

# RLI Corp. NYSE:RLI

## FQ2 2010 Earnings Call Transcripts

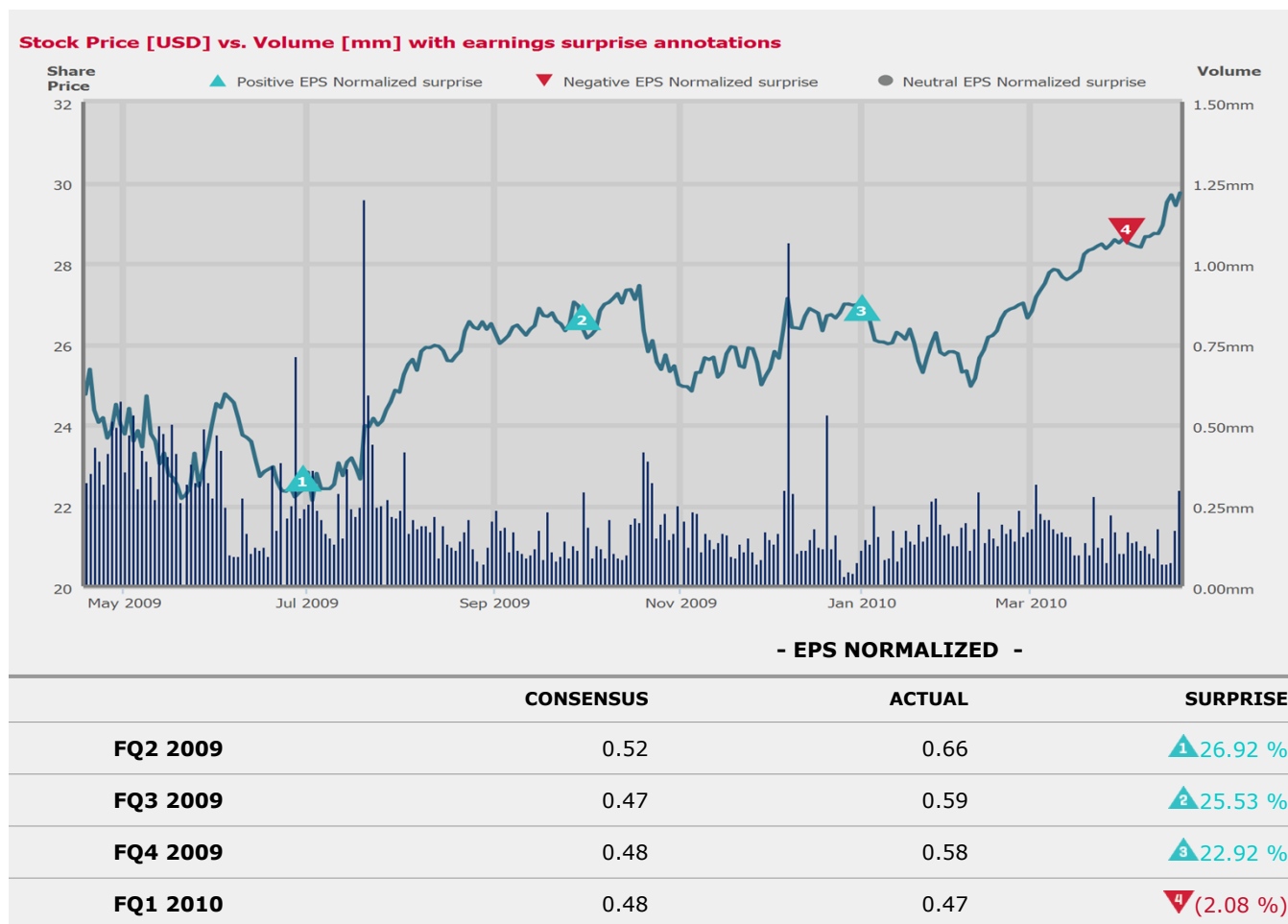
Tuesday, July 20, 2010 3:00 PM GMT

### S&P Capital IQ Estimates

	-FQ2 2010-			-FQ3 2010-	-FY 2010-	-FY 2011-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
<b>EPS Normalized</b>	0.51	0.76	▲49.02	0.45	2.04	1.91
<b>Revenue (mm)</b>	133.22	142.81	▲7.20	136.20	547.18	559.15

