

RLI Corp. NYSE:RLI

FQ3 2015 Earnings Call Transcripts

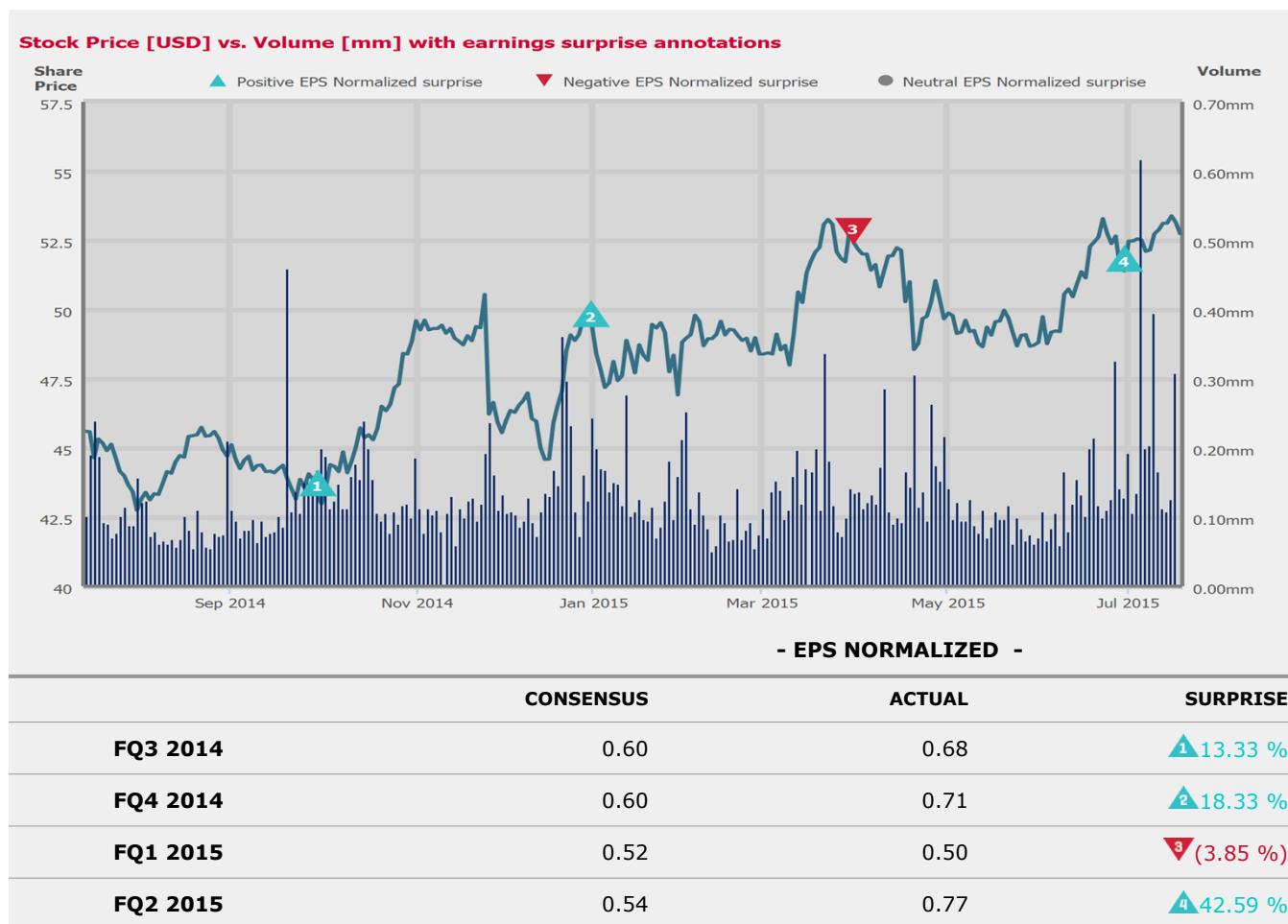
Tuesday, October 20, 2015 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2015-			-FQ4 2015-	-FY 2015-	-FY 2016-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.58	0.70	▲ 20.69	0.56	2.52	2.26
Revenue (mm)	189.65	200.95	▲ 5.96	194.38	771.74	762.90

Currency: USD

Consensus as of Oct-20-2015 9:00 AM GMT



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

Jeff Schmitt

Mark Alan Dwelle
*RBC Capital Markets, LLC,
Research Division*

Randolph Binner
*FBR Capital Markets & Co.,
Research Division*

Unknown Analyst

Presentation

Operator

Good morning, and welcome, ladies and gentlemen, to the RLI Corp. Third 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 a certain risk factor, 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 third quarter results. RLI management may make reflecting 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 consist of net earnings after the elimination of after-tax realized investment gains or losses.

