S&P Capital IQ

CONTENTS

RLI Corp. NYSE:RLI

FQ2 2014 Earnings Call Transcripts

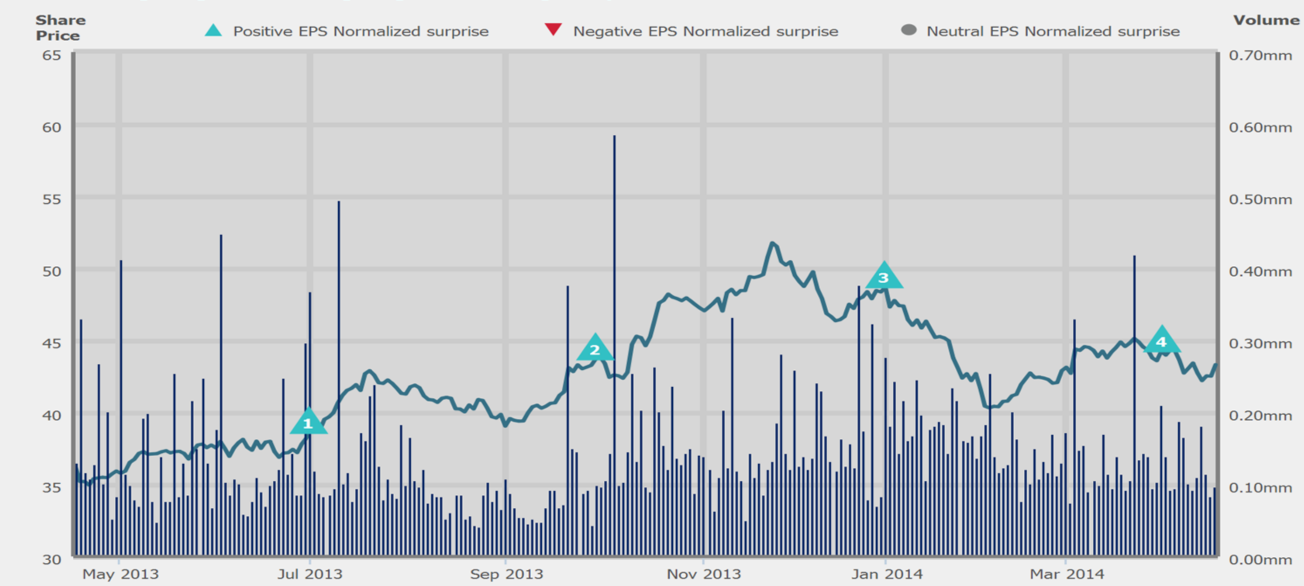
Thursday, July 17, 2014 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2014-			-FQ3 2014-	-FY 2014-	-FY 2015-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.60	0.66	▲10.00	0.57	2.35	2.34
Revenue (mm)	183.54	193.02	▲5.17	189.16	744.80	784.39

Currency: USD
Consensus as of Jul-17-2014 6:30 AM GMT

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



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2013	0.58	0.64	▲1 10.34 %
FQ3 2013	0.50	0.70	▲2 40.00 %
FQ4 2013	0.51	0.72	▲3 41.18 %
FQ1 2014	0.52	0.57	▲4 9.62 %

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

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

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

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Presentation

Operator

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

Before we get started, let me remind everyone that through the course of the teleconference, RLI management may make comments that reflect their intentions, beliefs and expectations for the future. As always, these forward-looking statements are subject to certain risk factors, which could cause actual results to differ materially. These risk factors are listed in the company's various SEC filings, including in the annual Form 10-K, which should be reviewed carefully. The company has filed a Form 8-K with the Securities and Exchange Commission that contains the press release announcing 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, and good morning to everyone. Welcome to the RLI earnings call for second quarter of 2014. Joining me on today's call are Jon Michael, Chairman and CEO; Mike Stone, President and Chief Operating Officer; Tom Brown, Vice President and Chief Financial Officer; and Craig Kliethermes, Executive Vice President, Operations.

