

RLI CORP  
Form 10-Q  
July 28, 2014

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended June 30, 2014

or

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-09463

**RLI Corp.**

(Exact name of registrant as specified in its charter)

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**ILLINOIS**

(State or other jurisdiction of  
incorporation or organization)

**37-0889946**

(I.R.S. Employer  
Identification Number)

**9025 North Lindbergh Drive, Peoria, IL**

(Address of principal executive offices)

**61615**

(Zip Code)

**(309) 692-1000**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer   
(Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

**APPLICABLE ONLY TO CORPORATE ISSUERS:**

As of July 11, 2014, the number of shares outstanding of the registrant's Common Stock was 43,023,504.

## PART I - FINANCIAL INFORMATION

## Item 1. Financial Statements

## RLI Corp. and Subsidiaries

## Condensed Consolidated Statements of Earnings and Comprehensive Earnings

(Unaudited)

(in thousands, except per share data)	For the Three-Month Periods Ended June 30,	
	2014	2013
Net premiums earned	\$ 168,604	\$ 154,553
Net investment income	13,982	12,847
Net realized investment gains	10,431	3,742
Consolidated revenue	\$ 193,017	\$ 171,142
Losses and settlement expenses	73,345	65,607
Policy acquisition costs	55,156	51,502
Insurance operating expenses	13,534	11,885
Interest expense on debt	1,874	1,513
General corporate expenses	2,549	1,692
Total expenses	\$ 146,458	\$ 132,199
Equity in earnings of unconsolidated investees	5,864	4,633
Earnings before income taxes	\$ 52,423	\$ 43,576
Income tax expense	16,698	13,674
Net earnings	\$ 35,725	\$ 29,902
Other comprehensive earnings (loss), net of tax	19,934	(33,481)
Comprehensive earnings (loss)	\$ 55,659	\$ (3,579)
Earnings per share:		
Basic:		
Basic net earnings per share	\$ 0.83	\$ 0.70
Basic comprehensive earnings (loss) per share	\$ 1.29	\$ (0.08)
Diluted:		
Diluted net earnings per share	\$ 0.82	\$ 0.69
Diluted comprehensive earnings (loss) per share	\$ 1.27	\$ (0.08)
Weighted average number of common shares outstanding		
Basic	43,001	42,628
Diluted	43,688	43,341
Cash dividends paid per common share	\$ 0.18	\$ 0.17

See accompanying notes to the unaudited condensed consolidated interim financial statements.



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RLI Corp. and Subsidiaries

Condensed Consolidated Statements of Earnings and Comprehensive Earnings

(Unaudited)

(in thousands, except per share data)	For the Six-Month Periods Ended June 30,	
	2014	2013
Net premiums earned	\$ 329,736	\$ 298,704
Net investment income	27,564	25,733
Net realized investment gains	16,932	7,426
Consolidated revenue	\$ 374,232	\$ 331,863
Losses and settlement expenses	144,361	127,055
Policy acquisition costs	110,207	101,838
Insurance operating expenses	26,067	24,454
Interest expense on debt	3,725	3,025
General corporate expenses	4,747	4,078
Total expenses	\$ 289,107	\$ 260,450
Equity in earnings of unconsolidated investees	9,289	8,132
Earnings before income taxes	\$ 94,414	\$ 79,545
Income tax expense	29,720	24,796
Net earnings	\$ 64,694	\$ 54,749
Other comprehensive earnings (loss), net of tax	37,671	(15,928)
Comprehensive earnings	\$ 102,365	\$ 38,821
Earnings per share:		
Basic:		
Basic net earnings per share	\$ 1.50	\$ 1.29
Basic comprehensive earnings per share	\$ 2.38	\$ 0.91
Diluted:		
Diluted net earnings per share	\$ 1.48	\$ 1.27
Diluted comprehensive earnings per share	\$ 2.34	\$ 0.90
Weighted average number of common shares outstanding		
Basic	42,993	42,587
Diluted	43,669	43,268
Cash dividends paid per common share	\$ 0.35	\$ 0.33

See accompanying notes to the unaudited condensed consolidated interim financial statements.

