S&P Capital IQ

CONTENTS

RLI Corp. NYSE:RLI

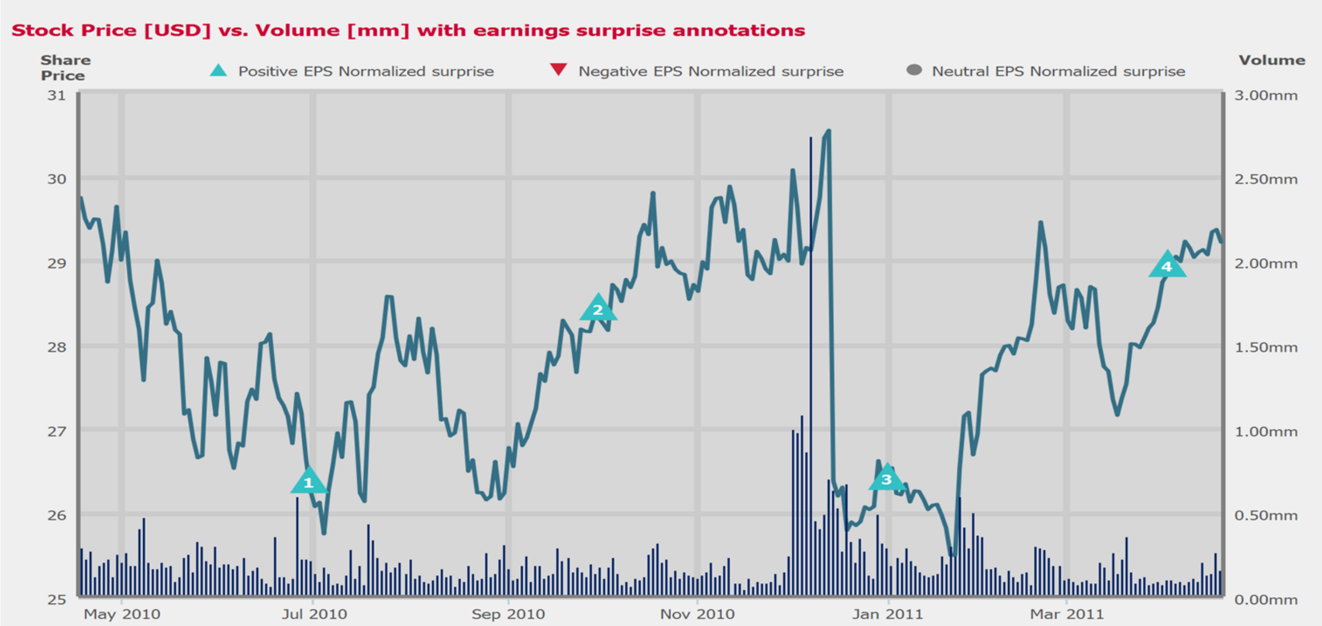
FQ2 2011 Earnings Call Transcripts

Thursday, July 21, 2011 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2011-			-FQ3 2011-	-FY 2011-	-FY 2012-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.53	0.96	▲81.13	0.52	2.47	2.10
Revenue (mm)	141.38	156.06	▲10.38	145.53	570.30	610.67

Currency: USD
Consensus as of Jul-21-2011 2:30 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ2 2010	0.51	0.76	▲1 49.02 %
FQ3 2010	0.48	0.60	▲2 25.00 %
FQ4 2010	0.49	0.83	▲3 69.39 %
FQ1 2011	0.46	0.56	▲4 21.74 %

Call Participants

EXECUTIVES

Aaron H. Jacoby
Vice President of Corporate Development

Jonathan E. Michael
Chairman and Chief Executive Officer

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

Michael J. Stone
Director

ANALYSTS

Adam Klauber
William Blair & Company L.L.C., Research Division

Douglas Robert Mewhirter
RBC Capital Markets, LLC, Research Division

Matthew John Carletti
JMP Securities LLC, Research Division

Michael Fitzgerald Grasher
Piper Jaffray Companies, 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. Second Quarter Earnings Teleconference. At this time, I 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 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 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 second 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 consist 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 Teleconference for the Second Quarter of 2011. Joining me for today's call are Jon Michael, Chairman 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.

The format for the call is as follows. I'll give a brief review of the financial highlights, then Mike Stone will talk about the quarter's operations and then we'll open the call up to questions. Jon Michael will finish up with some closing comments.