Currency: USD

Consensus as of Jul-20-2010 1:09 PM GMT



# Call Participants

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## EXECUTIVES

**John E. Robison**

*Former Chief Investment Officer  
and Treasurer*

**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

**Bijan Moazami**

*FBR Capital Markets & Co.,  
Research Division*

**Michael Steven Nannizzi**

*Oppenheimer & Co. Inc., Research  
Division*

**Caroline Steers**

*Macquarie Research*

**Dean Evans**

*Keefe, Bruyette, & Woods, Inc.,  
Research Division*

**Elizabeth C. Malone**

*Wunderlich Securities Inc.,  
Research Division*

**Matthew John Carletti**

*JMP Securities LLC, Research  
Division*

**Meyer Shields**

*Stifel, Nicolaus & Company,  
Incorporated, Research Division*

**Michael Fitzgerald Grasher**

*Piper Jaffray Companies, Research  
Division*

# Presentation

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## Operator

Good morning, and welcome, ladies and gentlemen, to the RLI Corp. Second Quarter Earnings Teleconference Call. [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 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 first quarter results.

RLI management may make referencing during the conference 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 realization investment gains or losses. RLI management believes their measure is useful in gauging core operating performance across reports periods but may not be comparable to the 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](http://www.rlicorp.com). 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 and Chief Investment Officer, Mr. John Robison. Please go ahead, sir.

## John E. Robison

*Former Chief Investment Officer and Treasurer*

Thank you, and good morning to everyone. Welcome to the RLI Earnings Teleconference for the Second Quarter of 2010. 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.

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

Our second quarter operating earnings were \$1.52 per share. Included in this quarter's earnings are \$19 million in pretax favorable development in prior year's loss reserves. The favorable development came from our Casualty and Surety books of business.

The combined ratio for the second quarter was 74.7%. Gross written premiums were up 7% for the quarter and flat through the first six months of the year. We were able to effectively offset the premium declines in our Casualty line, which are sensitive to economic conditions in the building and transportation industries with our crop and other assumed property reinsurance risks. Comprehensive earnings were \$23.2 million for the quarter. Through six months, our book value per share has grown nearly 5% to \$41.02.

Turning to the investment portfolio. As of June 30, our overall allocation was 79% in fixed-income securities, 15% in equities and 6% in short-term money market-type investments. The total return on the investment portfolio was 0.4% for the quarter. Our total return in the bond portfolio was 2.7% while equities were down 10.8%. Year-to-date, our total return in the portfolio is nearly 3%.

Investment income was \$16.8 million for the quarter, up slightly versus the same period last year. During the second quarter, the capital markets experienced increased volatility and a slight to quality as a result

of the financial crisis in Europe. With low inflation, a slower growing economy and financial troubles in Europe, the yield curve is beginning to flatten, making long treasury the best performing nature asset class year-to-date.

Equities lost ground in the second quarter as investors weigh the impact of high unemployment, a lackluster real estate construction recovery and the ability and desire of the consumer to actually spend. So what have we done? We have reduced our overall municipal exposures due to budget shortfall concerns and redeployed those assets into fixed income sectors while keeping duration low and credit quality high.

Compared to this time last year, our overall muni [municipal] portfolio is down from \$464 million in the second quarter of 2009 to \$297 million at the end of this quarter. While this increases our effective tax rate, we believe state local governments are fiscally strained, and this sector will be under pressure as budgetary shortfalls are tested.

Second quarter saw inflation levels fall to the lowest levels in 44 years. Deflation is once again a concern. With historically high unemployment rates, we look for continued contraction and the willingness and ability of the consumer to actually spend money. Unlike previous recessions, housing and construction has not been able to recover to help lift economic growth. We believe the economy will grow slower over the next several years hampered by debt, taxes and regulation.

While we recognize the near term will bring more volatility in the equity markets, we believe over the long run, equities will outperform bonds, and our asset allocation will help us effectively grow book value while supporting insurance operations. The tax equivalent book yields on our fixed income portfolio is approximately 5.1%, and our book yield on our equity portfolio is 4%. No change from the first quarter. In addition, the portfolio quality remains AA, and the duration is currently 3.5. Finally, we had no securities that were deemed OTTI for the quarter.