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RLI Corp. and Subsidiaries

Condensed Consolidated Balance Sheets

(Unaudited)

(in thousands, except share data)	June 30, 2014	December 31, 2013
<b>ASSETS</b>		
Investments		
Fixed income		
Available-for-sale, at fair value	\$ 1,534,622	\$ 1,440,052
Held-to-maturity, at amortized cost	650	651
Equity securities, at fair value	436,462	418,654
Short-term investments, at cost	18,489	23,232
Cash	27,234	39,469
Total investments and cash	\$ 2,017,457	\$ 1,922,058
Accrued investment income	15,229	15,710
Premiums and reinsurance balances receivable	203,499	152,509
Ceded unearned premium	72,396	60,407
Reinsurance balances recoverable on unpaid losses	339,104	354,924
Deferred policy acquisition costs	68,190	61,508
Property and equipment	42,935	40,261
Investment in unconsolidated investees	64,487	49,793
Goodwill and intangibles	74,407	74,876
Other assets	11,292	8,264
<b>TOTAL ASSETS</b>	<b>\$ 2,908,996</b>	<b>\$ 2,740,310</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Liabilities:		
Unpaid losses and settlement expenses	\$ 1,127,073	\$ 1,129,433
Unearned premiums	444,453	392,081
Reinsurance balances payable	62,402	47,334
Funds held	59,398	61,656
Income taxes-deferred	81,963	57,801
Bonds payable, long-term debt	149,604	149,582
Accrued expenses	40,199	59,596
Other liabilities	24,509	13,861
<b>TOTAL LIABILITIES</b>	<b>\$ 1,989,601</b>	<b>\$ 1,911,344</b>
Shareholders Equity		
Common stock (\$1 par value, 100,000,000 shares authorized) (65,953,718 shares issued, 43,023,504 shares outstanding at 6/30/14) (65,912,638 shares issued, 42,982,424 shares outstanding at 12/31/13)	\$ 65,954	\$ 65,913
Paid-in capital	211,774	208,705
Accumulated other comprehensive earnings	173,698	136,027
Retained earnings	860,968	811,320
Deferred compensation	11,626	11,562
Less: Treasury shares at cost (22,930,214 shares at 6/30/14 and 12/31/13)	(404,625)	(404,561)
<b>TOTAL SHAREHOLDERS EQUITY</b>	<b>\$ 919,395</b>	<b>\$ 828,966</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b>	<b>\$ 2,908,996</b>	<b>\$ 2,740,310</b>

See accompanying notes to the unaudited condensed consolidated interim financial statements.



## RLI Corp. and Subsidiaries

## Condensed Consolidated Statements of Cash Flows

(Unaudited)

(in thousands)	For the Six-Month Periods Ended June 30,	
	2014	2013
Net cash provided by operating activities	\$ 38,528	\$ 26,781
Cash Flows from Investing Activities		
Investments purchased	\$ (311,402)	\$ (295,508)
Investments sold	217,403	145,314
Investments called or matured	49,932	77,436
Net change in short-term investments	15,462	33,134
Net property and equipment purchased	(4,921)	(8,167)
Investment in equity method investee	(5,301)	
Net cash used in investing activities	\$ (38,827)	\$ (47,791)
Cash Flows from Financing Activities		
Cash dividends paid	\$ (15,046)	\$ (14,062)
Stock plan share issuance	2,760	1,545
Excess tax benefit from exercise of stock options	350	1,970
Net cash used in financing activities	\$ (11,936)	\$ (10,547)
Net decrease in cash	\$ (12,235)	\$ (31,557)
Cash at the beginning of the period	\$ 39,469	\$ 44,314
Cash at June 30	\$ 27,234	\$ 12,757

See accompanying notes to the unaudited condensed consolidated interim financial statements.



**NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**A. BASIS OF PRESENTATION**

The unaudited condensed consolidated interim financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (GAAP) for interim financial reporting and with the instructions to Form 10-Q and Regulation S-X. Accordingly, they do not include all of the disclosures required by GAAP for complete financial statements. As such, these unaudited condensed consolidated interim financial statements should be read in conjunction with our 2013 Annual Report on Form 10-K. Management believes that the disclosures are adequate to make the information presented not misleading, and all normal and recurring adjustments necessary to present fairly the financial position at June 30, 2014 and the results of operations of RLI Corp. and subsidiaries for all periods presented have been made. The results of operations for any interim period are not necessarily indicative of the operating results for a full year.

The preparation of the unaudited condensed consolidated interim financial statements requires management to make estimates and assumptions relating to the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the unaudited condensed consolidated interim financial statements, and the reported amounts of revenue and expenses during the period. These estimates are inherently subject to change and actual results could differ significantly from these estimates.

