RLI Corporation (RLI)

Updated October 17th, 2018 by Jonathan Weber

Key Metrics

Current Price:	$74	**5 Year CAGR Estimate:**	-8.9%	**Volatility Percentile:**	33.0%
Fair Value Price:	$40	**5 Year Growth Estimate:**	1.2%	**Momentum Percentile:**	89.3%
% Fair Value:	185%	**5 Year Valuation Multiple Estimate:**	-11.3%	**Growth Percentile:**	3.5%
Dividend Yield:	1.2%	**5 Year Price Target**	$43	**Valuation Percentile:**	1.3%
Dividend Risk Score:	D	**Retirement Suitability Score:**	D	**Total Return Percentile:**	0.2%

Overview & Current Events

RLI Corp. is an insurance company that operates 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 $3.3 billion.

RLI Corporation reported its third quarter earnings results on October 17. During Q3 RLI Corporation was able to grow its revenues by 22.6% year over year. The company's top line hit $241 million. Revenues were driven by higher net premiums, which rose by 10% year over year, as well as by higher net investment income (up 15% year over year) and by higher net realized gains. Operating net earnings per share (adjusted for one-time gains) rose to $0.46 per share, a vast increase from $0.04 during the previous year's quarter. Year-to-date net profits per share are up by 54% to $1.66.

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***
Shares	43.0	42.5	41.9	42.3	42.5	43.0	43.1	43.5	44.0	44.2	***43.0***	***40.5***

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. The impact of both of these items (higher investment earnings and lower taxes) was highly visible during the first three quarters of 2018, during which RLI Corporation has been able to increase its core profits by more than 50%.

RLI has increased its dividend by 6% annually through the last decade, which was primarily possible due to a steady 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	***30.8***	***16.9***
Avg. Yld.	1.8%	2.1%	2.1%	1.9%	1.8%	1.7%	1.6%	1.4%	1.2%	1.4%	***1.2%***	***1.8%***

RLI Corporation has been trading at a quite high valuation over the last three years. Right now, shares trade at slightly more than 30 times this year's expected earnings. This is a huge premium over what we deem a fair valuation.

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

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RLI Corporation's regular dividend yields just 1.2%, which is less than the broad market's average yield. The dividend has been increased regularly, but since the dividend growth rate is not overly high, RLI Corporation does not look like a strong dividend growth pick. When we include the most recent special dividend payment, the dividend yield would be 3.6%, but since the company's special dividends have fluctuated in size it is not guaranteed that they will remain at the current level. It is also possible that there will not be any special dividend payments during some years.

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 to three, 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.

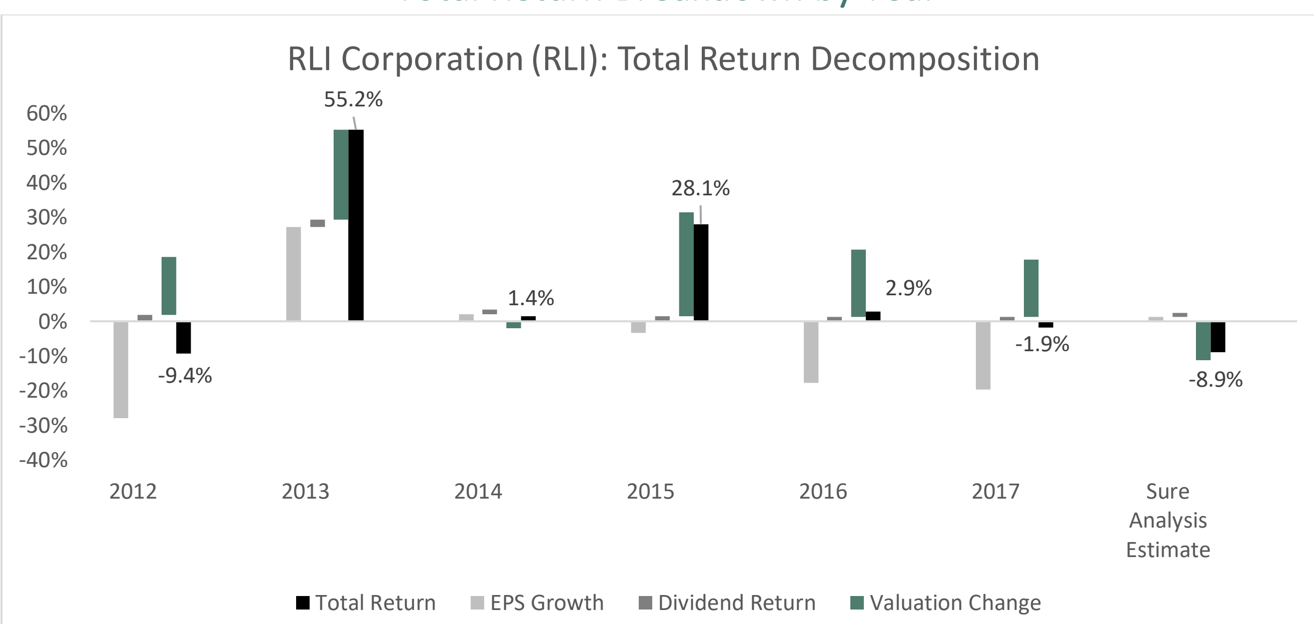
Many financial corporations, including some insurers, experienced significant difficulty during the last recession. RLI remained profitable though. Its EPS actually went up during the 2008 to 2010 time frame.