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

Thomas L. Brown
Chief Financial Officer and Senior Vice President

Thanks, Aaron. Good morning. Thank you for joining us today. We are pleased to announce another solid earnings quarter on the strength of both underwriting and investment results.

Starting with our most important metric, we posted an 84 combined ratio in the quarter, which is consistent with what we achieved in the second quarter last year. Profits were strong across each segment with Casualty at an 83, Property at a 95 and Surety at a 69 combined ratio. Reserve releases benefited both the Casualty and Surety segments. Property had a $6.8 million of spring storm-related losses, lower than last year's second quarter, but in line with our expectations given the weather events during the quarter. Ultimately, this quarter was a testament to our underwriting discipline.

On the premium side. Gross premium was up 3% and net premium was up 4%. Our casualty products continue to offer the best relative growth opportunities, a function of both market conditions and recent initiatives. Property and Surety were up to flat in the quarter, which we consider a good result in light of continued challenging competitive conditions that Mike and Craig will elaborate on.

Turning to investments. There were several positive trends in the quarter, including the 8.8% growth in investment income, our second consecutive quarter of such growth. In addition, both fixed income and equity portfolios turned in positive total returns enabling a combined portfolio of total return of 3% for the quarter and 5.8% year-to-date.

Not to be left out, Maui Jim also had an excellent results in the quarter, contributing $5.7 million of investment -- investee earnings up 24% from last year. Ultimately, the combination of underwriting and investment results drove operating earnings per share of $0.66, up 5% from last year, and book value per share growth of 4.9% in the quarter, bringing year-to-date book value growth to 11%.

I'll now turn over the discussion to Mike Stone. Mike?

Michael J. Stone
Director

Thanks, Tom. I'm going to talk a little bit about the insurance market and what we're seeing. First, another outstanding underwriting quarter with an 84 combined ratio. Gross written premium up 3%, net up 4%. You might think more the same, boring, but I assure you, this doesn't result without hard work, skillful underwriting and superior claim handling.

The market. It's tough out there, but we continue to find new opportunities and have been able to effectively manage our renewal books. Casualty, 82 combined ratio with gross written premium up 7% in the quarter or 8% year-to-date. Still some good pockets of opportunity. Our GL, or general liability, that's our primary liability surplus lines of book was up 2% as we are still getting a better rate in some subparts, and are benefiting from increased construction activity. Transportation was up 5% gross written premium as we continue to see more opportunities due to the exit by a number of our competitors late last year.

And our professional services group products -- basically our architects and engineers, gross written premium up about 15% as we build out our footprint in this space, and I might add that we eked out a small underwriting profit this quarter.

And the package business that we've been building to augment professional liability and contractors was up about 20% in the quarter. We expect that to continue to grow as we build out this business. All in all, Casualty is still a positive story.

Property, a different matter. Can't read a trade publication without some mention of alternative capital and what it's doing in the space, especially the CAT space. But, and I emphasize but, we have an excellent reputation, deep relationships with producers and most importantly, superior underwriting and claim talent, and we will continue to perform well in this tough environment.

Our DIC business of gross written premium down 8%, but we're still making our margins, and we are well within our exposure tolerances. We have a long-term presence in this space, and we will continue to maintain the business here even as we reduce our exposures with the rates coming down and premium being tough.

Our fire-wind business, down 3% gross written premium, again, making our margins and well within our exposure tolerances. I won't say we're waiting for an event, but we are well prepared to manage following one.

In Marine, gross written premium down 14% as we complete our reunderwriting of this book. We believe we have this business on the right track and are prepared to grow it, if the market will cooperate.