**B. ADOPTED ACCOUNTING STANDARDS**

We have not adopted any new accounting standards as there have been no accounting standard updates which would impact our financial statements.

**C. PROSPECTIVE ACCOUNTING STANDARDS**

There are no prospective accounting standards which would impact our financial statements as of June 30, 2014.

**D. INTANGIBLE ASSETS**

In accordance with GAAP guidelines, the amortization of goodwill and indefinite-lived intangible assets is not permitted. Goodwill and indefinite-lived intangible assets remain on the balance sheet and are tested for impairment on an annual basis, or earlier if there is reason to suspect that their values may have been diminished or impaired. Goodwill and intangibles totaled \$74.4 million at June 30, 2014.

Goodwill resulting from acquisitions completed prior to 2011 totaled \$26.2 million and is attributable to our surety segment. Goodwill and intangible assets resulting from the Contractors Bonding and Insurance Company (CBIC) acquisition in April 2011 totaled \$32.2 million. The CBIC-related assets include goodwill attributable to our casualty and surety segments of \$5.3 million and \$15.1 million, respectively, and an indefinite-lived intangible asset in the amount of \$8.8 million. Annual impairment testing was performed on each of these goodwill and indefinite-lived intangible assets during the

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second quarter of 2014. Based upon these reviews, none of the assets were impaired. In addition, as of June 30, 2014, there were no triggering events that occurred that would suggest an updated review was necessary. Definite-lived intangible assets related to the CBIC acquisition totaled \$3.0 million, net of amortization, as of June 30, 2014.

The remaining \$16.0 million of goodwill and intangibles relates to our purchase of Rockbridge Underwriting Agency (Rockbridge) in November 2012. Of this amount, \$12.4 million is recorded as goodwill attributable to our casualty segment. The remaining \$3.6 million relates to definite-lived intangible assets, net of amortization, as of June 30, 2014. Annual impairment testing was performed on this goodwill asset in the fourth quarter of 2013. Based upon this review, the asset was not impaired. In addition, as of June 30, 2014, there were no triggering events that occurred that would suggest an updated review was necessary.

The aforementioned definite-lived intangible assets are amortized against future operating results based on their estimated useful lives. Amortization of intangible assets resulting from the acquisitions of CBIC and Rockbridge was \$0.3 for the second quarter of 2014, and \$0.5 million for the six months ended June 30, 2014.

### E. EARNINGS PER SHARE

Basic earnings per share (EPS) excludes dilution and is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the dilution that could occur if securities or other contracts to issue common stock or common stock equivalents were exercised or converted into common stock. When inclusion of common stock equivalents increases the earnings per share or reduces the loss per share, the effect on earnings is anti-dilutive. Under these circumstances, the diluted net earnings or net loss per share is computed excluding the common stock equivalents.

The following represents a reconciliation of the numerator and denominator of the basic and diluted EPS computations contained in the unaudited condensed consolidated interim financial statements.

(in thousands, except per share data)	For the Three-Month Period Ended June 30, 2014			For the Three-Month Period Ended June 30, 2013		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
<b>Basic EPS</b>						
Income available to common shareholders	\$ 35,725	43,001	\$ 0.83	\$ 29,902	42,628	\$ 0.70
<b>Effect of Dilutive Securities</b>						
Stock options		687			713	
<b>Diluted EPS</b>						
Income available to common shareholders	\$ 35,725	43,688	\$ 0.82	\$ 29,902	43,341	\$ 0.69

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(in thousands, except per share data)	For the Six-Month Period Ended June 30, 2014			For the Six-Month Period Ended June 30, 2013		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
<b>Basic EPS</b>						
Income available to common shareholders	\$ 64,694	42,993	\$ 1.50	\$ 54,749	42,587	\$ 1.29
<b>Effect of Dilutive Securities</b>						
Stock options		676			681	
<b>Diluted EPS</b>						
Income available to common shareholders	\$ 64,694	43,669	\$ 1.48	\$ 54,749	43,268	\$ 1.27

F. COMPREHENSIVE EARNINGS

Our comprehensive earnings include net earnings plus unrealized gains/losses on our available-for-sale investment securities, net of tax. In reporting comprehensive earnings on a net basis in the statement of earnings, we used the federal statutory tax rate of 35 percent. The following table illustrates the changes in the balance of each component of accumulated other comprehensive earnings for each period presented in the unaudited condensed consolidated interim financial statements.

