RLI Corporation (RLI)

Updated July 19th, 2018 by Jonathan Weber

Key Metrics

Current Price:	$69	**5 Year CAGR Estimate:**	-7.6%	**Volatility Percentile:**	30.1%
Fair Value Price:	$41	**5 Year Growth Estimate:**	1.2%	**Momentum Percentile:**	81.5%
% Fair Value:	168%	**5 Year Valuation Multiple Estimate:**	-10.1%	**Valuation Percentile:**	1.7%
Dividend Yield:	1.3%	**5 Year Price Target**	$43	**Total Return Percentile:**	0.5%

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, and bonds). RLI was founded in 1965 and is currently valued at $3.1 billion.

RLI reported its most recent quarterly earnings on July 19. The company earned $0.60 per share during Q2, a decrease of one cent compared to Q2 2017. Net written premiums grew by 11% year over year, reaching $227 million during the quarter. The small earnings decline was primarily based on losses from volcanic activity in Hawaii.

RLI has increased its dividend by 5% in May. The new quarterly payout is $0.22 per share.

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 during H1 of 2018, as profits rose by 14% compared to H1 2017.

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 should 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	***28.8***	***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's shares have been valued at a substantial premium over the long-term median since 2015, and even though valuations have come down over the last year shares still look very expensive. The high valuation, compared to the 10-year median PE ratio of ~17, will limit total returns going forward.

Disclosure: This analyst has no position in the security discussed in this article, and no plans to initiate one in the next 72 hours.

RLI's regular dividend yield of 1.3% is not overly compelling, neither versus the broad market, nor versus what other stocks from the financial industry offer. RLI pays special dividends each year, but as those fluctuate in size, the total payout during 2017 was lower than the total payouts in 2016, 2015 and 2014.

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.

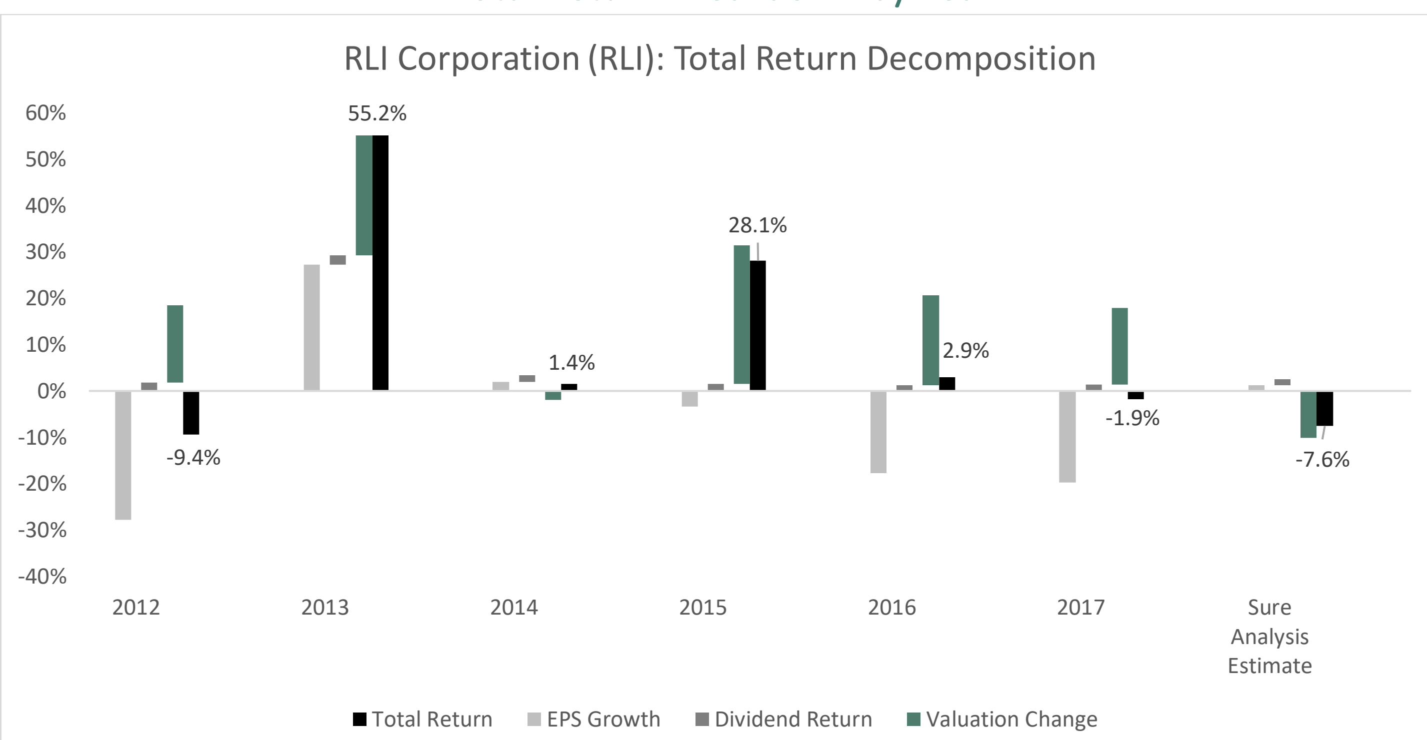
Many financial corporations, including some insurers, got into trouble during the last financial crisis. RLI remained profitable though, its EPS actually went up during the 2008 to 2010 time frame. The insurance business generally is not cyclical. Insurers who faced steep losses (e.g. AIG) did so because 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 very high valuation will be a major headwind going forward, though, as this will pressure share price appreciation significantly. 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



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