Turning to share repurchase. During the quarter, we repurchased roughly 190,000 shares at an average cost of \$55.78. Over the last three years, we have returned over \$250 million in capital to shareholders in the form of dividends and share repurchases. As we have said many times, our first choice is to deploy capital to create shareholder value. When we do not see opportunities to effectively use our excess capital, we return it to shareholders. We have roughly \$96 million remaining on our remaining on our current share buyback authorization.

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

### **Michael J. Stone**

*Director*

Thanks, John, and good morning, everybody. We continue to deliver excellent results in a difficult insurance market and soft economy. This is a real testament to the quality and discipline of our underwriters and to our business model, a model focused on a diverse set of niche products that can be underwritten to a profit. As an underwriting company, delivering underwriting profit is paramount for our success.

We were also able to increase our gross written premium in the quarter by 7%, again through our development of new product lines, as John mentioned, the crop, assumed reinsurance and expansion of existing products, our Surety products in particular. These more than offset the continued decay in the Casualty space, where we see our E&S [excess and surplus] and specialty products attacked by competition of all forms, most especially by the standard markets. Pricing in the marketplace continues with moderate decreases overall.

Now kind of talk a little bit about our segments. In Casualty, our gross written premium was down 9% for the quarter, 11% for the year. Our rates are off about 1% for the quarter and 4% for the year, so a little bit of a moderation there with our combined ratio coming in at 76%. Price levels continue to be challenging with continued encroachment from the embedded markets who offer broader coverage at lower prices. Transportation, the industry canary, I'm afraid, continues to soften with rates off 3% in the quarter, and our volume was off 18% in the quarter and 16% in the year as we continue to show discipline.

Somewhat balancing these declines, our design professional product, which is up over 100% for the quarter and 180% for the year as we build out that product. We expect to extend the professional product by adding packaged products for this class in late this year.

Our personal umbrella product, the stand-alone personal umbrella product, continues to perform nicely in a tough economy, where people are buying less limit or dropping coverage altogether. Gross written premium was flat in that line but continues to be nicely profitable. We continue to evaluate new products and new underwriting teams as we believe diversifying our portfolio will ameliorate the difficulties of the soft market and the weak economy.

In the Property segment, gross written premium was up 29% for the quarter, 19% for the year, mostly driven by the crop reinsurance business. Combined ratio came in at 78%. Our E&S Property business gross written premium was flat for the quarter as we continue to manage our exposures and our returns.

Our Property Facultative unit was up some 61% in the quarter as we continue to build out that business. And in our Marine business, we continue to re-underwrite, specifically, the hull and P&I [Protection and Indemnity] space and premiums there of some 16% in the quarter.

In the Surety segment, gross written premium up 4% in the quarter, 5% year-to-date, gross driven by our Commercial Contract and Energy segments, we continue to see good experience and have not seen any sign of adverse impact to the economy as our underwriters are being very disciplined in this space.

Over the past couple of years, our product mix has moved to 44% Casualty, 44% Property and 12% Surety versus 60% Casualty, 30% Property and 20% Surety a couple of years ago as these shorter-tail products provide better opportunity for underwriting profit.

Overall, gross written premium up 7% for the quarter. Combined ratio of 75%. Terrific results, like I said earlier, in a tough insurance market and a weak economy. We continue to invest in broadening our footprint by adding new products and evaluating many more. Again, a great underwriting quarter.

John, back to you.

**John E. Robison**

*Former Chief Investment Officer and Treasurer*

Thank you, Mike. We're now ready to open the call up to questions.

## Question and Answer

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### Operator

[Operator Instructions] Our first question comes from Dean Evans at KBW [Keefe, Bruyette, & Woods].

### Dean Evans

*Keefe, Bruyette, & Woods, Inc., Research Division*

My first question, I guess, I was wondering if you could give some more detail on the reserve movements in the quarter, both the favorable development as well as the slight adverse development?

