RLI Corporation (RLI)

Updated April 25th, 2018 by Jonathan Weber

Key Metrics

Current Price:	$64	**5 Year CAGR Estimate:**	-6.2%	**Quality Percentile:**	N/A
Fair Value Price:	$41	**5 Year Growth Estimate:**	1.2%	**Momentum Percentile:**	N/A
% Fair Value:	158%	**5 Year Valuation Multiple Estimate:**	-8.7%	**Total Return Percentile:**	N/A
Dividend Yield:	1.3%	**5 Year Price Target**	$43	**Valuation Percentile:**	

Overview & Current Events

RLI Corp. is an insurance company that is operating the following business units: Casualty (healthcare & transportation insurance), Property (fire, earthquake, difference in conditions, marine, etc.) and Surety (contract surety coverage, licenses, bonds). RLI was founded in 1965 and is currently valued at $2.8 billion.

The most recent quarterly results were announced in April. The company reported operating earnings of $0.60 for the first quarter of 2018, an increase of 36% over the prior year's quarter. Revenues were down six percent year-over-year, which was primarily due to a single accounting item; net unrealized losses on equity securities totaled $27 million during the quarter. Adjusted for that item revenues would have increased by a compelling eight percent year-over-year.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$2.50	$2.35	$2.66	$2.80	$2.02	$2.57	$2.62	$2.53	$2.08	$1.67	***$2.40***	***$2.55***
DPS	$0.49	$0.54	$0.57	$0.60	$0.63	$0.67	$0.71	$0.75	$0.79	$0.83	***$0.87***	***$1.05***

RLI Corp. has not been able to grow its profits consistently over the last decade. Profitability remained high through the last financial crisis, which is a positive, but since then earnings have gone up and down without any clear direction. This is, in large part, because low interest rates have reduced the income RLI can make on its insurance float. With rising interest rates the return on RLI's assets will in all likelihood increase over the coming years, which should be a positive for the company's profitability going forward. Tax legislation changes are also a positive for RLI, as this will increase the company's net earnings to operating earnings ratio significantly due to a lower tax rate going forward. The impact of both of these items (higher investment earnings and lower taxes) was already visible in Q1's earnings, which came in at a $2.40 annualized pace.

RLI has increased its dividend by 6% annually through the last decade, which was primarily possible due to a steadily increase in the company's dividend payout ratio. Since the payout ratio is still quite low, RLI will be able to keep its dividends growing going forward, even with only modest expected earnings-per-share growth ahead. RLI has, in addition to its regular dividends, made many special dividend payments over the last couple of years. The last one of these, in the amount of $1.75, was announced last November. RLI has made special dividend payments around that level in 2016 and 2015 as well.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	10.8	10.8	10.4	11.0	16.9	15.6	17.2	21.1	31.1	34.3	***26.7***	***16.9***
Avg. Yld.	1.8%	2.1%	2.1%	1.9%	1.8%	1.7%	1.6%	1.4%	1.2%	1.4%	***1.3%***	***1.8%***

RLI was valued at a relatively low P/E ratio for several years during and after the last financial crisis. The situation has reversed in recent years. Right now shares are trading at a high valuation of almost 27 times this year's earnings. The valuation has come down somewhat over the last two years, but is still substantially higher than the median over the last decade (~17). The high valuation, which makes multiple contraction very likely going forward, will limit total returns substantially.

RLI's regular dividends yield 1.4% right now, which isn't overly attractive versus peers from the financial industry, nor versus the broad market (which yields 1.9%). When we account for RLI's most recent special dividend (ex-div date was in November), the company's trailing dividend yield rises to 4.0%, which could appeal to income investors.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
Debt/A	70.7%	67.3%	68.5%	70.2%	70.1%	69.7%	69.4%	69.7%	70.1%	70.8%	***66.0%***	***68.0%***
Payout	19.6%	23.0%	21.4%	21.4%	31.2%	26.1%	27.1%	29.6%	38.0%	49.7%	***36.3%***	***41.2%***
Std. Dev.	47.3%	33.2%	20.1%	26.5%	17.2%	16.9%	16.8%	21.4%	23.7%	21.4%	***22.0%***	***21.0%***

RLI has a debt to assets ratio of roughly two thirds, which is not high for an insurance company. Due to the fact that the company owns many income producing assets, such as bonds and stocks, and because a large portion of the company's liabilities are not interest bearing, RLI produces positive net interest income. The company thus has a strong balance sheet even though the debt to assets ratio looks relatively high at first sight.

Many financial corporations, including some insurers, got into trouble during the last financial crisis. RLI remained profitable though, its EPS actually went up during the 2008 to 2010 time frame. The insurance business generally is not cyclical, insurers who faced steep losses (e.g. AIG) did so because they were making risky bets. RLI, which is employing its capital much more conservatively, is relatively recession-proof.

Going forward, rising interest rates will be a tailwind for RLI as well as for the rest of the insurance industry, as the company's assets can be invested at higher rates, which will allow for higher investment income in the coming years as long as the Fed remains on its current course.

Final Thoughts & Recommendation

RLI is not a high-growth company, but going forward results will improve due to two key tailwinds: Lower taxes (due to tax legislation changes) and rising investment income (due to rising interest rates). RLI's relatively high valuation will be a headwind going forward, though, as this will pressure share price appreciation significantly. Total returns, which consist of share price increases and dividend payments, don't look very promising when we do not include special dividend payments. Those have been not very consistent in the past, therefore it is hard to forecast how high the special dividend payments could be in the coming years. RLI's overvaluation and negative expected total returns – even after factoring in special dividends – make it a sell at current prices.

Total Return Breakdown by Year