RLI's management believes that this measure is useful in gauging core operating performances 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 would now like to 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 Third Quarter of 2015.

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 give some brief opening comments on the quarter's financial results, then Mike and Craig will talk about operations and market conditions. Next, we will 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, and good morning, everyone. We are pleased to announce another strong and consistent quarter delivering \$0.70 of operating income per share. Starting with the combined ratio, we achieved an 81.3 in the quarter, bringing the year-to-date combined ratio down to an 82.9 from 84.2 through 6 months ending June 30, 2015. These outstanding margins were coupled with top line growth as well. 3% growth in gross premiums and 5% growth in net premiums written.

In our Casualty segment, our underwriters delivered both an 87 combined ratio and 8% top line growth. The Property segment was more challenged from a premium perspective, off 7% in the quarter, while the combined ratio was a strong 79.

The decline in Property premium was not a surprise given the continued pricing pressures in E&S. Last but not least, our Surety segment turned in 5% growth in gross premiums written and an excellent 64 combined ratio.

Consistent with prior quarters, reserve releases had a positive impact across the segments, but primarily from Casualty and Surety. Turning to investments. Investment income remains a challenge as we reinvest new cash flow in bond maturities below the average yield on existing positions. As a result, investment income was down approximately 2% in the quarter.

It was obviously not a good quarter for equity markets although positive fixed income performance helped to offset this impact leading to a 0% total return for the quarter.

Maui Jim, our primary minority investment, contributed \$500,000 of income in the quarter. Though down from last year, we remain very optimistic about their prospects and note a write-down of a capital asset and adverse foreign exchange movements impacted the quarter.

All in all, with strong underwriting performance driving our results, operating income through 9 months came in at \$1.98, up 4% over last year, while book value per share is up 7% year-to-date, inclusive of dividends.

And with that, I'll turn the call over to Mike Stone. Mike?

Michael J. Stone
Director

Thanks, Tom, and good morning, everybody. I'm going to lateral this quickly to Craig. This is my last RLI quarterly earnings teleconference. Craig will provide the color now forward, while may be less colorful, probably more perspicacious. I expect the next stage for me will find an opportunity to do some good. For RLI, I'm certain this change will have a salutary effect as, Craig, brings encyclopedic knowledge of the insurance industry and of our business, and he will drive our operations to even greater heights.

Thank you, everybody. Craig?

Craig William Kliethermes
President and Chief Operating Officer

Thanks, Mike. Good morning, everyone. First, I want to thank Mike for his almost 20 years of service with RLI and for providing a strong foundation from which we will continue to build. RLI was founded on the premise of finding really smart, disciplined insurance professionals and aligning their interests with shareholders. The culture of underwriting excellence will continue to be the focal point of our organization. Thank you, Mike, for your insisting on the best from all the associates of RLI.

Now a little more about our results. A very good quarter despite some challenging market and economic headwinds. As Tom mentioned, we posted an 81 combined ratio for the quarter, which leaves us at 83 year-to-date. All of our segments came in under a 90 combined ratio. These very good underwriting margins did come with some revenue growth for the quarter. We're able to grow gross written premium 3%, the net written premium 5% in the quarter. We achieved this growth by having a well-diversified product footprint and giving our underwriters the incentives and discretion to grow when the opportunity arises and to shrink when the market presents little opportunity for underwriting profit. They delivered again.

In our Casualty segment, we continue to grow both gross and net written premium for the quarter by 8% and 10%, respectively. Rates overall have been slightly up about 1% to 2% for the quarter and year-to-date, mostly led by rate increases on all wheels-based businesses with most other Casualty products realizing flat to slight decreases in rates this quarter. Underwriting margins remain pretty stable across the segment.

In Casualty, we continue to be led by our transportation business. We grew over 40% in the quarter and are up over 20% year-to-date while margins remain good. Rates were up nearly 10% for the quarter, driven mostly by the public auto sector. While many have suffered terrible fates in the wheels business, our results have evidenced our underwriting discipline and that relationships and expertise really do matter in this business. We had several large customers return to us this quarter as a result of poor service and claim handling by our competition.