### Joseph E. Dondanville

*Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer*

This is Joe Dondanville. In the Casualty side, the Casualty improved about \$17 million from accident years 2003 through 2008. EPG or Executive Products Group, transportation and our umbrella lines were the contributors in that group. On Surety, it's \$5 million favorable. And that is across-the-board in our Surety products contracts, and Commercial made up the bulk of it that we saw favorable in all areas.

### Dean Evans

*Keefe, Bruyette, & Woods, Inc., Research Division*

What accident years was the Surety from?

### Joseph E. Dondanville

*Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer*

The Surety segment was from 2008 and 2009.

### Dean Evans

*Keefe, Bruyette, & Woods, Inc., Research Division*

And how about the kind of slight additions on the Property side?

### Joseph E. Dondanville

*Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer*

It was just at par, I think, from 2009, a pretty short tail.

### Dean Evans

*Keefe, Bruyette, & Woods, Inc., Research Division*

I guess, my second question is kind of few parts. I was looking for some color on ProAg for the quarter. First off, sort of what was the premium attributable to that? But also, did that have any impact on the low expense ratio in the Property segment?

### Joseph E. Dondanville

*Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer*

The premium was about \$18 million for the quarter. And yes, it had a marginal expense ratio of 8%.

### Dean Evans

*Keefe, Bruyette, & Woods, Inc., Research Division*

So as we think going forward about the expense ratio in the Property segment, is that something we can expect to be a fair run rate in the second quarter? Or is there any other moving parts in there?

### Joseph E. Dondanville

*Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer*

The moving parts is that the crop business is very seasonal. So in the second quarter, we believe that's going to be the peak premium quarter. Third quarter should be high but not as significant as the third quarter. And fourth quarter as the first quarter are the low quarters of that line.

**Dean Evans**

*Keefe, Bruyette, & Woods, Inc., Research Division*

And then, I guess, lastly, do you have any sort of updated commentary with respect to the SRA?

**Michael J. Stone**

*Director*

This is Mike Stone. Obviously, there's going to be an impact as a result of the SRA and the increased participation by the government, and the decrease in the E&O [excess and obsolescence]. While that will have an impact to the bad from a returns standpoint, we still think this business will provide a very good return. It's a good diversification play for us. So we think overall, it's still a very good space for us to be in.

**Operator**

We'll take our next question from Beth Malone at Wunderlich Securities.

**Elizabeth C. Malone**

*Wunderlich Securities Inc., Research Division*

Could you talk about -- as you move into these new markets, I would assume given the lack of demand because of the economy that you're gaining market share from some competitors. Could you talk about how you're able to do that or what these competitors are missing that you all are able to provide?

**Michael J. Stone**

*Director*

Beth, it's Mike Stone. I don't -- we can't give away all of our competitive secrets.

**Elizabeth C. Malone**

*Wunderlich Securities Inc., Research Division*

Maybe just a few.

**Michael J. Stone**

*Director*

But typically, we will find a group of people who have a following, if you will, or have producers that they have a relationship and have had relationship with. They have an insight into the business, be it from an underwriting perspective. The particular niches that are more profitable or they have some distribution play. It really depends on the people, it depends on the product. There are number of ways where there are underserved pieces of a big market. A company our size, we don't need huge market share. Somebody has a good insight into a particular product that have produced over time \$25 million book of business. That works for us. And you can find spaces in a lot of these markets that are fairly large at where you can find a book of business or a class of business that will significantly outperform the rest of the space.

**Elizabeth C. Malone**

*Wunderlich Securities Inc., Research Division*

So it's really getting teams of, I guess, underwriters that have knowledge in market presence?

**Michael J. Stone**

*Director*

Typically that, coupled with also us extending particular products that we may currently have. So for example, our primary liability underwriting team moving into the environmental liability space. That's another way of doing it, adding geography like our Surety group has done, adding underwriters in



underserved areas that we weren't playing and providing, adding people that have relationships with producers in areas that we're not currently serving.

**Elizabeth C. Malone**

*Wunderlich Securities Inc., Research Division*

And one other question, is it possible for you to look at the economic impact and tell how much of that is playing into the soft pricing and the high competition? How much is the economy being a factor as opposed to just regular competition?