(in thousands)	For the Three-Month Periods Ended June 30,		For the Six - Month Periods Ended June 30,	
	2014	2013	2014	2013
<b>Unrealized Gains/Losses on Available-for-Sale Securities</b>				
Beginning balance	\$ 153,764	\$ 160,723	\$ 136,027	\$ 143,170
Other comprehensive earnings before reclassifications	26,714	(30,824)	48,674	(10,557)
Amounts reclassified from accumulated other comprehensive earnings	(6,780)	(2,657)	(11,003)	(5,371)
Net current-period other comprehensive earnings	\$ 19,934	\$ (33,481)	\$ 37,671	\$ (15,928)
Ending balance	\$ 173,698	\$ 127,242	\$ 173,698	\$ 127,242

The sale or other-than-temporary impairment of an available-for-sale security results in amounts being reclassified from accumulated other comprehensive earnings to current period net earnings. The effects of reclassifications out of accumulated other comprehensive earnings by the respective line items of net earnings are presented in the following table.

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(in thousands) Component of Accumulated Other Comprehensive Earnings	Amount Reclassified from Accumulated Other Comprehensive Earnings				Affected line item in the Statement of Earnings
	For the Three-Month Periods Ended June 30, 2014		For the Six-Month Periods Ended June 30, 2013		
Unrealized gains and losses on available-for-sale securities	\$ 10,431	\$ 4,087	\$ 16,928	\$ 8,263	Net realized investment gains Other-than-temporary impairment (OTTI) losses on investments
	\$ 10,431	\$ 4,087	\$ 16,928	\$ 8,263	Earnings before income taxes
	(3,651)	(1,430)	(5,925)	(2,892)	Income tax expense
	\$ 6,780	\$ 2,657	\$ 11,003	\$ 5,371	Net earnings

## 2. INVESTMENTS

Our investments include fixed income debt securities and common stock equity securities. As disclosed in our 2013 Annual Report on Form 10-K, we present our investments in these classes as available-for-sale and held-to-maturity. When available, we obtain quoted market prices to determine fair value for our investments. If a quoted market price is not available, fair value is estimated using a secondary pricing source or using quoted market prices of similar securities. We have no investment securities for which fair value is determined using Level 3 inputs as defined in note 3 to the unaudited condensed consolidated interim financial statements, Fair Value Measurements.

The following tables show the amortized cost, unrealized gains/losses, fair value and contractual maturities for our available-for-sale and held-to-maturity securities.

### *Available-for-Sale Securities*

The amortized cost and fair value of available-for-sale securities at June 30, 2014 and December 31, 2013 were as follows:

### Available-for-sale

(in thousands)

Asset Class	Cost or Amortized Cost	6/30/2014		Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
U.S. agency	\$ 3,883	\$ 99	\$ (1)	\$ 3,981
Corporate	550,687	28,919	(797)	578,809
Mtge/ABS/CMBS*	375,116	11,242	(2,918)	383,440
Non-U.S. govt. & agency	13,853	1,064		14,917
U.S. government	31,571	168	(10)	31,729

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Municipal		510,516		13,111		(1,881)		521,746
<b>Total Fixed Income</b>	<b>\$</b>	<b>1,485,626</b>	<b>\$</b>	<b>54,603</b>	<b>\$</b>	<b>(5,607)</b>	<b>\$</b>	<b>1,534,622</b>
<b>Equity</b>	<b>\$</b>	<b>218,797</b>	<b>\$</b>	<b>217,731</b>	<b>\$</b>	<b>(66)</b>	<b>\$</b>	<b>436,462</b>

**Available-for-sale**

(in thousands)

Asset Class	12/31/2013			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. agency	\$ 10,513	\$ 22	\$ (237)	\$ 10,298
Corporate	511,748	22,302	(8,012)	526,038
Mtge/ABS/CMBS*	350,187	8,188	(7,650)	350,725
Non-U.S. govt. & agency	13,306	437	(65)	13,678
U.S. government	17,086	217		17,303
Municipal	528,209	6,495	(12,694)	522,010
<b>Total Fixed Income</b>	<b>\$ 1,431,049</b>	<b>\$ 37,661</b>	<b>\$ (28,658)</b>	<b>\$ 1,440,052</b>
<b>Equity</b>	<b>\$ 218,848</b>	<b>\$ 200,081</b>	<b>\$ (275)</b>	<b>\$ 418,654</b>