Our transportation brokers and customers recognized our team as experts in this space. We love trucks. We also saw a growth in the quarter from our commercial umbrella product, which continues to find opportunities in E&S space despite significant competition. The competition in E&S is particularly frenzied on larger accounts. We have made some significant investments in new products and businesses that are starting to bear fruit. The CBIC and professional package businesses continue to grow at a double-digit pace. Our 25% quarter share and our prime insurance partnership grew 24% for the quarter and we have started to get some traction with our new healthcare facility business this quarter.

Our Property segment continues to be challenged as we struggle to find growth opportunities in a market that is yet to find bottom for CAT exposed business. Overall, Property was down 7% for the quarter and is down 25% year-to-date. Excluding the impact of the loss of the crop program, we would still be down 4% for the quarter and 6% year-to-date.

CAT pricing continues to be down double digits. Wind down a little more than quake. A very challenging environment to write much new business. The focus is to keep the best renewal accounts. Our E&S Property business was down about 5% in the quarter and almost 10% year-to-date. On a much brighter note, our Marine business continues to ride a great turnaround story. As we have previously reported, we have had our challenges with this business.

The broader market in general does not seem rational and disciplined to us. We have completely re-underwritten the book and made some tough choices to let go of some underperforming products and underwriters over the last several years. Our tenacious underwriters are now reaping the rewards of their disciplined and difficult decisions, delivering a solid sub-90 combined ratio for the quarter for the first time. Good job and keep up the good work, Bob and team.

Our Surety business continued to grow gross written premium 5% in the quarter, while throwing up exceptional underwriting results for the sub-70 combined ratio. All of our products in this segment are growing top and bottom lines. We continue to invest heavily in systems to make it easier for our producers to do business with us so as to widen the moat we have built. Despite this, we continue to see new entrants in the space. We regularly see flights to markets that appear to produce exceptional underwriting results. It isn't that easy, whether it be Surety or more generally, the specialty space, it isn't the title specialty business that automatically earns you good underwriting results. You can't get specialty results without specialists. That is what we have at RLI. Specialists with a narrow and deep expertise in underwriting and handling claims in a particular niche market that should differentiate us in all market cycles, particularly in the more difficult troughs. Overall, a very good quarter. I congratulate the talented RLI underwriters claim and support staff for delivering differentiating results again this quarter. Thank you.

Aaron H. Jacoby

Vice President of Corporate Development

Thanks, Craig. We can now open the call for questions.

Question and Answer

Operator

[Operator Instructions] And we'll go to Randy Binner.

Randolph Binner

FBR Capital Markets & Co., Research Division

Before I start, Mike, congratulations and it's been great to work with you and I wish you the best in your next step.

Michael J. Stone

Director

Thanks, Randy. You got a really good early education in your career.

Randolph Binner

FBR Capital Markets & Co., Research Division

That's right. And so on the commentary, I'm just looking for market color from Craig now. The wheels comment was interesting and it's something that I think we've been tracking for a couple of quarters. You're talking about I'd say, kind of midsized commercial auto accounts when you say that, is that right? And how much higher is your pricing basically when your repricing these books and they are coming over? I'd like to hear more about that because commercial auto has been kind of a disaster for just about everyone.

Craig William Kliethermes

President and Chief Operating Officer

Randy, this is Craig. In regard to commercial auto, our biggest segment or biggest product is transportation, which includes trucks and public autos mostly and some specialized commercial autos. But we also write recreational vehicles and some commercial auto business through our package business. So it's fairly broad, I could tell you the rates are up across the board, across all that wheels-based business. Some places a little more than others. As far as the price, the price maybe a little higher than what it left us for, but I think a lot of people found out the service was not nearly as good for the price they were paying.

Randolph Binner

FBR Capital Markets & Co., Research Division

And where does that service fall apart? Because I think of these claims as being litigated. Is that usually I guess the problem with them? So what -- where do others fall down on that servicing claim side versus what RLI can offer?

Michael J. Stone

Director

This is Mike stone. I'll try that one. I think it's a whole host of things. First off, it's an understanding of the risks associated with transportation, with trucks and buses. From things like MCS 90 to collateral to claim handling and the ability to properly manage litigation. So when I think all of those things -- I mean, the guy that runs our transportation business is a 35-year expert, that's all he has done all his career through a number of companies. He's been with us about 20 years now and has had stellar results. While the industry has performed rather poorly overall. So he's an expert. We have expert claim handlers and this is a good business. You'll see his volume is what will actually vary as opposed to his rates. I mean, he is getting a rate now. But when you hear people talking about getting 25% or 50% rate, they probably need 200%, okay? So we're getting 5% to 10%. And we were profitable to begin with. So we're getting a little extra rate. We're getting new opportunities because of the turmoil in the space. So we like this business and it's performed well for us over time.