**Michael J. Stone**

*Director*

This is Mike Stone again. Actually to quantify that precisely, I can't do that, but we do know that we play heavily in the construction space. And in the E&S space, that construction is heavily in states like California and Florida that have been significantly impacted by the economy. There is hardly any construction activity, certainly nothing approaching what it was in the early 2000s to the mid-2000s. So we're feeling that very significantly. And you couple that -- that helps also drive the prices down as all the companies, the insurance companies that were riding that business now are chasing less and less premium.

**Elizabeth C. Malone**

*Wunderlich Securities Inc., Research Division*

On the Maui Jim, it looks like results were a little bit better. Is that -- do you get some hope that, that's an indication that consumers are becoming more open with their pocketbooks? Can we take any hope from the fact that people are willing to buy more of Maui Jim sunglasses?

**Joseph E. Dondanville**

*Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer*

This is Joe Dondanville. We're very pleased with Maui Jim's success in the second quarter. Sales were up over 30%. But to say that high-end sunglasses is connected to the overall economy, I really couldn't make that overall connection, but we are pleased at Maui Jim's results.

**Michael J. Stone**

*Director*

I would add, this is Mike Stone, I would add that while our Transportation business is off considerably, they are reporting that receipts are starting, and revenue is starting to go up in the trucking side, which would be a very early indication that things are starting to improve. But it's a very early indication, and it's not really robust, but it's much better than it was a year ago.

**Operator**

And we'll take our next question from Bijan Moazami with FBR Capital Markets.

**Bijan Moazami**

*FBR Capital Markets & Co., Research Division*

First of all, I was wondering if you can spend a little bit of time talking about the crop insurance business? The government obviously is cutting the subsidies on that front. Is it going to have an impact on the reinsurance side of it? Joe mentioned that there is some seasonality to it. If we can talk a little bit more in terms of exactly what percentages of that premium is going to come in different kind of quarters. I know second quarter is heavier. It is not very clear to me how it's going to evolve throughout the year. And also in terms of the logic as you got into that business, why you decided to get into it? And if you refresh my memory in terms of how much premium volume that business represents?

**Joseph E. Dondanville**

*Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer*



Bijan, this is Joe Dondanville. The seasonality is we'll see about 80% of the crops, being spring crops, which the reporting of that takes place in the second and third quarter where people sign up. And they actually report their acreages in the third quarter, so you'll have some split there. But 80% to 85% is going to be in that second, third quarter time period.

**Bijan Moazami**

*FBR Capital Markets & Co., Research Division*

And in terms of losses that you're going to get from it, is the premium earned throughout the year? Or the premium is earned in the second and third quarter also?

**Joseph E. Dondanville**

*Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer*

The premiums are earned over the growing season. So from a Midwest corn and beans, that would be, looking at May through October and then from the final loss standpoint, it takes a while after that for the numbers to play out as to what the actual yields are and what the price of the individual crop would be. And we get preliminary reports or estimates throughout the year in which we use as a basis to determine the appropriate level of losses that we've seen from a historical standpoint, but it is very dependent on final reports and final yields and final price reports.

**Bijan Moazami**

*FBR Capital Markets & Co., Research Division*

So the price of the commodity will have more of an impact than the yield of the acreage?

**Joseph E. Dondanville**

*Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer*

No, because there's a certain retention that the farmers take. So I think that is about a 10% yield. We'd have to -- price would have to drop at least 10% for that to kick in. And in a lot of the business, it's total revenue, which is both a yield and price. So the yield driver is about 90%, 95% of the total underwriting.

**Michael J. Stone**

*Director*

Bijan, it's Mike Stone. The big impact was nearly twofold, about half the impact is on expense reimbursement. We've been, as the reinsurer, our seat is locked in so that it won't have an impact on us, at least at this stage. Secondly, on the return side, probably returns going from north of 15 to somewhere around 12, probably, thereabouts. And it will be impacted less also because it was the I states, the Indiana, Illinois, Iowa that's going to be more severely impacted due to the returns that they were getting out of those states, and basically spreading that throughout the rest of the U.S where it's more -- places have been more difficult.

