RLI CORP
Form 10-Q
October 28, 2009

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 September 30, 2009

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 October 15, 2009, the number of shares outstanding of the registrant s Common Stock was 21,628,875.

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 September 30, 2009**		**2008 (1)**	
Net premiums earned	$	122,736	$	130,850
Net investment income		16,295		19,844
Net realized investment gains		6,985		7,960
Other-than-temporary impairment losses on investments(1)				(32,172)
Consolidated revenue		146,016		126,482
Losses and settlement expenses		47,677		66,013
Policy acquisition costs		41,627		41,424
Insurance operating expenses		10,480		8,216
Interest expense on debt		1,512		1,646
General corporate expenses		2,177		1,735
Total expenses		103,473		119,034
Equity in earnings of unconsolidated investee		1,120		248
Earnings before income taxes		43,663		7,696
Income tax expense (benefit)		12,644		(890)
Net earnings	$	31,019	$	8,586
Other comprehensive earnings (loss), net of tax		36,969		(24,109)
Comprehensive earnings (loss)	$	67,988	$	(15,523)
Earnings per share:				
Basic:				
Basic net earnings per share	$	1.43	$	0.40
Basic comprehensive earnings per share	$	3.14	$	(0.73)
Diluted:				
Diluted net earnings per share	$	1.42	$	0.40
Diluted comprehensive earnings per share	$	3.12	$	(0.72)
Weighted average number of common shares outstanding				
Basic		21,622		21,342
Diluted		21,769		21,678
Cash dividends declared per common share	$	0.27	$	0.25

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(1) There were no OTTI losses recognized in AOCI in the periods presented. 2008 amounts were reclassified to conform to current period s presentation.

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

3

RLI Corp. and Subsidiaries

Condensed Consolidated Statements of Earnings and Comprehensive Earnings

(Unaudited)

(in thousands, except per share data)	**For the Nine-Month Periods Ended September 30,**			
		2009		**2008 (1)**
Net premiums earned	$	370,910	$	399,110
Net investment income		50,494		58,707
Net realized investment gains		24,442		25,350
Other-than-temporary impairment losses on investments(1)		(45,231)		(37,746)
Consolidated revenue		400,615		445,421
Losses and settlement expenses		157,678		190,043
Policy acquisition costs		121,196		121,721
Insurance operating expenses		28,814		28,346
Interest expense on debt		4,537		5,191
General corporate expenses		5,847		5,759
Total expenses		318,072		351,060
Equity in earnings of unconsolidated investee		5,242		6,417
Earnings before income taxes		87,785		100,778
Income tax expense		24,502		28,083
Net earnings	$	63,283	$	72,695
Other comprehensive earnings (loss), net of tax		63,357		(68,274)
Comprehensive earnings	$	126,640	$	4,421
Earnings per share:				
Basic:				
Basic net earnings per share	$	2.93	$	3.37
Basic comprehensive earnings per share	$	5.86	$	0.20
Diluted:				
Diluted net earnings per share	$	2.91	$	3.32
Diluted comprehensive earnings per share	$	5.82	$	0.20
Weighted average number of common shares outstanding				
Basic		21,599		21,574
Diluted		21,759		21,893
Cash dividends declared per common share	$	0.80	$	0.73

(1) There were no OTTI losses recognized in AOCI in the periods presented. 2008 amounts were reclassified to conform to current period s presentation.