Operating income came in at $1.91, up from $1.52 last year. There were, however, a variety of items that impacted these results, positively on balance. First, there was favorable development on prior year's loss reserves of $43 million, which more than offset spring storm losses of $12 million. The favorable development spanned each of our segments which was most pronounced in Casualty. Also of note during the quarter, we closed on our acquisition of CBIC. As a result, our topline increased by $10 million or 2 months worth of premium. With the addition of CBIC, gross premium grew 10%.

Since Michael will provide more detail on underwriting performance, I'll jump ahead quickly to investments. Here, we, like the rest of the industry, continue to be challenged by a low interest-rate environment. There were no material changes to the asset allocation in the quarter, other than the buildup of cash which was temporary as we reposition the CBIC portfolio we acquired to match the profile of our existing investments.

The investment portfolio total return in the quarter was 2%. Through the six months, it was up 3.7%. Add up all the moving pieces and book value per share came in at $41, up 9% from year end. I will now turn the call over to Mike Stone. Mike?

Michael J. Stone
Director

Thanks, Aaron. Good morning, everybody. I think it's a very good quarter. We continue to execute and thrive in this difficult insurance market and soft economic environment. In our Casualty business, our gross written premium was flat for the quarter. Our combined ratio was 54. Our new products, the CBIC packaged policy that we provide to contractors produced some $6 million of premium in the quarter and our professional services product line, the architect and engineers, Professional Liability and now packaged policy provided some growth of some $2.5 million in the quarter.

Our E&S business, our more cyclical businesses, our E&S, GL and Commercial Umbrella business, off some 17% in the quarter of $5 million and our Transportation product are down some 12% or a $1.5 million in the quarter.

Pricing is basically flat in the Casualty lines. I wish it was fat. And as we struggle with the soft insurance market as I have indicated and a difficult economic climate, we're not seeing business growth, and we're not seeing new business opportunities and with everybody fighting for their renewals.

Our management liability business with D&O coverage is a different story. The pricing is up some 15% year-to-date as too much capacity chases way too little demand.

Overall, we're expanding our specialty admitted businesses, our professional services, the packaged policy there and the Professional Liability in our CBIC packages for contractors, while our E&S is shrinking. This is how we're trying to manage through the cycle. And so far I think we are performing very well.

Property, gross written premium is up 15% with the combined ratio of 80%, a pretty good performance in a very difficult environment with quite a bit of catastrophe loss and a version change in the models that we continue to work through.

Our Reinsurance business, was up some 67% or $4 million in the quarter, as we find more opportunity and grow out our footprint in that business. Our E&S Property business is up 3%, about $1 million in the quarter. As I indicated, the version change has helped mitigate the cyclical deterioration in this business.

We did have spring storm losses as mentioned by Erin of some $12 million. These were offset by a takedown on the last remaining Northridge claim of some $6 million. By the way, that's a short tail line of business. We think we're done in that 17 years later.

Our Crop business is up some 35% or $6 million in the quarter. While that business is performing well from a top-line perspective, the profit picture is a little murky with the drought in the Southwest and the tepid moisture in the Midwest and Mississippi Valley, probably driving some issues on the profit side. We don't expect it to be as profitable as last year, but we're still optimistic that it will produce a profit.

Surety, gross written premium up some 26% in the quarter or $5.7 million. CBIC contributed some $4.6 million for that in the quarter. Our contract, our extant RLI business in contract commercial, miscellaneous, oil and gas, grew slightly in the quarter. Surety is still performing well. The combined ratio -- still not seeing any adverse trends from the economic slowdown.

On our CBIC integration is moving according to plan. We began integrating the Surety team enhancing the product mix by offering CBIC products to the RLI agents and vice versa. The property-casualty packaged product has been analyzed. Some enhancements implemented in the product will be offered through the RLI agents in the very near future. Overall, we've seen real upside on the Surety and the packaged products overtime with the integration of this business and being able to offer these products to the RLI agents, we're pleased with the speed and efficiency of the integration thus far.

So that's it, a good quarter. A superior quarter with prior year consideration. We continue to outperform. We believe it's our business model and that's what makes us different. It's our underwriting culture and discipline, underwriter compensation and paying them a percentage of the underwriting profits paid-up over the tail of the particular product. It's a diversified product mix. We shifted from -- in 2005, where we were about 70% Casualty to today, we're 43% Casualty. The shorter tail lines, Property and Surety, they used to be 30%, now they're 57%. And we grow by design. This is how we try to manage through the cycle. Organic growth were warranted, talent acquisitions and acquisitions as they present themselves as opportunities as the CBIC did. So overall, very good quarter, a testament to our underwriters and our business model. And with that, I'll turn it back to Aaron.