**Bijan Moazami**

*FBR Capital Markets & Co., Research Division*

I have a follow-up question on the Surety business. One of your competitors mentioned that Surety losses was very low in the recession because the credit quality of a lot of the contractors was very high. They have lots of money that they accumulated throughout the good times. And now, they're running out of money. And they were also mentioning that the bids on the new projects are becoming so competitive that nobody is making any money. And therefore, they were projecting a big increase in the Surety losses going forward. Do you guys see anything like that happen? And should we assume the higher losses on Surety? Or do you believe that the trends are going to continue? Obviously, the reserves are being released.

**Michael J. Stone**

*Director*

Bijan, it's Mike Stone again. I think we've thought over the last year that there might be a bump up in the losses for some of the reasons that you stated. We haven't seen it in our book, and we went

through a pretty tough period back about seven or eight years ago. We've been very conservative in our underwriting. But Surety is also a very low loss ratio business, and it doesn't take many losses to change your outlook. We've been fortunate, I think, because we've been disciplined, but certainly, the evidence on bids, on the quality of the contractors that are able to make it in the space are bidding down, and we'll see if the economy picks up, if that has an impact on the space as well. We're being very careful in this space. Our growth is coming from geographic expansion with seasoned teams, and we're not trying to organically grow the business. It becomes fine but we're being very disciplined in the underwriting side.

## **Operator**

We'll take our next question from Michael Nannizzi with Oppenheimer.

### **Michael Steven Nannizzi**

*Oppenheimer & Co. Inc., Research Division*

I know you didn't talk a lot in your comments, Mike, about the habitational insurance products in the Casualty business, but can you talk a bit about how, what your experiences have been in that book, whether it's accident year or calendar-year basis? And also maybe, I think Joe had mentioned in his comments, reserve releases associated with the personal book. Can you talk a little bit about that relative to the commercial umbrella book as well? Just give us a feel for how those two different books have performed?

### **Michael J. Stone**

*Director*

Our primary liability book is made up predominantly of Construction business and Habitational business with a little bit of product liability in there. Our Construction business is off, from a gross written premium standpoint, due to the economy. As I indicated, a lot of that business in California and Florida. Habitational has become a bigger portion. Historically, Construction has been run to that much, much better loss ratio than Habitational. So we see the mix change will have an impact on our primary liability book to the negative. The Habitational business is tougher by and large. There's a lot of competition out there that used to write a lot of Construction business, now write Habitational, so we see prices under pressure there as well. So you see our premiums have declined considerably in the space over the past three to four years, and that's really due to the fact -- there were two things really, lack of construction activity and our pulling back because of rates.

### **Michael Steven Nannizzi**

*Oppenheimer & Co. Inc., Research Division*

And then on the reserve releases related to personal, and then, can you just talk a little bit about just premium volume between the two umbrella types and what the sort of lost experience or reserve experience was on the commercial side?

### **Joseph E. Dondanville**

*Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer*

The commercial umbrella from a volume standpoint is about half or a little less than half the size of our personal umbrella book, which is about 29 million is personal umbrella through the six months and 13 million for the commercial. The commercial side, we're looking at reserve releases of about 1.5 million versus 5.4 million for personal umbrella. And then in the commercial side, it goes into older years, all the way back to 2001. And the personal umbrella is primarily in 2008 going back to about 2004, so it's a little bit longer tail and hold on the reserves a little bit longer.

### **Michael Steven Nannizzi**

*Oppenheimer & Co. Inc., Research Division*

Mr. John Robison, you had mentioned in the portfolio that your approach to owning equities, you feel like equities are going to outperform fixed income. I think that's what you had said. Concernedly correct me if I'm wrong, but it looks like the equity book is declining relative to fixed income, and I mean, I know RLI has this approach of shareholder capital versus policyholder capital. So if the shareholder pieces equity

and that's shrinking, can you just kind of talk about your approach there? Is that changing or do you expect to see kind of a bounce back towards equities at some point?

**John E. Robison**

*Former Chief Investment Officer and Treasurer*

Yes, we believe over the long run, equities will outperform bonds. You may have periods where bonds outperform of course, but over the long run, equity should outperform bond. Our allocation hasn't changed significantly. We want to have 15% of our portfolio in equities until this economy stabilizes more, and we have more firm footing on our belief that the direction equities will go. And we have bond in some of the debts, not a lot, but our allocation is roughly 15% right now and that hasn't changed significantly from the first quarter. Equities have declined significantly during the second quarter. The S&P was down nearly 12% just in the quarter, and so the fact that we're still hovering around 15% allocation shows our commitment to the long-term benefits of equities in our portfolio.

