

RLI CORP  
Form 10-Q  
April 24, 2015  
Table of Contents

13

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2015

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from                      to

Commission File Number: 001-09463

RLI Corp.

(Exact name of registrant as specified in its charter)

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ILLINOIS (State or other jurisdiction of incorporation or organization)	37-0889946 (I.R.S. Employer Identification Number)
9025 North Lindbergh Drive, Peoria, IL (Address of principal executive offices)	61615 (Zip Code)

(309) 692-1000

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS:

As of April 13, 2015, the number of shares outstanding of the registrant's Common Stock was 43,190,481.

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Table of Contents

Table of Contents

	Page
<u>Part I - Financial Information</u>	3
<u>Item 1. Financial Statements</u>	3
<u>Condensed Consolidated Statements of Earnings and Comprehensive Earnings For the Three-Month Periods Ended March 31, 2015 and 2014 (unaudited)</u>	3
<u>Condensed Consolidated Balance Sheets as of March 31, 2015 (unaudited) and December 31, 2014</u>	4
<u>Condensed Consolidated Statements of Cash Flows For the Three-Month Periods Ended March 31, 2015 and 2014 (unaudited)</u>	5
<u>Notes to unaudited condensed consolidated interim financial statements</u>	6
<u>Item 2. Management’s discussion and analysis of financial condition and results of operations</u>	18
<u>Item 3. Quantitative and qualitative disclosures about market risk</u>	28
<u>Item 4. Controls and procedures</u>	28
<u>Part II - Other Information</u>	28
<u>Item 1. Legal proceedings</u>	28
<u>Item 1a. Risk factors</u>	29
<u>Item 2. Unregistered sales of equity securities and use of proceeds</u>	29
<u>Item 3. Defaults upon senior securities</u>	29

<u>Item</u>	<u>Mine safety disclosures</u>	
<u>4.</u>		29
<u>Item</u>	<u>Other information</u>	
<u>5.</u>		29
<u>Item</u>	<u>Exhibits</u>	
<u>6.</u>		29
<u>Signatures</u>		30

Table of Contents

## PART I - FINANCIAL INFORMATION

## Item 1. Financial Statements

## RLI Corp. and Subsidiaries

## Condensed Consolidated Statements of Earnings and Comprehensive Earnings

(Unaudited)

(in thousands, except per share data)	For the Three-Month Periods Ended March 31,	
	2015	2014
Net premiums earned	\$ 169,003	\$ 161,132
Net investment income	13,495	13,582
Net realized investment gains	13,286	6,501
Consolidated revenue	\$ 195,784	\$ 181,215
Losses and settlement expenses	80,861	71,016
Policy acquisition costs	58,973	55,051
Insurance operating expenses	11,531	12,533
Interest expense on debt	1,856	1,851
General corporate expenses	2,244	2,198
Total expenses	\$ 155,465	\$ 142,649
Equity in earnings of unconsolidated investees	4,194	3,425
Earnings before income taxes	\$ 44,513	\$ 41,991
Income tax expense	13,915	13,022
Net earnings	\$ 30,598	\$ 28,969
Other comprehensive earnings (loss), net of tax	(7,595)	17,737
Comprehensive earnings	\$ 23,003	\$ 46,706
Earnings per share:		
Basic:		
Basic net earnings per share	\$ 0.71	\$ 0.67
Basic comprehensive earnings per share	\$ 0.53	\$ 1.09

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Diluted:

Diluted net earnings per share	\$ 0.70	\$ 0.66
Diluted comprehensive earnings per share	\$ 0.52	\$ 1.07
Weighted average number of common shares outstanding		
Basic	43,141	42,985
Diluted	43,992	43,674
Cash dividends paid per common share	\$ 0.18	\$ 0.17

See accompanying notes to the unaudited condensed consolidated interim financial statements.