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

RLI Corp. and Subsidiaries Condensed Consolidated Balance Sheets

(in thousands, except share data)	September 30, 2009 (unaudited)	December 31, 2008
ASSETS		
Investments		
Fixed income		
Available-for-sale, at fair value	$ 1,295,233	$ 1,224,215
Held-to-maturity, at amortized cost	178,731	39,821
Trading, at fair value	1,068	10,020
Equity securities, at fair value	238,590	286,790
Short-term investments, at cost	142,771	97,982
Total investments	1,856,393	1,658,828
Accrued investment income	15,598	17,226
Premiums and reinsurance balances receivable	86,033	92,149
Ceded unearned premium	66,417	65,977
Reinsurance balances recoverable on unpaid losses	343,377	350,284
Deferred policy acquisition costs	79,923	78,520
Property and equipment	19,592	21,565
Income taxes-deferred		24,141
Investment in unconsolidated investees	44,348	38,697
Goodwill	26,214	26,214
Other assets	25,063	45,800
TOTAL ASSETS	$ 2,562,958	$ 2,419,401
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Unpaid losses and settlement expenses	$ 1,159,025	$ 1,159,311
Unearned premiums	330,629	335,170
Reinsurance balances payable	22,844	30,224
Income taxes-deferred	26,089	
Bonds payable, long-term debt	100,000	100,000
Accrued expenses	36,327	32,894
Other liabilities	61,100	53,648
TOTAL LIABILITIES	$ 1,736,014	$ 1,711,247
Shareholders Equity		
Common stock ($1 par value)		
(32,157,159 shares issued at 9/30/09)		
(32,106,085 shares issued at 12/31/08)	32,157	32,106
Paid-in capital	205,859	196,989
Accumulated other comprehensive earnings	78,485	15,130
Retained earnings	853,184	807,195
Deferred compensation	7,846	8,312
Less: Treasury shares at cost		
(10,528,284 shares at 9/30/09)	(350,587)	(351,578)
(10,631,656 shares at 12/31/08)		
TOTAL SHAREHOLDERS EQUITY	826,944	708,154
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 2,562,958	$ 2,419,401

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

5

RLI Corp. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(in thousands)	For the Nine-Month Period Ended September 30, **2009**	**2008**
Net cash provided by operating activities	$ 108,445	$ 126,732
Cash Flows from Investing Activities		
Investments purchased	(776,811)	(496,511)
Investments sold	334,386	141,378
Investments called or matured	353,230	306,973
Net change in short-term investments	(11,695)	13,762
Net property and equipment purchased	(507)	(4,632)
Net cash used in investing activities	$ (101,397)	$ (39,030)
Cash Flows from Financing Activities		
Cash dividends paid	$ (16,494)	$ (15,406)
Payment on short-term debt		(81,992)
Proceeds from issuance of short-term debt		54,017
Stock option plan share issuance	3,441	(79)
Excess tax benefit from exercise of stock options	257	3,663
Treasury shares reissued	5,748	
Treasury shares purchased		(47,905)
Net cash used in financing activities	$ (7,048)	$ (87,702)
Net increase in cash		
Cash at the beginning of the year		
Cash at September 30	$	$

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

6

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. BASIS OF PRESENTATION

The unaudited condensed consolidated 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 2008 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 September 30, 2009 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 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 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

FASB Accounting Standards Codification

On July 1, 2009, the FASB Accounting Standards Codification (ASC) became the single official source of authoritative, nongovernmental GAAP, superseding existing FASB, AICPA, EITF, and related literature. Prospectively, only one level of authoritative GAAP will exist, excluding the guidance issued by the Securities and Exchange Commission (SEC). All other literature will be non-authoritative. The Codification does not change GAAP but instead reorganizes the U.S. GAAP pronouncements into accounting Topics, and displays all Topics using a consistent structure. As the Codification does not change GAAP, it did not have a material impact on our financial statements. The Codification was effective on a prospective basis for interim and annual reporting periods ending after September 15, 2009. Previous references to applicable literature via our disclosures have been updated with references to the new Codification section.

