Grasher**

Thanks for taking my follow-up.

Just a question for Mike. You were commenting earlier on the market, and what

it resembled in terms of history. Just wondering if the capital that's out there today is it more responsible today then previous stock markets, if so, then could this soft part of the cycle be more elongated cycle, and one that maybe isn't as severe as previous cycles. Or, alternatively, is it simply too early to really tell.

**Michael Stone**

Mike, we've been telling ourselves that, the industry has, that we're better, we have better data, better governance, and we also got a heck of a lot more capital, so I don't think the cycle's dead. What will the (trough) be less severe, shorter, I think it's too early to tell.

**Mike Grasher**

Ok, thanks for your comment.

**Operator**

If there are no further questions, I will now turn the conference back to Mr. Jonathan Michael.

**Jonathan Michael**

Thank you all for all of your questions, it's always good to talk to you after the quarter. The quarter was obviously impacted in a positive way by the reserve release, but even without that reserve release the quarter was an excellent underwriting result. I'll let you do the math, but if you look period over period, and compare the quarter versus what all the analyst estimates were, you'll see that the result was very, very good indeed, and all segments, across all segments, they performed well. Mike said we are an underwriting company first and foremost. His presentation mostly dealt with that. We are different. We seek to produce an underwriting profit first, and we deliver. In this soft market we'll continue to grow when and where it makes sense to grow, where we're seeing pressure and ridiculous rate reductions, we'll pull back. We are mining for opportunities. We talked about that. RLI RE, was one of those, that operation is up and running and it has now produced some business, and we hope to continue to build our platform for the future.

Through all of this we're going to continue to be disciplined underwriters, that's one thing that you can rest assured, with RLI we’ll have discipline in RLI. Thanks for listening and we'll

talk to you again next quarter.

**Operator**

(Operator Instructions)

This concludes our conference for

today. Thank you for participating and have a nice day. All parties my now disconnect.