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 Corporation has not been able to produce compelling earnings growth rates over the last couple of years (although 2018 looks better), and shares of RLI Corporation are currently trading well above fair value. RLI Corporation earns a sell recommendation from Sure Dividend at current prices. In addition, the company earns D rating for both Dividend Safety and Retirement Suitability due to its significant (85%+) historical stock price drawdowns and its low dividend yield.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	561.0	546.55	583.42	621.38	662.71	707.73	777.12	796.47	817.85	800.80
SG&A Exp.	42.06	47.71	46.58	7.77	7.87	8.75	10.22	9.84	10.17	11.34
D&A Exp.	3.60	3.28	3.04	3.18	3.15	3.77	4.56	5.41	6.43	6.94
Net Profit	78.68	93.85	127.43	126.60	103.35	126.26	135.45	137.54	114.92	105.03
Net Margin	14.0%	17.2%	21.8%	20.4%	15.6%	17.8%	17.4%	17.3%	14.1%	13.1%
Free Cash Flow	155.3	126.93	97.94	112.61	20.95	117.44	115.96	142.55	158.31	188.29
Income Tax	27.92	38.59	51.06	56.99	39.39	49.41	54.04	59.14	42.16	-20.44

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	2419	2539	2515	2655	2645	2740	2776	2735	2778	2947
Cash & Equivalents	0.00	0.00	0.00	81.18	44.31	39.47	30.62	11.08	18.27	24.27
Accounts Receivable	92.15	83.96	107.39	478.30	499.24	507.43	489.68	441.51	414.61	436.34
Goodwill & Int. Ass.	26.21	26.21	26.21	60.48	76.11	74.88	72.70	71.29	64.37	59.30
Total Liabilities	1711	1706	1723	1862	1848	1911	1930	1912	1954	2094
Accounts Payable	30.22	22.43	23.85	50.86	43.96	47.33	38.01	37.56	17.93	21.62
Long-Term Debt	100.0	100.00	100.00	100.00	100.00	149.58	149.63	148.55	148.74	148.93
Shareholder's Equity	708.2	832.25	791.38	792.63	796.36	828.97	845.06	823.47	823.57	853.60
D/E Ratio	0.14	0.12	0.13	0.13	0.13	0.18	0.18	0.18	0.18	0.17

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	3.1%	3.8%	5.0%	4.9%	3.9%	4.7%	4.9%	5.0%	4.2%	3.7%
Return on Equity	10.6%	12.2%	15.7%	16.0%	13.0%	15.5%	16.2%	16.5%	14.0%	12.5%
ROIC	9.2%	10.8%	14.0%	14.2%	11.6%	13.5%	13.7%	14.0%	11.8%	10.6%
Shares Out.	43.0	42.5	41.9	42.3	42.5	43.0	43.1	43.5	44.0	44.2
Revenue/Share	12.84	12.58	13.73	14.49	15.35	16.26	17.73	18.05	18.41	18.00
FCF/Share	3.55	2.92	2.31	2.63	0.49	2.70	2.65	3.23	3.56	4.23

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.