RLI Corporation (RLI)

Updated July 23rd, 2020 by Jonathan Weber

Key Metrics

Current Price:	$95	**5 Year CAGR Estimate:**	-8.6%	**Market Cap:**	$4.2B
Fair Value Price:	$48	**5 Year Growth Estimate:**	3.0%	**Ex-Dividend Date:**	08/28/20[1]
% Fair Value:	200%	**5 Year Valuation Multiple Estimate:**	-12.9%	**Dividend Payment Date:**	09/20/20[2]
Dividend Yield:	1.0%	**5 Year Price Target**	$55	**Years Of Dividend Growth:**	45
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	4.3%

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 headquartered in Peoria, Illinois.

RLI Corporation reported its second quarter earnings results on July 22. The company reported revenues of $298 million during the quarter, which represents an increase of 25% compared to the revenues that RLI Corporation generated during the previous year's quarter. Gross written premiums rose by 1% year-over-year, while investment income was in line with the prior year's level. The massive revenue increase can be explained by the equity market recovery during the second quarter of 2020, which resulted in large net unrealized gains during that quarter, although it should be noted that this is a non-cash item that will not occur on a repeated basis.

RLI Corporation earned $0.77 per share on an adjusted basis, which was 17% more than the earnings-per-share that RLI Corporation generated during the previous year's quarter. On a GAAP basis, net earnings were $2.04, but this is due to the one-time impact of higher unrealized gains, and is thus backed out for a cleaner view on the company's underlying earnings generation. The increase in Q1 adjusted earnings can be explained by an improved combined ratio.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$2.66	$2.80	$2.02	$2.57	$2.62	$2.53	$2.08	$2.30	$2.05	$2.57	***$2.80***	***$3.25***
DPS	$0.57	$0.60	$0.63	$0.67	$0.71	$0.75	$0.79	$0.83	$0.87	$0.91	***$0.92***	***$1.23***
Shares[3]	41.9	42.3	42.5	43.0	43.1	43.5	44.0	44.2	44.5	45.4	***45.8***	***46.5***

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 generate with its insurance float.

Rising interest rates were a positive for the company's profitability during the Fed's tightening cycle, but now that the Fed has gone back to a more dovish policy, this tailwind will likely disappear. Tax legislation changes are a tailwind for RLI Corporation, as this has increased the company's net earnings substantially, thanks to a drastic reduction in the company's tax rate. We believe that RLI Corporation should be able to grow its profits slightly going forward, as written premiums continue to grow, which provides some revenue growth tailwinds over the coming years. RLI has, in the recent past, also been able to improve its combined ratio, which should help in growing profits over the coming years. Due to the company's choppy earnings history, we do not forecast a high long-term earnings-per-share growth rate, though. Instead, we believe that 3% annual earnings-per-share growth is realistic.

RLI has increased its dividend, on average, by 6% annually through the last decade, which was primarily possible due to a steady increase in the company's dividend payout ratio. In May, RLI has increased its dividend by 4.3%.

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[1] Estimated date

[2] Estimated date

[3] In Millions

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	10.4	11.0	16.9	15.6	17.2	21.1	31.1	34.3	33.7	35.0	***33.9***	***17.0***
Avg. Yld.	2.1%	1.9%	1.8%	1.7%	1.6%	1.4%	1.2%	1.4%	1.3%	1.0%	***1.0%***	***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 massive premium relative to how shares were valued in the past, which is why we see huge downside risk for RLI Corporation's share price.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	21.4%	21.4%	31.2%	26.1%	27.1%	29.6%	38.0%	49.7%	42.4%	35.4%	***32.9%***	***37.9%***