FASB ASC 805, Business Combinations (previously SFAS No. 141(R), Business Combinations)

On January 1, 2009, we adopted GAAP guidelines in regard to business combinations. Assets and liabilities that arose from business combinations which occurred prior to the adoption of the most recent standard are not adjusted upon the adoption. Among other things, the recent standard broadens the scope of the previous guidance to include all transactions where an acquirer obtains control of one or more other businesses. It retains the

guidance to recognize intangible assets separately from goodwill and requires, with limited exceptions, that all assets acquired and liabilities assumed, including certain contractual contingencies, be measured at their acquisition date fair values. Recent guidelines require most acquisition and restructuring related costs to be expensed as incurred. Step acquisitions, once control is acquired, are to be recorded at the full amounts of the fair values of the identifiable assets, liabilities and the non-controlling interest in the acquiree. The guidelines also replace the reduction of asset values and recognition of negative goodwill with a requirement to recognize a gain in earnings. The adoption had no impact on our financial position or results of operations. We will apply the provisions as applicable.

FASB ASC 350, Intangibles Goodwill and Other (previously FSP No. 142-3, Determination of the Useful Life of Intangible Assets)

New GAAP guidance regarding the useful life of intangible assets became effective January 1, 2009. It amends the factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of recognized intangible assets under previous guidance. The intent of the new guidance is to improve the consistency between the useful life of a recognized intangible asset under FASB ASC 350 (previously SFAS 142) and the period of expected cash flows used to measure the fair value of the asset under FASB ASC 805 (previously SFAS 141(R)) and other generally accepted accounting principles. This new guidance applies to intangible assets that are acquired individually or with a group of other assets in business combinations and asset acquisitions. The implementation of this new guidance did not have a significant impact on our financial position or results of operations.

FASB ASC 320-10-65, Debt and Equity Securities - Transition and Open Effective Date Information (previously FSP No. FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments)

In April 2009, the FASB issued new guidance on the recognition and presentation of other-than-temporary impairments (OTTI) which amends the recognition guidance for OTTI of debt securities and expands the financial statement disclosures for OTTI on debt and equity securities. We adopted this new guidance in the second quarter of 2009.

The new guidance essentially states that an OTTI write-down of debt securities, where fair value is below amortized cost, is triggered in circumstances where (1) an entity has the intent to sell a security, (2) it is more-likely-than-not that the entity will be required to sell the security before recovery of its amortized cost basis, or (3) the entity does not expect to recover the entire amortized cost basis of the security. If an entity intends to sell a security or if it is more-likely-than-not the entity will be required to sell the security before recovery, an OTTI write-down is recognized in earnings equal to the difference between the security s amortized cost and its fair value. If an entity does not intend to sell the security or it is not more-likely-than-not that it will be required to sell the security before recovery, the OTTI write-down is separated into an amount representing the credit loss, which is recognized in earnings, and the amount related to all other factors, which is recognized in other comprehensive income.

The guidance requires that companies record, as of the beginning of the interim period of adoption, a cumulative-effect adjustment to reclassify the noncredit component of a previously recognized OTTI loss from retained earnings to other comprehensive income if the company does not intend to sell the security and it is more-likely-than-not that the company will not be required to sell the security before recovery of its amortized cost basis. The adoption had no impact on our financial position or results of operations.

We had no cumulative-effect adjustment upon adoption at the beginning of the second quarter given our intent to sell securities with previously recognized OTTI losses, the majority of which were exited during the second quarter.

FASB ASC 820-10-65-4, Fair Value Measurements and Disclosures Transition and Open Effective Date Information (previously FSP No. FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly)

In April 2009, the FASB issued new guidance on determining fair value when the volume and level of activity for the asset or liability have significantly decreased and identifying transactions that are not orderly. Our adoption of this new guidance was effective April 1, 2009. The guidelines reaffirm that fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date under current market conditions. The guidelines also reaffirm the need to use judgment in determining if a formerly active market has become inactive and in determining fair values when the market has become inactive. The adoption did not impact our financial position or results of operations.

FASB ASC 825-10-65-1, Financial Instruments Transition and Open Effective Date Information (previously FSP No. FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments)

In April 2009, the FASB issued new guidance regarding interim disclosures about fair value of financial instruments. The new guidelines require disclosing qualitative and quantitative information about the fair value of all financial instruments on a quarterly basis, including methods and significant assumptions used to estimate fair value during the period. These disclosures were previously only done annually. The disclosures required by the guidelines are effective for the quarter ending June 30, 2009 and are included in note 2 to the unaudited condensed consolidated financial statements, Investments , and in the Liquidity and Capital Resources section of Management s Discussion and Analysis of Financial Condition and Results of Operations.