Table of Contents

RLI Corp. and Subsidiaries

Condensed Consolidated Balance Sheets

(Unaudited)

(in thousands, except share data)	March 31, 2015	December 31, 2014
<b>ASSETS</b>		
Investments		
Fixed income		
Available-for-sale, at fair value	\$ 1,529,559	\$ 1,495,087
Equity securities, at fair value	391,663	410,642
Short-term investments, at cost	16,008	16,339
Other invested assets	11,402	11,597
Cash	31,514	30,620
Total investments and cash	\$ 1,980,146	\$ 1,964,285
Accrued investment income	12,411	14,629
Premiums and reinsurance balances receivable	145,948	154,573
Ceded unearned premium	49,011	53,961
Reinsurance balances recoverable on unpaid losses	336,747	335,106
Deferred policy acquisition costs	65,247	65,123
Property and equipment	42,458	42,549
Investment in unconsolidated investees	65,089	60,046
Goodwill and intangibles	72,472	72,695
Other assets	11,035	12,575
<b>TOTAL ASSETS</b>	<b>\$ 2,780,564</b>	<b>\$ 2,775,542</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Liabilities</b>		
Unpaid losses and settlement expenses	\$ 1,150,795	\$ 1,121,040
Unearned premiums	388,776	401,412
Reinsurance balances payable	33,083	38,013
Funds held	53,713	51,481
Income taxes-deferred	79,356	82,285
Bonds payable, long-term debt	149,636	149,625
Accrued expenses	33,902	63,148
Other liabilities	29,308	23,476
<b>TOTAL LIABILITIES</b>	<b>\$ 1,918,569</b>	<b>\$ 1,930,480</b>
<b>Shareholders' Equity</b>		



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Common stock (\$1 par value, 100,000,000 shares authorized)		
(66,120,695 shares issued, 43,190,481 shares outstanding at 3/31/15)		
(66,032,929 shares issued, 43,102,715 shares outstanding at 12/31/14)	\$ 66,121	\$ 66,033
Paid-in capital	215,345	213,737
Accumulated other comprehensive earnings	163,788	171,383
Retained earnings	809,740	786,908
Deferred compensation	13,946	13,769
Less: Treasury shares at cost		
(22,930,214 shares at 3/31/15 and 12/31/14)	(406,945)	(406,768)
TOTAL SHAREHOLDERS' EQUITY	\$ 861,995	\$ 845,062
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 2,780,564	\$ 2,775,542

See accompanying notes to the unaudited condensed consolidated interim financial statements.

Table of Contents

RLI Corp. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(in thousands)	For the Three-Month Periods Ended March 31,	
	2015	2014
Net cash provided by (used in) operating activities	\$ 23,407	\$ (2,007)
<b>Cash Flows from Investing Activities</b>		
Investments purchased	\$ (196,468)	\$ (129,559)
Investments sold	140,445	92,989
Investments called or matured	39,781	31,770
Net change in short-term investments	2,572	2,286
Net property and equipment purchased	(1,062)	(2,933)
Investment in equity method investee	(1,711)	(5,301)
Net cash used in investing activities	\$ (16,443)	\$ (10,748)
<b>Cash Flows from Financing Activities</b>		
Cash dividends paid	\$ (7,766)	\$ (7,305)
Stock plan share issuance	330	1,123
Excess tax benefit from exercise of stock options	1,366	86
Net cash used in financing activities	\$ (6,070)	\$ (6,096)
Net increase (decrease) in cash	\$ 894	\$ (18,851)
Cash at the beginning of the period	\$ 30,620	\$ 39,469
Cash at March 31	\$ 31,514	\$ 20,618

See accompanying notes to the unaudited condensed consolidated interim financial statements.

