RLI CORP
Form 10-Q
April 30, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2012

or

o **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)

ILLINOIS	**37-0889946**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

9025 North Lindbergh Drive, Peoria, IL	**61615**
(Address of principal executive offices)	(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 x No o

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 x No o

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 x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

As of April 13, 2012, the number of shares outstanding of the registrant s Common Stock was 21,209,853.

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 March 31, 2012		2011	
Net premiums earned	$	137,280	$	116,051
Net investment income		15,293		16,303
Net realized investment gains		11,416		4,472
Other-than-temporary impairment (OTTI) losses on investments				
Consolidated revenue		163,989		136,826
Losses and settlement expenses		61,883		46,871
Policy acquisition costs		48,197		38,618
Insurance operating expenses		12,259		9,615
Interest expense on debt		1,500		1,512
General corporate expenses		1,987		2,005
Total expenses		125,826		98,621
Equity in earnings of unconsolidated investee		2,946		2,616
Earnings before income taxes		41,109		40,821
Income tax expense		13,071		13,115
Net earnings	$	28,038	$	27,706
Other comprehensive earnings (loss), net of tax				
Unrealized gains (losses) on securities:				
Unrealized holding gains arising during the period		19,509		8,154
Less: Reclassification adjustment for (gains) included in net earnings		(8,733)		(2,906)
Other comprehensive earnings		10,776		5,248
Comprehensive earnings	$	38,814	$	32,954
Earnings per share:				
Basic:				
Basic net earnings per share	$	1.32	$	1.32
Basic comprehensive earnings per share	$	1.83	$	1.57
Diluted:				
Diluted net earnings per share	$	1.30	$	1.30
Diluted comprehensive earnings per share	$	1.80	$	1.55
Weighted average number of common shares outstanding				
Basic		21,188		21,025
Diluted		21,528		21,285

Cash dividends declared per common share	$	0.30	$	0.29

The accompanying notes are an integral part of the unaudited condensed consolidated interim financial statements.

RLI Corp. and Subsidiaries Condensed Consolidated Balance Sheets

(Unaudited)

(in thousands, except share data)	**March 31, 2012**	**December 31, 2011**
ASSETS		
Investments		
Fixed income		
Available-for-sale, at fair value	$ 1,251,451	$ 1,146,317
Held-to-maturity, at amortized cost	161,756	260,226
Trading, at fair value	8	7
Equity securities, at fair value	406,399	388,689
Short-term investments, at cost	58,451	23,865
Cash	70,306	81,184
Total investments and cash	1,948,371	1,900,288
Accrued investment income	11,862	13,865
Premiums and reinsurance balances receivable	132,352	124,496
Ceded unearned premium	61,998	61,629
Reinsurance balances recoverable on unpaid losses	324,952	353,805
Deferred policy acquisition costs	51,655	52,105
Property and equipment	19,168	20,104
Investment in unconsolidated investees	53,146	49,968
Goodwill and intangibles	60,248	60,482
Other assets	15,198	18,092
TOTAL ASSETS	$ 2,678,950	$ 2,654,834
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Unpaid losses and settlement expenses	$ 1,121,730	$ 1,150,714
Unearned premiums	340,915	341,267
Reinsurance balances payable	52,318	50,861
Funds held	111,362	110,555
Income taxes-deferred	43,837	37,867
Bonds payable, long-term debt	100,000	100,000
Accrued expenses	42,558	58,883
Other liabilities	37,553	12,053
TOTAL LIABILITIES	$ 1,850,273	$ 1,862,200
Shareholders Equity		
Common stock ($1 par value)		
(32,674,960 shares issued at 3/31/12)		
(32,627,244 shares issued at 12/31/11)	32,675	32,627
Paid-in capital	231,331	227,788
Accumulated other comprehensive earnings	128,101	117,325
Retained earnings	829,569	807,893
Deferred compensation	9,179	10,445
Less: Treasury shares at cost		
(11,465,107 shares at 3/31/12)		
(11,465,107 shares at 12/31/11)	(402,178)	(403,444)
TOTAL SHAREHOLDERS EQUITY	828,677	792,634
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 2,678,950	$ 2,654,834

The accompanying notes are an integral part of the unaudited condensed consolidated interim financial statements.

RLI Corp. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(in thousands)	For the Three-Month Periods Ended March 31, **2012**		**2011**	
Net cash provided by (used in) operating activities	$	(3,247)	$	17,938
Cash Flows from Investing Activities				
Investments purchased		(289,784)		(60,240)
Investments sold		113,584		76,360
Investments called or matured		180,660		39,787
Net change in short-term investments		(6,775)		(69,590)
Net property and equipment purchased		(2,545)		(1,030)
Net cash used in investing activities	$	(4,860)	$	(14,713)
Cash Flows from Financing Activities				
Cash dividends paid	$	(6,362)	$	(6,104)
Stock option plan share issuance		2,736		918
Excess tax benefit from exercise of stock options		855		1,961
Treasury shares purchased				
Net cash used in financing activities	$	(2,771)	$	(3,225)
Net decrease in cash		(10,878)		
Cash at the beginning of the period		81,184		
Cash at March 31	$	70,306	$	

The accompanying notes are an integral part of 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 2011 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 March 31, 2012 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 from these estimates.

B. ADOPTED ACCOUNTING STANDARDS

ASU 2010-26, Financial Services Insurance (Topic 944): Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts

Accounting guidance for deferred acquisition costs incurred by insurance entities changed under this Accounting Standards Update (ASU) and was designed to eliminate inconsistent industry practices. The ASU requires costs to be incrementally or directly related to the successful acquisition of new or renewal insurance contracts in order to be capitalized as deferred acquisition costs.