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\*Mortgage-backed, asset-backed and commercial mortgage-backed

The following table presents the amortized cost and fair value of available-for-sale debt securities by contractual maturity dates as of June 30, 2014:

AFS (in thousands)	6/30/2014	
	Amortized Cost	Fair Value
Due in one year or less	\$ 11,557	\$ 11,628
Due after one year through five years	211,437	221,664
Due after five years through 10 years	618,409	642,994
Due after 10 years	269,107	274,896
Mtge/ABS/CMBS*	375,116	383,440
Total available-for-sale	\$ 1,485,626	\$ 1,534,622

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\*Mortgage-backed, asset-backed & commercial mortgage-backed

*Held-to-Maturity Debt Securities*

The carrying value and fair value of held-to-maturity securities was \$0.7 million at June 30, 2014 and December 31, 2013. Held-to-maturity securities are carried on the unaudited condensed consolidated balance sheets at amortized cost and changes in the fair value of these securities, other than impairment charges, are not reported on the financial statements. Unrecognized gains on our held-to-maturity securities were less than \$0.1 million at June 30, 2014 and December 31, 2013. As of June 30, 2014, the carrying value and fair value of all debt securities held-to-maturity had a contractual maturity date of one year or less.

*Unrealized Losses*

We conduct and document periodic reviews of all securities with unrealized losses to evaluate whether the impairment is other-than-temporary. The following tables are used as part of our impairment analysis and illustrate the total value of securities that were in an unrealized loss position as of June 30, 2014 and December 31, 2013. The tables segregate the securities based on type, noting the fair value, cost (or amortized cost), and unrealized loss on each category of investment as well as in total. The tables further classify the securities based on the length of time they have been in an unrealized loss position. As of June 30, 2014 unrealized losses, as shown in the following tables, were 0.3 percent of total invested assets. Unrealized



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losses decreased in 2014, as interest rates declined during the first half of the year.

(in thousands)	June 30, 2014			December 31, 2013		
	< 12 Mos.	12 Mos. & Greater	Total	< 12 Mos.	12 Mos. & Greater	Total
<b>U.S. Government</b>						
Fair value	\$ 4,423	\$	\$ 4,423	\$	\$	\$
Cost or amortized cost	4,433		4,433			
Unrealized Loss	\$ (10)	\$	\$ (10)	\$	\$	\$
<b>U.S. Agency</b>						
Fair value	\$ 1,883	\$	\$ 1,883	\$ 5,760	\$	\$ 5,760
Cost or amortized cost	1,884		1,884	5,997		5,997
Unrealized Loss	\$ (1)	\$	\$ (1)	\$ (237)	\$	\$ (237)
<b>Non-U.S. Government</b>						
Fair value	\$	\$	\$	\$ 1,825	\$	\$ 1,825
Cost or amortized cost				1,890		1,890
Unrealized Loss	\$	\$	\$	\$ (65)	\$	\$ (65)
<b>Mortgage-backed</b>						
Fair value	\$ 7,349	\$ 79,004	\$ 86,353	\$ 118,283	\$	\$ 118,283
Cost or amortized cost	7,392	81,396	88,788	124,034		124,034
Unrealized Loss	\$ (43)	\$ (2,392)	\$ (2,435)	\$ (5,751)	\$	\$ (5,751)
<b>ABS/CMBS*</b>						
Fair value	\$ 16,557	\$ 16,457	\$ 33,014	\$ 54,115	\$	\$ 54,115
Cost or amortized cost	16,659	16,838	33,497	56,014		56,014
Unrealized Loss	\$ (102)	\$ (381)	\$ (483)	\$ (1,899)	\$	\$ (1,899)
<b>Corporate</b>						
Fair value	\$ 51,213	\$ 32,233	\$ 83,446	\$ 190,470	\$ 2,245	\$ 192,715
Cost or amortized cost	51,414	32,829	84,243	198,250	2,477	200,727
Unrealized Loss	\$ (201)	\$ (596)	\$ (797)	\$ (7,780)	\$ (232)	\$ (8,012)
<b>Municipal</b>						
Fair value	\$ 22,079	\$ 117,639	\$ 139,718	\$ 309,407	\$ 943	\$ 310,350
Cost or amortized cost	22,132					