Surety business. Competition intensifies, and I'll say but again, we continue to perform very well with the 69 combined ratio with gross written premium being flat. We have a well-diversified product mix, good geographic spread with deep underwriting talent and producer relationships. We will continue to slug it out in this space. I'll say it again, as I have in the past, as new competitors enter the surety space, it's really not that easy. We have deep underwriting skills, superior technology and produce the relationships built over the past quarter century. We'll still be in this place thriving when others run away, not unlike the Transportation business.

So overall, excellent underwriting quarter, a testament to all of our associates. And I would like to thank each and every one of them for their effort and performance. This does not get ho-hum to me.

Now Craig will talk about rates, crop, that's with an O, and reinsurance.

Craig William Kliethermes
President and Chief Operating Officer

Thank you, Mike. First on the pricing front. I think we would view pricing overall as it's -- we've seen some plateauing and an increasing -- increasingly competitive market. Driven mainly, we believe by benign loss trends, a lack of shock losses and cheaper capital that's available to us and also competing with us. We could have bucket-ized or bucket our pricing into a couple groups. We still have some spots that are strong, but slowing a bit in our umbrella space, transportation, auto, in general, is still -- the pricing is pretty good. And our Marine business, we continue to get mid-single digit price increases.

In a more moderate group, our package businesses, our fire non-CAT businesses and our personal, especially, personal line businesses flat, but at least covering trend, loss trends. So we're still pretty positive about those.

And then there's a group we call the weakening group, which is some of the E&S space on the casualty, particularly; the D&O space on an excess side. And our medical professionals, we're starting to fill that as we are running through renewals now. We're seeing some decreases run through that business that we bought, and particularly, as Mike mentioned in the CAT space, that is becoming increasingly competitive.

On the reinsurance front, which does tie in here obviously, we placed 3 treaties during the year -- or during this quarter. It's about -- makes about 25% of the placements from a premium perspective during the year. That covers our marine, our D&O and our earthquake DIC treaties. We were fortunate to receive about a 15% to 20% exposure adjusted rate decrease on those treaties. So we're the benefactor of that. Although we are concerned -- increasingly concerned about the spillover effect as people will be. Our competitors seem to be willing to give back that fairly quickly, and we'd rather hold onto that for as long as we could. We did receive better terms we would say across-the-board in addition to the rate decreases in regards to we were able to buy down our retention on our Marine business covering CAT. We have a little more coverage, but still less premium. So we feel pretty good about that result. You can see in our numbers, also, the net written premium continues to grow at a little bit faster pace than our gross written premium, mainly because of some of the restructuring we've done in our reinsurance treaties over the last couple of years, as well as the benefit of the rate decreases that we've received.

Mike had asked me to talk a little bit about crop. Crop is -- there's not a lot to say at this point in the year. Premium is down a little bit in crop, 4%, 5% on a gross basis. That's mainly driven by crop prices are down. As you probably noticed, also the government has decided to lower rates again. So the rates the farmer pays relative to that price is down. Although offsetting that somewhat is farmers -- we've seen the trend the farmers are actually buying up more coverage since they're saving, much like you're seeing cedents do on the reinsurance side. They're buying -- they're spending about close to the same amount of money, but they're just buying down their deductible some.

Weather looks good so far. Hail, there's been a little bit of hail activity this year, which has led to the -- in line with the past years on the hail. But certainly the weather looks good for the main and PCI business, and crops are growing well. Of course, we still need heat and rain.

So finally, just on other new products, Mike mentioned that a bit. Our professional liability business, our CBIC acquisition and integration, the prime business that we acquired -- security guards, RV, environmental, all these things are businesses that we've invested in recently in the last 3 to 5 years. We're seeing very good traction in that business and seeing a lot of growth coming from that over time.

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

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

Question and Answer

Operator

[Operator Instructions] And we will take the first question from Arash Soleimani.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

I just had a couple quick questions. First, I know obviously, reinsurance capacity has been impacting primary property rates, but to what extent? You sort of touched on this, but to what extent do you expect it to spill over into casualty and start impacting pricing there?

