RLI Corporation (RLI)

Updated January 25th, 2019 by Jonathan Weber

Key Metrics

Current Price:	$66	**5 Year CAGR Estimate:**	-7.6%	**Volatility Percentile:**	33.1%
Fair Value Price:	$39	**5 Year Growth Estimate:**	1.2%	**Momentum Percentile:**	87.9%
% Fair Value:	169%	**5 Year Valuation Multiple Estimate:**	-10.1%	**Growth Percentile:**	2.9%
Dividend Yield:	1.3%	**5 Year Price Target**	$41	**Valuation Percentile:**	1.2%
Dividend Risk Score:	F	**Retirement Suitability Score:**	F	**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 fourth quarter and full year earnings results on January 23. The company reported revenues of $172 million for the fourth quarter, which represents a decline of 17% compared to the prior year's quarter. Gross premiums written rose by 12% year over year, investment income rose by an even better 17% compared to the prior year's quarter. The revenue decline was based on $64 million in net unrealized losses on equity securities, which can be explained by the broad market's downturn during the fourth quarter. This is somewhat of a one-time item, though, as equity markets will in all likelihood not continue to decline forever. Apart from this item RLI Corporation's performance was quite solid during the fourth quarter, as net premiums earned, net investment income, and net realized gains all grew compared to the prior year's quarter.

RLI Corporation earned $0.40 per share on an adjusted basis, which represents a substantial decline versus the previous year's $1.20 in earnings-per-share. For fiscal 2018 RLI Corporation has earned $2.05 per share, which represents a low double digit decline versus 2017's earnings-per-share of $2.30.

During the fourth quarter RLI Corporation has declared a special dividend payment of $1.00 per share.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$2.35	$2.66	$2.80	$2.02	$2.57	$2.62	$2.53	$2.08	$2.30	$2.05	***$2.29***	***$2.43***
DPS	$0.54	$0.57	$0.60	$0.63	$0.67	$0.71	$0.75	$0.79	$0.83	$0.87	***$0.91***	***$1.10***
Shares	42.5	41.9	42.3	42.5	43.0	43.1	43.5	44.0	44.2	44.5	***44.8***	***46.0***

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 generate with 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 a tailwind for RLI Corporation as well, as this has increased the company's net earnings relative to the operating profits that the company generates. The impact of both of these items, higher investment earnings and lower taxes, was highly visible during the first three quarters of 2018, although Q4's weak profitability has led to an earnings decline for fiscal 2018.

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 $1.00, was announced in November 2018. RLI has made special dividend payments of $1.75 in 2017 and 2016, thus special dividend payments can be a bit erratic and do not necessarily grow over time.

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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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	10.8	10.4	11.0	16.9	15.6	17.2	21.1	31.1	34.3	33.7	***28.8***	***16.9***
Avg. Yld.	2.1%	2.1%	1.9%	1.8%	1.7%	1.6%	1.4%	1.2%	1.4%	1.3%	***1.3%***	***2.2%***

RLI Corporation's price to earnings multiple has been moving in a very wide range over the last decade. Shares were valued at a low-double-digit price to earnings multiple shortly after the financial crisis, but the company's valuation exploded upwards over the last couple of years. Shares trade at a huge premium relative to how shares were valued in the past, which is why we see considerable downside risk for RLI Corporation's share price.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	23.0%	21.4%	21.4%	31.2%	26.1%	27.1%	29.6%	38.0%	49.7%	42.4%	***39.7%***	***45.3%***

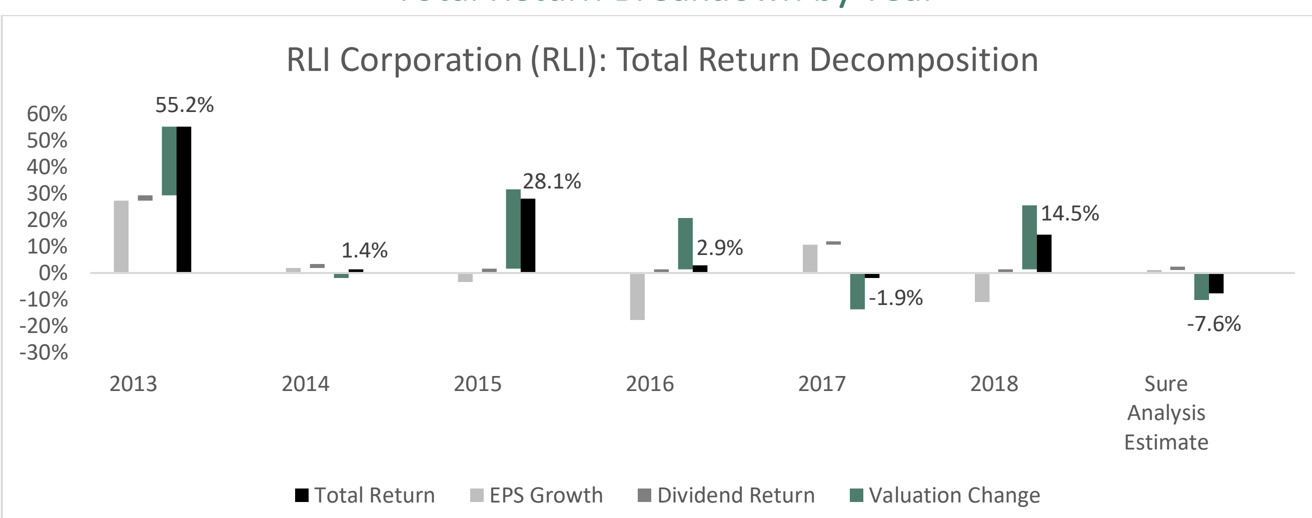
RLI Corporation has raised its regular dividend very steadily over the last couple of years, which was possible due to increases in the company's payout ratio. RLI Corporation still pays out less than half of its profits in the form of regular dividends, which makes the payout look sufficiently safe for the foreseeable future.

Many financial corporations, including some insurers, experienced significant difficulty during the last recession. RLI remained profitable though, its earnings-per-share actually increased during the 2008 to 2010 time frame. We believe that RLI Corporation will be relatively stable during future recessions as well. 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.

Final Thoughts & Recommendation

RLI Corporation is a smaller insurance company which has produced solid underlying results during Q4, with written premiums and investment income rising year over year. Payouts for damages have hurt its profitability, though. RLI Corporation does not have a strong track record when it comes to generating earnings-per-share growth, and we believe that shares are heavily overvalued right here. Because of this, RLI Corporation earns a sell recommendation from Sure Dividend at current prices.

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.

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