**Operator**

We'll move to our next question from Meyer Shields at Stifel, Nicolaus.

**Meyer Shields**

*Stifel, Nicolaus & Company, Incorporated, Research Division*

Mike, I think you mentioned the deflation in your comments something whether you could specify whether that's your general economic deflation or something you're seeing specifically on insurance loss cost?

**Michael J. Stone**

*Director*

Yes, Mike Stone here. We certainly haven't seen the loss cost inflation that we anticipated that the trend is moderated. And that's part of why our results are better than we originally anticipated.

**Meyer Shields**

*Stifel, Nicolaus & Company, Incorporated, Research Division*

And do you see the -- I'm trying to think of how to ask this because clearly, there is more than enough capital of there. But is there any shift in the asset for share repurchase given that your book of business is becoming more short tail?

**Joseph E. Dondanville**

*Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer*

This is Joe Dondanville. No, we don't necessarily see that in that regard. We do have the economic capital model that is driven based off of the collection of lines of businesses that we have. And as it shifts to some of the shorter tail side, it does have an impact on the amount of capital that's required.

**Operator**

We'll take our next question from Matthew Carletti with JMP.

**Matthew John Carletti**

*JMP Securities LLC, Research Division*

I just wanted to follow up on the capital question. In terms of kind of what we saw in the quarter, if you take share repurchase in dividend, I think about \$16 million, \$17 million, is that a comfortable capital return level for you guys? Or do you see that changing materially as we go throughout the year?

**Joseph E. Dondanville**

*Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer*

Matt, it's Joe Dondanville again. We'll evaluate that as we see what opportunities that are out there for us and the economy in general. We don't want to be too aggressive on the share repurchase. As John has mentioned about our equity portfolio, the second quarter wasn't particularly strong quarter from that

standpoint. And so we kind of gave some ground there. So it will be measured going forward as we have done in the past.

**Matthew John Carletti**

*JMP Securities LLC, Research Division*

Joe, one more just follow up, if I could, on the effective cost of business. You said 80% to 85% of the premiums are split between Q2 and Q3. Is that a pretty even split or is it more heavily weighted towards one of those quarters?

**Joseph E. Dondanville**

*Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer*

It'll be more heavily in the second quarter.

**Operator**

We'll take our next question from Michael Grasher at Piper Jaffray.

**Michael Fitzgerald Grasher**

*Piper Jaffray Companies, Research Division*

Just a question around as you look at the premium growth in the quarter. The teams of underwriters that maybe you've brought on, what's the pipeline look like from a volume standpoint? Is there any way to sort of, I guess, characterize that or give us some sort of idea as to where we're headed?

**Michael J. Stone**

*Director*

It's Mike Stone. Obviously, that's difficult because it depends on a number of things, including our pricing and the economy and the competition. But we'll continue to build out our design professional business. I would expect that to continue to grow. Our Surety book should continue to grow. Obviously, that's dependent upon the economy and construction activity and some of the other smaller, well, direct crop and we talked about that. Talk about our Property Facultative business, I would expect that to continue to grow, probably at a more moderate rate as been added for about three and half years now. I would expect that some point in the not-too-distant future, our Marine book would return to at least flat. And we've got a whole host of smaller products that are just getting off the home plate, and I would expect to see some growth from them over time, but it's going to be fits and starts. Some will make it and some won't. But it's very hard to predict, that kind of volume. We would expect that for any product that we start up that over time, it's going to get up to somewhere around at least \$20 million. So...

**Michael Fitzgerald Grasher**

*Piper Jaffray Companies, Research Division*

And taking over, how much time would that \$20 million be?

**Michael J. Stone**

*Director*

Again, that will depend on the product, but we certainly want to see that within five years. Now that would be start-up products if extensions of particular product lines wouldn't need to be that much. Or where they already have a fairly sizable premium base, and we're not adding a whole lot of expense associated with that. For example, the environmental side on GL, it doesn't need to get to \$20 million. So there's a whole host of characteristics that will drive each one of these individual products to maturity.