Michael J. Stone
Director

This is Mike Stone. I'll give it a try. I think it probably will at some point in time. I think it really depends on the performance in the property side. A big event might slow things down quite a bit. So I think it's a little early to make any accurate prediction in that space. I think it really will depend on how things perform over the next probably 18 months. And if it performs well, I would suspect we'll see some entry there. It's a lot more difficult. It takes more than a model and somebody pushing the button to evaluate casualty risks, and it's long tail. They don't tend to be a long tail from the standpoint of returns. So it will be a bit more difficult. But like I said, I think, if their performance turns out to be pretty good, then we'll probably see some of them try it. But it's a little early.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. That's helpful. And I know it's still early for this, too, but I just wanted to see if you had any preliminary thoughts on your willingness at year end to continue your special dividends?

Jonathan E. Michael
Chairman and Chief Executive Officer

Yes, we'll evaluate that. We continually evaluate that and we'll evaluate it before the end of the year. Today, it's too early.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

And lastly, was there anything in particular that drove Maui Jim's strong performance or...

Jonathan E. Michael
Chairman and Chief Executive Officer

Maui Jim continues to perform well. Their sales are up nicely. Margins have improved for Maui Jim, and it's showing up in the earnings.

Operator

[Operator Instructions] We'll go next to Scott Heleniak.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Just had a couple quick questions. First is on casualty. Just wondering what -- how much more runway you think you have for growth there and some of the lines that you guys have been growing in nicely over the past couple of quarters. Do you kind of expect that to continue? Or do you see some of the competition you're talking about kind of spilling over to casualty into the second half of '14 and into '15?

Craig William Kliethermes

President and Chief Operating Officer

This is Craig, Scott. I think we continue to expect to see momentum. We've seen momentum in that space for the last, at least over the last 2 years. That's where a lot of our smaller investments, I guess, have been in businesses, but we tend to like to grow things a little slowly and make sure -- gain confidence over time that we're doing it particularly in this market because it's challenging. But I think, we'll continue to see growth there because we're continuing to expand relationships with producers in geographic areas. So I think you'll continue to see that.

Michael J. Stone
Director

And this is Mike Stone, I'll just augment that we -- our package business that we spent a lot of time, made a lot of investment on. We've finally got that completed in all 50 states, so we're up and running. So we would expect some momentum there. But like Craig said, it's not going to be rapid growth. It's going to be a moderate controlled. So -- but we like those new businesses.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Okay. And then just had a quick question too about the property premiums which were pretty much flat to down a little bit in the quarter. I know they've been weak over the past 2 or 3 quarters, and obviously, pricing is under pressure there. So just wondering what -- where you saw the opportunities or why we didn't see a bigger decline there or if you can touch on the premium trends there.

Craig William Kliethermes
President and Chief Operating Officer

Scott, this is Craig. Our RV business that we have invested, especially personal space, that's really built momentum. Then, actually, we've taken even rate increases in that space recently. So almost all the property growth is coming out of that investment. And they offset some of the declines in some other spaces.

Scott Gregory Heleniak
RBC Capital Markets, LLC, Research Division

Okay. And I just had one more question on -- just on the investment income side. Investment income has been up sort of, I think, first quarter was up 5% this quarter, up 9%. And is there anything that's driving that just beyond higher-invested asset balances? Are you getting any benefit from any dividends and portfolio or anything else that we should be thinking of?

Thomas L. Brown
Chief Financial Officer and Senior Vice President

Maybe I'll touch on your last question first on the dividend. Nothing is distinguished in the dividend space, I think it's -- the primary driver is they're up about $90 million since year end on the investment portfolio. And we are seeing reinvestment rates approximately where we were on our book yield, a little over 3%. So we're moderating there as I think the market cycle has stabilized a bit. And we have made a little bit of a push into some maybe perhaps higher yield, but a very modest amount allocated to that sector.