FASB ASC 855, Subsequent Events (previously SFAS No. 165, Subsequent Events)

In May 2009, the FASB issued new guidance regarding subsequent events which established general standards of accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. The new standard provides guidance on the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. We adopted the new guidance during the second quarter of 2009, and its application had no impact on our condensed consolidated financial statements. We evaluated subsequent events through the date the accompanying financial statements were issued, which was October 28, 2009.

C. PROSPECTIVE ACCOUNTING STANDARDS

SFAS No. 166, Accounting for Transfers of Financial Assets (SFAS 166) and SFAS No. 167, Amendments to FASB Interpretation No. 46(R) (SFAS 167)

In June 2009, the FASB issued SFAS 166, Accounting for Transfers of Financial Assets and SFAS 167, Amendments to FASB Interpretation No. 46(R) , which update accounting for securitizations and special-purpose entities. SFAS 166 is a revision to FASB ASC 860, Transfers and Servicing (previously SFAS 140)and will require additional information regarding financial asset transfers, including securitization transactions, and the presence of continuing exposure around the risks related to transferred financial assets. It removes the concept of a qualifying special-purpose entity from FASB ASC 810, Consolidation (previously SFAS 140) and removes the exception from applying FASB Interpretation No. 46(R), Consolidation of Variable Interest Entities , to variable interest entities that are qualifying special-purpose entities. SFAS 167 is a revision to FASB Interpretation No. 46(R) and modifies a Company s determination of consolidating an entity that is insufficiently capitalized or is not controlled through voting or similar ownership rights. SFAS 166 and 167 will be effective January 1, 2010, and are effective for interim periods within the first annual reporting period. Earlier application is prohibited. We do not expect the implementation of SFAS 166 or 167 to have a significant impact on our financial statements.

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, which relates to our surety segment, is listed separately on the balance sheet and totaled $26.2 million at September 30, 2009 and December 31, 2008. Annual impairment testing was performed during the second quarter of 2009. Based upon this review, this asset was not impaired. In addition, as of September 30, 2009, there were no triggering events that had occurred that would suggest an updated review was necessary.

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 condensed consolidated financial statements.

	For the Three-Month Period Ended September 30, 2009			For the Three-Month Period Ended September 30, 2008		
(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	$ 31,019	21,622	$ 1.43	$ 8,586	21,342	$ 0.40
Effect of Dilutive Securities						
Stock Options		147			336	
Diluted EPS						
Income available to common shareholders	$ 31,019	21,769	$ 1.42	$ 8,586	21,678	$ 0.40

	For the Nine-Month Period Ended September 30, 2009			For the Nine-Month Period Ended September 30, 2008		
(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	$ 63,283	21,599	$ 2.93	$ 72,695	21,574	$ 3.37
Effect of Dilutive Securities						
Stock Options		160			319	
Diluted EPS						
Income available to common shareholders	$ 63,283	21,759	$ 2.91	$ 72,695	21,893	$ 3.32

2. INVESTMENTS

Our investments include fixed income debt securities and common stock equity securities. As disclosed in our 2008 Annual Report on Form 10-K, we present our investments in the above classes as either available-for-sale, held-to-maturity, or trading securities. 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 financial statements, Fair Value Measurements.

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 September 30, 2009 and December 31, 2008. 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 September 30, 2009 and December 31, 2008, unrealized losses, as shown in the following tables, were less than 1% and 4%, respectively, of total invested assets. Unrealized losses have decreased in 2009, as the capital markets and general market conditions have continued to improve throughout 2009.

Investment Positions with Unrealized Losses

Segmented by Type and Period of Continuous

Unrealized Loss at September 30, 2009

(dollars in thousands)	0-12 Mos.	> 12 Mos.	Total