Randolph Binner*FBR Capital Markets & Co., Research Division*

That's helpful. And then just one more, just jumping to Property. And I know it's going to be hard for you, all, to answer. But if you look at the model, I mean, there is -- the decrease in gross premiums written in the Property area seems to be kind of moderating and it's coming in roughly around \$50 million a quarter. Is there -- is it possible for us to think of there being a stabilized level of Property? Or are we in a situation where there's so much alternative capacity coming in that it could go a lot lower than this from a premium written perspective? I mean, it's kind of like how low can you go question.

Craig William Kliethermes*President and Chief Operating Officer*

Randy, this is Craig. Certainly, we have a certain amount of business that we probably need to write to stay in the business to be relevant to our brokers. I don't think we have reached that floor yet. And we are -- we do have -- remember a big part of the drop in Property this year is the loss of the crop program. I mean, our premium is down, I think about 6% year-to-date in -- or maybe it is 10 in E&S Property. And mostly, that was rate-driven. So -- I mean, I think we still have probably a little way to go before we get the floor of -- to cover other fixed costs.

Operator

We'll go next to Mark Dwelle.

Mark Alan Dwelle*RBC Capital Markets, LLC, Research Division*

I'll extend my congratulations to Mr. Stone as well. I don't know if Craig will be more perspicacious, but at least I understand him, when he says, we love trucks.

Michael J. Stone*Director*

Thank you, Mark.

Jonathan E. Michael*Chairman and Chief Executive Officer*

I don't even know what that means.

Mark Alan Dwelle*RBC Capital Markets, LLC, Research Division*

The question I wanted to ask first was, you commented on the healthcare facility and the business growth there. Can you just expand on that a little bit in terms of what we're writing and kind of what the expectations are there over time?

Craig William Kliethermes*President and Chief Operating Officer*

Well, we just started -- this is Craig, Mark. We just started this year, getting that up and going. We've grown a little bit and hit on a few accounts. It is a tough market. It is facility-based business, assisted-living type business, as Mike would say -- he used to call those nursing homes. And -- so I mean, we're hoping to grow that business to a relevant size over the next couple of years. And we've got a pretty good track record since [indiscernible].

Mark Alan Dwelle*RBC Capital Markets, LLC, Research Division*

Primarily liability business or . . .

Craig William Kliethermes

President and Chief Operating Officer

Yes, it's all liability business. The E&S liability. So it's all written on an E&S basis.

Mark Alan Dwelle

RBC Capital Markets, LLC, Research Division

All right. That's a business that's definitely been challenging to people in the past. Does there a particular edge you guys have just other than your general skills?

Craig William Kliethermes

President and Chief Operating Officer

Well, we think we're pretty good about picking people to support our business. We think we've got a pretty good person to lead that effort under the guidance of our E&S Casualty leader who has been with us for quite some time.

Mark Alan Dwelle

RBC Capital Markets, LLC, Research Division

Okay, that's good answer. The second question is on the Surety business. This is second straight quarter in a row where the results have been beyond excellent, nearly spectacular. Are there any particular products there that are accounting for kind of the better -- the margin improvement? I know there's been a little bit of rate there and I know there's been a little bit of growth there, but it's kind of more than 10 point improvement over the last year or 2?

Michael J. Stone

Director

This is Mike Stone. Since I'm the Surety head for a few more months, I'll try to answer that. Actually, we've got basically 4 different products there and they all performed well. Obviously, the oil and gas, the energy Surety and what we call commercial Surety have performed very well, not a lot of loss activity. And our contract Surety business, which can be pretty volatile, has performed okay. So when it performs okay and the other businesses perform the way they do, you're going to see pretty good results in that space.

Thomas L. Brown

Chief Financial Officer and Senior Vice President

Mark, It's Tom, I'll just add 2 on the expense side, you've see -- I think I would call a sequential decline in expense ratio as we've seen that kind of consistent modest growth over those 4, Mike just mentioned, the fixed cost, if you will, has remained relatively stable and supported that growth and you will see that quarter-over-quarter decline in the expense ratio as well.