Operator

We'll go next to Ken Billingsley.

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

I wanted to follow-up on the Property business. On the accident year loss ratio improved pretty dramatically year-over-year. And given where rates have been, is that all rate-driven? Or can you talk about maybe what is driving that big improvement?

Craig William Kliethermes
President and Chief Operating Officer

This is Craig, Ken. I think most of that would be driven by mix.

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

The mix, you said. So where are you seeing specifically more growth or where are you paring down versus another area?

Craig William Kliethermes
President and Chief Operating Officer

On the property side, our RV businesses is -- continues to grow, as I mentioned. And our Marine space has continued to shrink, which has had a higher loss ratio, historically. So you've kind of got both of things moving in the opposite direction. So that you can imagine how that mix might have pretty big impact.

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

Okay. And then on a -- kind of a follow-up on opportunities. I know there was a focus just on the property side. We talked about RV in the last question. Given where rates are and where reinsurance is likely to be for the next, say, 18 to 24 months, or are there any lines of business either that you are currently active in or looking at, that you think might have an opportunity in general for the market given where pricing is -- or reinsurance opportunities may exist?

Michael J. Stone
Director

Ken, this is Mike Stone. You're talking in the property space?

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

Anywhere, just any opportunities for RLI, in general, like where do you -- I mean, looking at your capital that you have to deploy that capital, where do you guys see yourself moving or...

Michael J. Stone
Director

Well, again, I think the Casualty business continues to be a positive story. We have a lot of our new opportunities around the casualty space that we would expect to grow out over the next 12 to 24 months. And our E&S business continues to perform well. There's pockets of opportunities there that some underserved areas that we are -- I don't like the word exploiting, we are thinking optimizing, if you will. And we see other products, I mean, we've entered into some health care space. And we would expect to grow that out over time, that's a casualty product. So we think Casualty is -- will continue to perform and continue to provide opportunities. And you never know in property. Property is a much more volatile. Subject to much more volatility. I mean, an event, I don't think one relative event will change things markedly, but it might put a halt to the slide. It might change the appetite of some alternative capital. So 12 to 24 months, a lot of things can happen in that space. Same thing in Surety. And all of a sudden you can see some surety losses that will change the underwriting appetite and the ardor of some of these new entrants.

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

Just to clarify, I thought maybe I wrote this wrong down that Craig had said that one of the weakening groups was E&S space, but you're saying that you're seeing some opportunities?

Michael J. Stone

Director

Well, yes, it is. And just let me clarify, so that we're -- Craig and I are saying the same thing. All I'm saying is there's pockets of opportunity. So we're seeing opportunities in some areas where we are getting some rates. So for example, the OL&T space, commercial umbrella in certain areas. Overall, it's trending a little negative, but there's pockets of opportunities. If those opportunities expand and we see some likelihood that they might, then things will look up. Again, the E&S space is also subject to a little bit more volatility, more new entrants, people exiting, people get in trouble. We saw that in 2013. So I would suspect that you might see some more of that as time goes on.

Operator

[Operator Instructions] And if there are no further questions, I'll now turn the conference back to Mr. Jonathan Michael.

Jonathan E. Michael
Chairman and Chief Executive Officer

Thank you. Thanks very much. A good quarter, good earnings. Premiums earned were up over 9% for the quarter, a little bit more than that year-to-date nearly 10% revenue sub-13%. Our book value increased year-to-date, 11%. So a very good first half for us. The market, as we mentioned -- had new capital in the market, reflective of the reinsurance pricing decreases that we've seen the last 18 months really and that continues. So -- but on the positive side, we do have new products that are helping to offset some of the competition that we're seeing, especially in the E&S space and others. So thanks very much for attending and we look forward to talking to you next quarter. Bye.

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 2222171. This concludes our conference for today. Thank you for participating and have a nice day. All parties may now disconnect.