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

Question and Answer

Operator

[Operator Instructions] We will go with Randy Binner with FBR Capital Markets.

Randolph Binner
FBR Capital Markets & Co., Research Division

So I thought your comments on Surety were interesting. Obviously, it seems to be a place where you're making a larger allocation of the business and you commented that the results were good. You're not seeing an impact from the economic slowdown and Travelers also saw some favorable contract Surety development in the quarter. So I'd just like to get some color on the comfort level around that versus soft patch in the economy and is Surety, overall, holding up well? Or is it more what you're doing on the underwriting side there?

Michael J. Stone
Director

This is Mike Stone. That's what we're doing in the underwriting side, but we think Surety -- overall Surety industry performance will be pretty good. I don't think we've seen adverse trends that you might expect through this economic downturn. We are very vigilant about this particularly in the contract side and watching that business and how it's performed. We've been through difficult patches and Surety in the past, both through economic times, but also through we think probably we performed not too well on the underwriting side. We've improved our underwriting markedly and I think we are managing through this cycle very well. And I do think as things continue to soften that there's a risk in the commercial Surety side as well. That's where things like Enron came in and provided a very difficult fixture for Surety underwriters in the past. So we're vigilant in that area as well and that's continued to perform probably a little bit better than expected. So overall we like -- obviously we lack Surety business. I think that's a big part of why we acquired CBIC.

Randolph Binner
FBR Capital Markets & Co., Research Division

Okay, just a follow up there, because I think it's interesting just on the contract side. I think -- has the dynamic been a lot of the contractors just were able to build up and maintain cash reserves across the economic patch better than they did last cycle? Because, again, intuitively, it just seems like it would be more of an issue and it's not. So I just want to flesh that out a little bit more, and then I'll drop back in the queue.

Michael J. Stone
Director

Actually, I think at least from our business standpoint, overall, I guess the rest of the Surety are experiencing fairly favorable results, as what you say is probably correct. But certainly we've done a better job in making sure that the contractors that we have are -- that we provide us are more financially secure. We do a better underwriting from the standpoint of the technical aspects and making sure where their cash reserves are and how well they're managed. So at least our contractors have come through this, not without exception, but all in all in pretty good shape. And there's not so much room for air in Surety. It doesn't take many losses to turn what's actually what you think is a pretty good result into a not so good result.

Operator

We'll go next to Mike Grasher with Piper Jaffray.

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

The -- a few questions here. I guess around the property losses and CAT-exposed property. Is that resulted in any change in sort of your expectation or anticipation on exposure and likelihood of driving through more rate?

Michael J. Stone
Director

Mike, this is Mike Stone. I think it's going to drive more rate. It doesn't look like that is really happening. We're getting a little bit of rate in the Wind business, actually a better rate deterioration on the DIC business. A lot of the storms, certainly the storms that we experienced, the spring storms that are little less acceptable to modeling. Certainly, the RMS subversion change has, I think, buoyed rates a bit, maybe not as much as we first anticipated as people kind of try to figure out how to manage through that. So, all in all, I think, we've done a deep analytical look at our CAT business and we do that on a very regular basis and feel comfortable with our exposures and how they're being managed. So we don't look at it just on a model basis, but we always look at it on an actual exposure basis and how much we have in various zones and how we manage that. So, all-in-all, I think we're comfortable with our Catastrophe business and exposure and also I think rates, again, without some event, I'm not real optimistic that rates will move north.

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

Okay. Fair enough. And then just around Casualty, I think you mentioned that pretty much flat here with the competition. Is it -- the competition more standard lines or standard carriers coming in and then is it more pricing or is it terms and conditions that maybe they're offering?

Michael J. Stone
Director

This is Mike Stone. Certainly, there's no want of competition. And the standardized companies are obviously moving into the, what was the surplus lines space in the hard market and just by the sheer dint of being an admitted product, their terms and conditions are more expensive than what were people to provide and the circles lines carrier. What we can provide is a surplus lines carrier. But there's certainly plenty of competition from the surplus lines company as well. I think what you see in our Casualty business is we are fighting for our renewals and are working hard to keep them and there's just not a whole lot of new business out there circulating for our underwriters.

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

And did you mention what it was on the renewals that you're seeing? I mean are you getting pushback for single-digit rate increases? Are you being able to drive through the single-digit rate increases?