We adopted this new accounting standard effective January 1, 2012 on a retrospective basis. Our adoption of the new standard resulted in a $40.3 million reduction of deferred policy acquisition costs asset and a $26.2 million decrease to consolidated shareholders equity, net of a $14.1 million deferred income tax benefit at December 31, 2011. The adjustment to shareholders equity resulted in a reduction in book value of $1.24 per share, based on the number of shares outstanding at January 1, 2012.

As of January 1, 2011, the beginning of the earliest period presented in these interim financial statements, the cumulative effect of our adoption of the new standard was a $22.2 million reduction to consolidated shareholders equity at December 31, 2010. The adjustment to shareholders equity resulted in a reduction in book value of $1.06 per share, based on the number of shares outstanding at January 1, 2011. While not presented in this filing, the

December 31, 2010 balance sheet will be revised as part of our 2012 annual filing.

The new standard affects the timing of the recognition of policy acquisition costs. Costs associated with unsuccessful efforts or costs that cannot be tied directly to a successful policy acquisition are treated as period costs and expensed as incurred, as opposed to being deferred and amortized as the premium is earned. In periods of expansion, the new standard will result in an acceleration of expense recognition. In periods of contraction, the inverse will occur.

All comparative period information presented has been revised to reflect changes due to our adoption of this guidance. Comparative period information for the first quarter of 2011 has been revised to reflect changes resulting from our retrospective adoption of the new accounting standard. The first quarter of 2011 was a period where premium and business were contracting. As a result, the application of the new standard resulted in a $1.9 million decrease in policy acquisition costs recognized in the revised first quarter of 2011 and a corresponding 1.6 point reduction to our revised combined ratio. The revised net earnings increased by $1.2 million, or $0.06 per share. In contrast, the impact of applying the new standard to the first quarter of 2012 resulted in an increase of approximately $1.6 million in policy acquisition costs recognized, which decreased net earnings by $0.05 per share. The increase in expense was due largely to costs associated with CBIC, but was also impacted by investments in expansion of other products. Going forward, however, the impact of this new standard will vary based on expansion or contraction, as well as changes in mix of business.

ASU 2011-08, Intangibles - Goodwill and Other (Topic 350): Testing Goodwill for Impairment

This ASU, issued on September 15, 2011, permits an entity to make a qualitative assessment of whether it is more-likely-than-not that a reporting unit s fair value is less than its carrying amount before applying the two-step goodwill impairment test. If an entity can support the conclusion that it is more-likely-than-not that the fair value of a reporting unit is greater than its carrying amount, it would not need to perform the two-step impairment test for that reporting unit. Goodwill must be tested for impairment at least annually, and prior to this ASU, a two-step test was required to assess goodwill for impairment. In Step One, the fair value of a reporting unit is compared to the reporting unit s carrying amount. If the fair value is less than the carrying amount, Step Two is used to measure the amount of goodwill impairment, if any.

We adopted ASU 2011-08 on January 1, 2012. The adoption did not have an impact on our financial statements. There have been no triggering events that would suggest possible impairment or that it is more-likely-than-not that the fair values of the reporting units related to our goodwill are less than their carrying amounts. We will utilize the new guidance during our annual impairment testing in May 2012.

ASU 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income

This ASU was issued to increase the prominence of other comprehensive income in financial statements and to help financial statement users better understand the causes of an entity s change in financial position and results of operations. Under the standard, an entity is required to present the components of net income and other comprehensive income in either one continuous statement or two separate but consecutive financial statements. In December 2011, ASU 2011-12 was issued in order to defer the effective date of specific provisions of ASU 2011-05 related to the presentation of reclassification adjustments. Both standards are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The new requirements do not have a material effect on our financial statements, and we have adopted the standards effective with this interim filing.

C. PROSPECTIVE ACCOUNTING STANDARDS

There are no prospective accounting standards which would impact our financial statements as of March 31, 2012.

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. The portion of goodwill which relates solely to our surety segment totaled $26.2 million at March 31, 2012 and December 31, 2011 and is included in the total goodwill and intangibles on the balance sheet of $60.2 million at March 31, 2012. Annual impairment testing was performed during the second quarter of 2011. Based upon this review, this asset was not impaired. In addition, as of March 31, 2012, there were no triggering events that had occurred that would suggest an updated review was necessary.

The remaining $34.0 million of goodwill and intangibles relates to both our casualty and surety segments, in connection with the purchase of CBIC in April 2011. Intangible assets with definite lives are amortized against future operating results. Amortization of intangible assets was $0.3 million for the first quarter of 2012. In addition to these assets, the acquisition of CBIC resulted in a value of business acquired (VOBA) asset, which is also being amortized. We completed our evaluation of the acquisition under ASC Topic 805, Business Combinations, in the fourth quarter of 2011. (See Note 6 to the unaudited condensed consolidated interim financial statements).

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

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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 financial statements.

	For the Three-Month Period Ended March 31, 2012			For the Three-Month Period Ended March 31, 2011		
(in thousands, except per share data)	**Income (Numerator)**	**Shares (Denominator)**	**Per Share Amount**	**Income (Numerator)**	**Shares (Denominator)**	**Per Share Amount**
Basic EPS						
Income available to common shareholders	$ 28,038	21,188	$ 1.32	$ 27,706	21,025	$ 1.32
Effect of Dilutive Securities						
Stock Options		340			260	
Diluted EPS						
Income available to common shareholders	$ 28,038	21,528				