Table of Contents

NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. BASIS OF PRESENTATION

The unaudited condensed consolidated interim financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (GAAP) for interim financial reporting and with the instructions to Form 10-Q and Regulation S-X. Accordingly, they do not include all of the disclosures required by GAAP for complete financial statements. As such, these unaudited condensed consolidated interim financial statements should be read in conjunction with our 2014 Annual Report on Form 10-K. Management believes that the disclosures are adequate to make the information presented not misleading, and all normal and recurring adjustments necessary to present fairly the financial position at March 31, 2015 and the results of operations of RLI Corp. and subsidiaries for all periods presented have been made. The results of operations for any interim period are not necessarily indicative of the operating results for a full year.

The preparation of the unaudited condensed consolidated interim financial statements requires management to make estimates and assumptions relating to the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the unaudited condensed consolidated interim financial statements, and the reported amounts of revenue and expenses during the period. These estimates are inherently subject to change and actual results could differ significantly from these estimates.

B. ADOPTED ACCOUNTING STANDARDS

No new accounting standards have been adopted as no issued updates would impact our financial statements.

C. PROSPECTIVE ACCOUNTING STANDARDS

ASU 2015-03, Interest-Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs

This ASU was issued to simplify the presentation of debt issuance costs by requiring them to be presented in the balance sheet as a direct deduction from the carrying amount of the related recognized debt liability, consistent with debt discounts. This ASU is effective for annual and interim reporting periods beginning after December 15, 2015. Early adoption is permitted. We have not early-adopted this ASU and do not believe adoption will have a material effect on our financial statements.

#### D. INTANGIBLE ASSETS

In accordance with GAAP guidelines, the amortization of goodwill and indefinite-lived intangible assets is not permitted. Goodwill and indefinite-lived intangible assets remain on the balance sheet and are tested for impairment on an annual basis, or earlier if there is reason to suspect that their values may have been diminished or impaired. Goodwill and intangible assets totaled \$72.5 million at March 31, 2015.

Goodwill and intangible assets resulting from acquisitions completed prior to 2011 totaled \$26.2 million and is attributable to our surety segment. Of this \$26.2 million, \$25.6 million relates to goodwill and \$0.6 million relates to an indefinite-lived intangible asset. Goodwill and intangible assets resulting from the Contractors Bonding and Insurance Company (CBIC) acquisition in April 2011 totaled \$30.5 million. The CBIC-related assets include goodwill attributable to our casualty and surety segments of \$5.3 million and \$15.1 million, respectively, and an indefinite-lived intangible asset in the amount of \$7.5 million, which relates to state insurance licenses. Impairment testing is performed on each of these goodwill and indefinite-lived intangible assets during the second quarter of each year. There were no triggering events that occurred during the first quarter of 2015 that would suggest an updated review was necessary. Definite-lived intangible assets related to the CBIC acquisition totaled \$2.6 million, net of amortization, as of March 31, 2015.

The remaining \$15.8 million of goodwill and intangibles relates to our purchase of Rockbridge Underwriting Agency (Rockbridge) in November 2012. Of this amount, \$12.4 million is recorded as goodwill attributable to our casualty segment. The remaining \$3.4 million relates to definite-lived intangible assets, net of amortization, as of March 31, 2015. Impairment testing is performed on this goodwill asset in the fourth quarter of each year. There were no triggering events that occurred during the first quarter of 2015 that would suggest an updated review was necessary.

Table of Contents

The aforementioned definite-lived intangible assets are amortized against future operating results based on their estimated useful lives. Amortization of intangible assets resulting from the acquisitions of CBIC and Rockbridge was \$0.2 million for the first quarter of 2015.

## E. EARNINGS PER SHARE

Basic earnings per share (EPS) excludes dilution and is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the dilution that could occur if securities or other contracts to issue common stock or common stock equivalents were exercised or converted into common stock. When inclusion of common stock equivalents increases the earnings per share or reduces the loss per share, the effect on earnings is anti-dilutive. Under these circumstances, the diluted net earnings or net loss per share is computed excluding the common stock equivalents.

The following represents a reconciliation of the numerator and denominator of the basic and diluted EPS computations contained in the unaudited condensed consolidated interim financial statements.