Michael J. Stone
Director

It's basically flat. It's been basically flat for the last couple of quarters. 5 points here, 5 points there. Depends on what the renewal is. It depends on the quality individual opening on an aggregate basis [indiscernible].

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

Okay. And then final question would just be around the CBIC business. Is there anyway we can gain some perspective on the products? The Surety product and then the CMP, how maybe they're different than what you're existing product line up looked like and what it means for the RLI agent force?

Michael J. Stone
Director

Well again, it's Mike Stone. On the Surety side, they really operated in a smaller contractors and they have some products that are very marketable to smaller contractors. And I think an FDA product, a product that went to contractors that were doing $500,000 to $1 million single aggregate jobs that fairly small contractors that we're not really as good at. So we want to be able to offer those products into our agency force and we're going to be able to offer a larger limit product to the CBIC agents. So there's really opportunity both ways. And on the packaged policy, we don't have a packaged policy in the contractor space. So this provides an opportunity for us to roll out the packaged policy to our Surety agents and we have a significantly larger number of contract bonds than to CBIC. So as we roll this out to additional geographies, we expect to gain some traction with that product.

Michael Fitzgerald Grasher
Piper Jaffray Companies, Research Division

Okay, that's very helpful. Any -- be taking a stab at sort of what you're projecting for the cross-sell opportunity here with regard to the package product?

Michael J. Stone
Director

We see significant opportunity. As we go from, in the new states, we'll talk on what we think our opportunities are going to be. But right now, an overall basis we're trying to get the product enhancements in place, and talk to our production sources, our agency groups and get a sense of where we're headed. So it's a little early for that.

Operator

We'll go next to Matt Carletti with JMP.

Matthew John Carletti
JMP Securities LLC, Research Division

Just a couple of questions. One is on the casualty reserve releases in the quarter. Can you give a little more color? I mean you guys have had strong releases for a while, but the level we saw in the quarter even for you guys was something we haven't seen in several years. Is there anything unique in the quarter either we're looking at different accident years or kind of a one-time item that popped it up?

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

Matt, this is Joe Dondanville. The casualty releases really took place in the '01 to '03 and '05 to '09 years, with a large portion being closer to that '09 year, where we had reacted pretty conservatively on some habitational problems that we saw in the GL book. And after a couple of years of evaluating it, we have made some revisions down on those losses.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay, that's very helpful.

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

So on the other Casualty lines, we've seen favorable development, pretty much across the board. Loss trends continue to be favorable.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay. And then can you -- do you have the accident year loss pick for Q1 and Q2 handy? I mean I can back off the development, but I know the profit contingent is kind of an expense item that gets in the number you report, so do have the actual -- just the loss pick handy for Casualty?

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

It's around 70 and it would be very consistent between the first and second quarter.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay and then last question is on just the Crop business. I know Mike commented on this year's view. If I recall that was kind of a couple-year quarter share you entered into, and I think coming up for renewal sometime in the near intermediate future. How pleased have you been with that, kind of entering into that line? Is that something we're likely to see renew or something that didn't live up to expectations?

Michael J. Stone
Director

Well, we're in discussions on renewal now obviously, when you go through a little bit more of this crop year, but we think it's a good business long term so we'll continue to work on managing that relationship and we look at other opportunities as they come along on providence as well.

Operator

We'll take our next question from Rash Sulemani [ph] with Stifel Nicolaus.

Unknown Analyst

Just a couple of quick questions. One is on the expense ratio. I just wanted to make sure -- it had gone up a little higher than we had expected. Is that more related to bonus accruals or perhaps just the CBIC transaction or -- just want to get a little bit more color on that, please?

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

And this is Joe Dondanville. It's both. The CBIC acquisition contributed $1.6 million of that increase for their home office expenses and the other portion, $2.1 million is bonus and profit-sharing related.

Analyst

Okay. And then just the next question. I saw that your equity allocation had gone down a little bit this quarter. I just wanted to see is 20% still your long-term target or has that strategy changed at all?

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

No, that strategy has not changed and in part it's the consolidation of the CBIC portfolio that helped, or contributed to that allocation going down. We will be looking at that CBIC portfolio over the next several months to reposition it to match what we're doing in our other lines.

Operator

We'll go next to Doug Mewhirter with RBC Capital Markets.