Mark Alan Dwelle

RBC Capital Markets, LLC, Research Division

Okay, that's helpful. Last question, I just -- you guys anticipated some of my question on Maui Jim. So the capital write-down in FX, those were the primary reasons. It wasn't any change in sales trends or anything there that might be notable in terms of thinking ahead?

Jonathan E. Michael

Chairman and Chief Executive Officer

No. This is Jon. No, we're very happy with Maui Jim. Their sales were actually up for the quarter and year-to-date without the FX drag. So, yes.

Operator

We'll go to Jeff Schmitt.

Jeff Schmitt

Good morning. The Property book, the ex loss ratio, ex-CAT, I'm sorry, looks to be quite a bit lower. What -- is that just the crop book coming off? Or what might be driving that?

Craig William Kliethermes
President and Chief Operating Officer

Jeff, this is Craig. I mean it's driven -- As I mentioned, the Marine results have been exceptional over the last, I'll say, a year, but particular this quarter and our RV results have gotten much better than they were last year at this time. Those are the primary drivers of the improvement.

Jeff Schmitt

Yes, okay. And then are you seeing any increased competition from any of the standard writers coming into the E&S space at all?

Craig William Kliethermes
President and Chief Operating Officer

We are always seeing both standard and E&S specialty writers increasing competition at this point in time. So both, yes.

Jeff Schmitt

But there's no sort of pickup in flow from just the. . .

Craig William Kliethermes
President and Chief Operating Officer

I don't see any measurable -- I mean, the competition is tough. So we haven't seen any measurable increase in that but it's been tough for a while now. So it's hard to get top line growth.

Operator

We'll go next to Christopher Campbell [ph].

Unknown Analyst

My first question relates to margins. Do you anticipate that the Property business you're writing, these margins will stay at their current level or will they glide down over time?

Craig William Kliethermes
President and Chief Operating Officer

Christopher, it's Craig Kliethermes. I mean, obviously, without a CAT, the margins look pretty good. If you looked at it on an expected basis for a Catastrophe business, certainly you would expect the loss ratio and expected loss ratio to go up over time. In our Marine business, as I talked about before, we actually still are getting some rate that's holding up pretty close to what we think loss cost trends are. And RV is more of a getting our underwriting right. So we are seeing some improvement there and we're getting significant rate increase in that space. So I mean, overall, you would see -- you have things moving in different directions, I think. CAT obviously on an expected basis, margins would be thinning. But if you don't have a CAT, still looks pretty good. Marine holding steady and RV improving, which is most of it. And then you have the loss of crop, which is booked at a fairly high loss ratio and deservingly so. And that's -- obviously that mix change has improved overall margins and results and loss ratio.

Unknown Analyst

That's helpful. My other question relates to M&A. So you have a very attractively valued stock that could potentially be leveraged for acquisitions. Do any opportunities look particularly eye-catching in the current environment?

Jonathan E. Michael
Chairman and Chief Executive Officer

This is Jon Michael. We're always looking at opportunities, for opportunities and we'll continue to do that. But obviously, we're not going to make any announcements here or in the near future that we can see. Yes, we constantly look for M&A opportunities as we have in the past and we'll continue to do that in the future.

Operator

There are no further questions. I would now like to turn the conference back to Mr. Jonathan Michael.

Jonathan E. Michael

Chairman and Chief Executive Officer

Yes, another good quarter. Thanks for joining us. We had 81 combined for the quarter, modest growth in gross premiums with 5% net written premium growth and our book value is up to \$20.36. There have been headwinds this past 2 or 3 years, but we've really persevered, been able to get through the storm and our underwriters just delivered solid results quarter after quarter and we're pleased with this quarter's results. And I too would like to thank Mike Stone for his nearly 20 years at RLI. I think Michael would tell you or he would point to as he does every morning to me that ever since he has been at RLI, RLI has been below 100 combined every year. So Mike, thanks to you. And we'll miss the multi-syllable words, but I think, Craig, will do just a terrific job in your stead. Mike will still be around. We hope to keep him around for a while. He's going to continue as a board member and we'll probably find some other things for him to do. Thanks, again, and we'll talk to you next quarter.

Operator

Ladies and gentlemen, if you wish to access the replay of this call, you may be doing so by (888) 203-1112, with an ID number of 953563. This does conclude our conference for today. Thank you for your participation, and have a nice day. All parties may now disconnect.

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