(in thousands, except per share data)	For the Three-Month Period Ended March 31, 2015			For the Three-Month Period Ended March 31, 2014		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS						
Income available to common shareholders	\$ 30,598	43,141	\$ 0.71	\$ 28,969	42,985	\$ 0.67
Effect of Dilutive Securities						
Stock options	-	851		-	689	
Diluted EPS						
Income available to common shareholders	\$ 30,598	43,992	\$ 0.70	\$ 28,969	43,674	\$ 0.66

## F. COMPREHENSIVE EARNINGS

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Our comprehensive earnings include net earnings plus unrealized gains/losses on our available-for-sale investment securities, net of tax. In reporting comprehensive earnings on a net basis in the statement of earnings, we used the federal statutory tax rate of 35 percent. The following table illustrates the changes in the balance of each component of accumulated other comprehensive earnings for each period presented in the unaudited condensed consolidated interim financial statements.

(in thousands)	For the Three-Month Periods Ended March 31,	
Unrealized Gains/Losses on Available-for-Sale Securities	2015	2014
Beginning balance	\$ 171,383	\$ 136,027
Other comprehensive earnings before reclassifications	996	21,960
Amounts reclassified from accumulated other comprehensive earnings	(8,591)	(4,223)
Net current-period other comprehensive earnings	\$ (7,595)	\$ 17,737
Ending balance	\$ 163,788	\$ 153,764

Table of Contents

The sale or other-than-temporary impairment of an available-for-sale security results in amounts being reclassified from accumulated other comprehensive earnings to current period net earnings. The effects of reclassifications out of accumulated other comprehensive earnings by the respective line items of net earnings are presented in the following table.

(in thousands)	Amount Reclassified from Accumulated Other Comprehensive Earnings For the Three-Month Periods Ended March 31,		Affected line item in the Statement of Earnings
	2015	2014	
Component of Accumulated Other Comprehensive Earnings			
Unrealized gains and losses on available-for-sale securities	\$ 13,217	\$ 6,497	Net realized investment gains
	-	-	Other-than-temporary impairment (OTTI)
	\$ 13,217	\$ 6,497	losses on investments
	(4,626)	(2,274)	Earnings before income taxes
	\$ 8,591	\$ 4,223	Income tax expense
			Net earnings

## 2. INVESTMENTS

Our investments include fixed income debt securities and common stock equity securities. As disclosed in our 2014 Annual Report on Form 10-K, we present all of our investments as available-for-sale, which are carried at fair value. During the fourth quarter of 2014, we sold our last remaining fixed income security that was classified as held-to-maturity. When available, we obtain quoted market prices to determine fair value for our investments. If a quoted market price is not available, fair value is estimated using a secondary pricing source or using quoted market prices of similar securities. We have no investment securities for which fair value is determined using Level 3 inputs as defined in note 3 to the unaudited condensed consolidated interim financial statements, "Fair Value Measurements."

The following tables show the amortized cost, unrealized gains/losses, fair value and contractual maturities for our available-for-sale securities.

8

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Table of Contents

## Available-for-Sale Securities

The amortized cost and fair value of available-for-sale securities at March 31, 2015 and December 31, 2014 were as follows:

Available-for-sale (in thousands)				
	3/31/2015			
Asset Class	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government	\$ 33,313	\$ 279	\$ -	\$ 33,592
U.S. agency	13,498	554	-	14,052
Non-U.S. govt. & agency	1,892	125	-	2,017
Agency MBS	244,344	10,480	(510)	254,314
ABS/CMBS*	125,847	2,298	(223)	127,922
Corporate	593,814	25,378	(3,130)	616,062
Municipal	463,355	18,517	(272)	481,600
Total Fixed Income	\$ 1,476,063	\$ 57,631	\$ (4,135)	\$ 1,529,559
Equity	\$ 191,993	\$ 200,630	\$ (960)	\$ 391,663
Available-for-sale (in thousands)				
	12/31/2014			
Asset Class	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government	\$ 33,668	\$ 131	\$ (11)	\$ 33,788
U.S. agency	6,385	362	-	6,747
Non-U.S. govt. & agency	9,862	803	-	10,665
Agency MBS	256,443	9,401	(1,376)	264,468
ABS/CMBS*	133,894	1,821	(411)	135,304
Corporate	543,183	23,697	(4,190)	562,690
Municipal	464,769	16,789	(133)	481,425
Total Fixed Income	\$ 1,448,204	\$ 53,004	\$ (6,121)	\$ 1,495,087
Equity	\$ 193,535	\$ 218,105	\$ (998)	\$ 410,642

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\*Non-agency asset-backed and commercial mortgage-backed

The following table presents the amortized cost and fair value of available-for-sale debt securities by contractual maturity dates as of March 31, 2015:

AFS (in thousands)	3/31/2015 Amortized Cost	Fair Value
Due in one year or less	\$ 15,466	\$ 15,604
Due after one year through five years	240,318	249,737
Due after five years through 10 years	571,095	592,340
Due after 10 years	278,993	289,642
Mtge/ABS/CMBS*	370,191	382,236
Total available-for-sale	\$ 1,476,063	\$ 1,529,559

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\*Mortgage-backed, asset-backed and commercial mortgage-backed

Table of Contents

## Unrealized Losses

We conduct and document periodic reviews of all securities with unrealized losses to evaluate whether the impairment is other-than-temporary. The following tables are used as part of our impairment analysis and illustrate the total value of securities that were in an unrealized loss position as of March 31, 2015 and December 31, 2014. The tables segregate the securities based on type, noting the fair value, cost (or amortized cost) and unrealized loss on each category of investment as well as in total. The tables further classify the securities based on the length of time they have been in an unrealized loss position. As of March 31, 2015 unrealized losses, as shown in the following tables, were 0.3 percent of total invested assets. Unrealized losses decreased in 2015, as interest rates declined during the first quarter of the year.

(in thousands)	March 31, 2015			December 31, 2014		
	< 12 Mos.	12 Mos. & Greater	Total	< 12 Mos.	12 Mos. & Greater	Total
<b>U.S. Government</b>						
Fair value	\$ —	\$ —	\$ —	\$ 4,416	\$ —	\$ 4,416
Cost or amortized cost	—	—	—	4,427	—	4,427
Unrealized Loss	\$ —	\$ —	\$ —	\$ (11)	\$ —	\$ (11)
<b>Agency MBS</b>						
Fair value	\$ 15,867	\$ 15,778	\$ 31,645	\$ 12,840	\$ 61,534	\$ 74,374
Cost or amortized cost	15,976	16,179	32,155	12,947	62,803	75,750
Unrealized Loss	\$ (109)	\$ (401)	\$ (510)	\$ (107)	\$ (1,269)	\$ (1,376)
<b>ABS/CMBS*</b>						
Fair value	\$ 33,838	\$ 11,464	\$ 45,302	\$ 63,782	\$ 11,616	\$ 75,398
Cost or amortized cost	34,014	11,511	45,525	64,084	11,725	75,809
Unrealized Loss	\$ (176)	\$ (47)	\$ (223)	\$ (302)	\$ (109)	\$ (411)
<b>Corporate</b>						
Fair value	\$ 69,222	\$ 9,796	\$ 79,018	\$ 123,617	\$ 14,488	\$ 138,105
Cost or amortized cost	72,219	9,929	82,148	127,634	14,661	142,295
Unrealized Loss	\$ (2,997)	\$ (133)	\$ (3,130)	\$ (4,017)	\$ (173)	\$ (4,190)
<b>Municipal</b>						
Fair value	\$ 22,189	\$ —	\$ 22,189	\$ 12,382		