Douglas Robert Mewhirter
RBC Capital Markets, LLC, Research Division

Looking at your Casualty line, assuming if you back out some of the CBIC contribution, it looks like there's a slight downtick in the organic growth, which has sort of been the norm for the past 5 years or so, it isn't anything unusual. You said prices were flat. Does that imply that you're still, I guess, booking on a written basis, at least, a downward trend in exposure units? Or is there so much business mix shifting around that it's hard to look at it that way, looking from an economic perspective?

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

This is Joe Dondanville. Line by line, there are certain lines like GL in which our exposure units are going down. They continue to go down. And then we have other lines, new product lines like the architects and engineers design program. Those are actually going up, so but because GL has been our largest line, the impact on the economy on that line still is lingering and it has had a bigger impact on overall direction of the book of business. But units is -- exposure units are going down. We are seeing the increase. It's not a significant rate change that's driving that number.

Douglas Robert Mewhirter
RBC Capital Markets, LLC, Research Division

And I just had a question about your Ag business. Could you go over again the seasonality with the business. I know that you book a large portion of your premiums sort of in the mid-year, but then they earn out in a specific time as well. And also is there a point in time where you have to, I guess, true up the pricing volume and maybe make a reserve adjustment associated with those contracts?

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

This is Joe Dondanville again. On the Crop, about 80% of the Crop premium -- written premium books in the second quarter and the season is typically in starting in April, late April, May through October and November through the whole growing season, primarily for corn and beans are the 2 biggest drivers there. As the Ag puts out estimates, we react on those estimates on yield and then monitoring price that drives any changes that we see. But at this point, the drought effect and some late planting effect has caused us to book Crop at a slightly higher than their average, their historical average. And I think just recently, we received the final Crop numbers for 2010 Crop years, so it pretty much flushes itself out within a one-year period.

Operator

[Operator Instructions] We'll go next to Adam Klauber with William Blair.

Adam Klauber
William Blair & Company L.L.C., Research Division

Could we maybe get some more color on the reserve -- favorable reserve development? How big a factor was that -- the release in the habitational, which says more than 1/3 of the release, say?

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

It's probably in that third ballpark. It's one of the largest pieces.

Adam Klauber
William Blair & Company L.L.C., Research Division

Okay, okay. And then, just from that, it sounds like you're seeing pretty good development in more recent years. Does that account for also someone to step up in favorable reserve releases?

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

Well, we do have development going back in 2001 and 2004 in the Casualty as well. So it's not all the most recent years, but 2006 through 2009 are also seeing some favorable developments as well. So it's kind of across the board in all years and the loss trends have been favorable.

Adam Klauber
William Blair & Company L.L.C., Research Division

Okay, and just from a process standpoint,

being midyear, did you do more of a significant review? I mean you obviously look at them on a quarterly basis, but did you do a bit more midyear review on them?

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

Well, our processes to do a detailed review starting in the second quarter, third and fourth and we do not do a detailed review in the first quarter.

Adam Klauber
William Blair & Company L.L.C., Research Division

Okay, okay. So that helps out. And then on the property which you've talked about a bit. Could you be more specific where the growth opportunities in the property area are?

Michael J. Stone
Director

It's Mike Stone. We certainly grew our ROI re-business and we see opportunity as we build out that footprint there. Marine was up and certainly the Crop business is up.

Adam Klauber
William Blair & Company L.L.C., Research Division

And is the re-business, is that more domestic or international?

Michael J. Stone
Director

No, it's domestic.

Adam Klauber
William Blair & Company L.L.C., Research Division

Okay. And do you see those opportunities in the re and marine continuing, going forward?

Michael J. Stone
Director

Yes, I think our Reinsurance business has some legs. It's got some opportunities to grow. We're fairly small. We're going to continue to be small overall, but we're going to be a specialty player. So there's some opportunity there. Marine, we've spent a lot of time fixing the underwriting on that business. And we think we're getting there, so a modest amount of growth as we move forward and certainly we need a change in the market for us to see real more significant growth.

Operator

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

Jonathan E. Michael
Chairman and Chief Executive Officer

Thank you, and thank you all for joining us this morning. It was a great quarter with the reserve release, as Mike indicated and a very, very good quarter even without that release.

Premiums were up 10% underwriting income, $46 million, combined ratio, 65% and it was 89% without the reserve development. Book value was up nearly 9% since year-end. The CBIC acquisition was completed and integration is proceeding smoothly. We continue to be well-capitalized and we're prepared to be opportunistic as the market allows. We had a good quarter and we thank you for joining us and we'll talk to you next quarter. Thank you.

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 543-6380. This concludes our conference for today. Thank you all for participating and have a nice day. All parties, you may now disconnect.