**Michael Fitzgerald Grasher**

*Piper Jaffray Companies, Research Division*

Outside of the sort of de novo type of startups, what are you seeing on the other side where maybe acquisition opportunity be in an MGA or balance sheet?

**Michael J. Stone**

**WWW.SPCAPITALIQ.COM**

Director

We're always looking. We're always looking and evaluating things...

**Michael Fitzgerald Grasher**

*Piper Jaffray Companies, Research Division*

I mean, is there any one particular area that maybe looks a little bit more enticing now, or I guess, did the bid ask spread had been narrowed any at all?

**Michael J. Stone**

*Director*

No, I still think there's still a spread there that makes acquisitions difficult.

**Michael Fitzgerald Grasher**

*Piper Jaffray Companies, Research Division*

And Joe, just a follow-up question on the capital management aspect. Any opportunity here? Or has it been discussed to maybe throw out a one-time dividend ahead of the change in the tax law?

**Joseph E. Dondanville**

*Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer*

That's an interesting question about the change in the tax law. But historically, RLI has not been one that has done a one-time dividend, and I would think that, that would not necessarily be the highest on our list to do.

**Operator**

And we'll take our next question from Caroline Steers at Macquarie Capital.

**Caroline Steers**

*Macquarie Research*

Just going back to the Marine line, have you guys seen any increase in demand there or an increase in pricing? Sort of what's the market environment like in that line?

**Michael J. Stone**

*Director*

Carol, it's Mike Stone. No, we really haven't seen an increase in demand. Pricing still is soft. We're seeing some activity in the Gulf given what's going on down there. But overall, cargo is fairly flat. And the economy has had enough of fairly significant impact in that space.

**Operator**

And we'll take a follow-up question from Michael Nannizzi with Oppenheimer.

**Michael Steven Nannizzi**

*Oppenheimer & Co. Inc., Research Division*

As far as catastrophe exposure is concerned, can you talk a little bit about you writing a little bit more property? I mean, is it property in different areas or have a different catastrophe exposure profiles than your legacy book? And have you made any changes to your reinsurance program to account for that? Or just generally, how should we think about the evolution of that exposure?

**Michael J. Stone**

*Director*

This is Mike Stone. Our overall exposure, the California quake, Southeast wind is down, and we've added a couple of assumed reinsurance deals that diversify some of that CAT exposure. So some South Carolina wind, but overall, our CAT exposure is down.

**Operator**

And if there are no further questions, I'll turn the conference back over to Mr. Jonathan Michael.

**Jonathan E. Michael**

*Chairman and Chief Executive Officer*

Thank you all. Overall, we're very pleased with our results. It's a relatively good premium quarter for RLI. Our efforts to find new niches and opportunities are continuing to bear fruit for us. We had a combined ratio of about 75%. Obviously, we released some reserves again this quarter. We had book value growth of 5% since year end and our ROE trailing, fourth quarter ROE, is nearly 15%.

As you know, those kinds of metrics are the foundation for determining valuations, and we continue to deliver solid results to testament to our underwriters and our staff throughout the company. The market is still very competitive. There's just too much capital chasing, too little premium and with the low interest rate environment, it'll be difficult for insurers to make up for those underpriced risks so I would expect to see industry-combined ratios overall climbing. Can't predict when this is going to end but we have seen some moderation at least in the first six months of this year.

We will continue to do what we do best, and that's underwrite. We'll continue to look for new opportunities, new products, new teams, expand our geographical footprint all the while being mindful of the expense associated with that expansion in this soft market. And we'll continue to look for, as Mike suggested, we constantly look at acquisitions. The M&A environment is difficult but we'll continue to look at different types of acquisitions that would help to either diversify our portfolio or to supplement what we're doing today.

I want to thank you all for your time and your questions. So we do look forward to talking to you again next quarter. Thanks.

**Operator**

Ladies and gentlemen, if you wish to access the replay for this call, you may do so by dialing 1 (888) 203-1112 with an ID number of 6145991. This concludes our conference for today. Thank you all for participating and have a nice day. All parties may now disconnect.

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