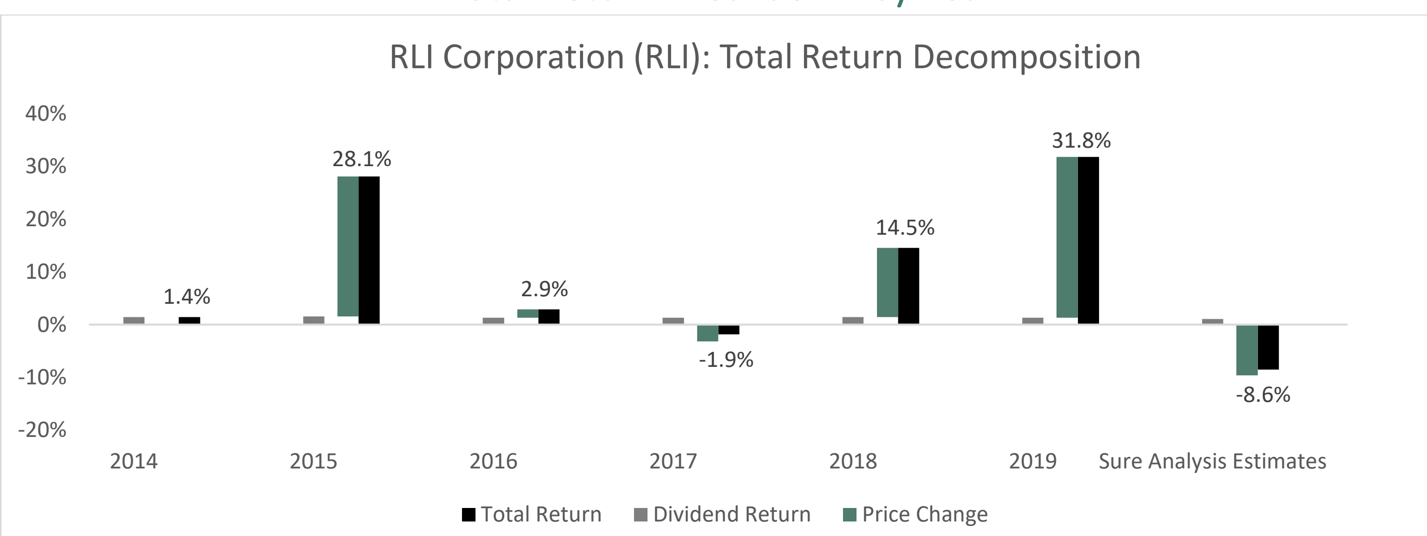
RLI Corporation has raised its regular dividend very steadily over the last couple of years, which was possible due to ongoing increases in the company's payout ratio. RLI Corporation still pays out just about one-third of its profits in the form of regular dividends, which makes the payout look sufficiently safe for the foreseeable future. Due to RLI Corporation's very low dividend yield, we do not believe that shares are attractive for income investors.

Many financial corporations, including some insurers, experienced significant difficulty during the last recession. RLI remained profitable, and 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, including the current pandemic. Compared to other corporations from the financial industry, RLI Corporation thus looks like a more stable, lower-risk pick.

Final Thoughts & Recommendation

RLI Corporation is a small insurance company which generated solid operational results in recent years, with written premiums and investment income rising. Earnings will likely continue to grow during the next couple of years, but we see substantial deceleration in its earnings growth. RLI Corporation does not have a strong long-term track record, and lower interest rates could dampen its investment income growth rate. We believe that shares are heavily overvalued today. Because of this, RLI Corporation earns a sell recommendation from Sure Dividend at current prices.

Total Return Breakdown by Year



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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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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	583	621	663	708	777	796	818	801	820	1,007
SG&A Exp.	47	8	8	9	10	10	10	11	9	13
D&A Exp.	3	3	3	4	5	5	6	7	7	8
Net Profit	127	127	103	126	135	138	115	105	64	192
Net Margin	21.8%	20.4%	15.6%	17.8%	17.4%	17.3%	14.1%	13.1%	7.8%	19.0%
Free Cash Flow	98	113	21	117	116	143	158	188	211	270
Income Tax	51	57	39	49	54	59	42	(20)	3	41

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	2,515	2,655	2,645	2,740	2,776	2,735	2,778	2,947	3,105	3,546
Cash & Equivalents	-	81	44	39	31	11	18	24	30	46
Accounts Receivable	107	478	499	507	490	442	415	436	518	545
Goodwill & Int. Ass.	26	60	76	75	73	71	64	59	55	54
Total Liabilities	1,723	1,862	1,848	1,911	1,930	1,912	1,954	2,094	2,298	2,550
Accounts Payable	24	51	44	47	38	38	18	22	23	26
Long-Term Debt	100	100	100	150	150	149	149	149	149	149
Shareholder's Equity	791	793	796	829	845	823	824	854	807	995
D/E Ratio	0.13	0.13	0.13	0.18	0.18	0.18	0.18	0.17	0.18	0.15

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	5.0%	4.9%	3.9%	4.7%	4.9%	5.0%	4.2%	3.7%	2.1%	5.8%
Return on Equity	15.7%	16.0%	13.0%	15.5%	16.2%	16.5%	14.0%	12.5%	7.7%	21.3%
ROIC	14.0%	14.2%	11.6%	13.5%	13.7%	14.0%	11.8%	10.6%	6.6%	18.2%
Shares Out.	41.9	42.3	42.5	43.0	43.1	43.5	44.0	44.2	44.5	45.4
Revenue/Share	13.73	14.49	15.35	16.26	17.73	18.05	18.41	18.00	18.30	22.24
FCF/Share	2.31	2.63	0.49	2.70	2.65	3.23	3.56	4.23	4.71	5.97

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