

PROGRESSIVE CORP/OH/
Form 10-Q
November 07, 2011

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 September 30, 2011

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: 1-9518

THE PROGRESSIVE CORPORATION

(Exact name of registrant as specified in its charter)

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Ohio
(State or other jurisdiction of
incorporation or organization)

34-0963169
(I.R.S. Employer
Identification No.)

6300 Wilson Mills Road, Mayfield Village, Ohio
(Address of principal executive offices)

44143
(Zip Code)

(440) 461-5000

(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. (Check one):

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Shares, \$1.00 par value: 620,628,395 outstanding at September 30, 2011

PART I FINANCIAL INFORMATION**Item 1. Financial Statements.**

The Progressive Corporation and Subsidiaries

Consolidated Statements of Income

(unaudited)

Periods Ended September 30, (millions except per share amounts)	2011	Three Months 2010	% Change	2011	Nine Months 2010	% Change
Revenues						
Net premiums earned	\$ 3,740.7	\$ 3,599.9	4	\$ 11,125.9	\$ 10,691.2	4
Investment income	117.4	131.5	(11)	361.5	391.9	(8)
Net realized gains (losses) on securities:						
Other-than-temporary impairment (OTTI) losses:						
Total OTTI losses	(1.4)	(1.9)	(26)	(5.9)	(19.1)	(69)
Non-credit losses, net of credit losses recognized on previously recorded non-credit OTTI losses	0	(.2)	NM	.9	5.3	(83)
Net impairment losses recognized in earnings	(1.4)	(2.1)	(33)	(5.0)	(13.8)	(64)
Net realized gains (losses) on securities	(51.2)	29.0	NM	78.1	32.0	144
Total net realized gains (losses) on securities	(52.6)	26.9	NM	73.1	18.2	302
Service revenues	5.6	4.8	17	16.8	14.0	20
Net gain (loss) on extinguishment of debt	(.1)	6.4	NM	(.1)	6.4	NM
Total revenues	3,811.0	3,769.5	1	11,577.2	11,121.7	4
Expenses						
Losses and loss adjustment expenses	2,749.3	2,543.4	8	7,918.3	7,510.0	5
Policy acquisition costs	350.2	342.4	2	1,045.2	1,014.3	3
Other underwriting expenses	460.5	459.1	0	1,381.2	1,331.8	4
Investment expenses	4.0	.3	1233	10.6	8.5	25
Service expenses	5.1	5.2	(2)	13.9	15.9	(13)
Interest expense	33.4	31.9	5	96.4	102.2	(6)
Total expenses	3,602.5	3,382.3	7	10,465.6	9,982.7	5
Net Income						
Income before income taxes	208.5	387.2	(46)	1,111.6	1,139.0	(2)
Provision for income taxes	57.8	125.6	(54)	352.8	369.9	(5)
Net income	\$ 150.7	\$ 261.6	(42)	\$ 758.8	\$ 769.1	(1)
Computation of Earnings Per Share						
Basic:						
Average shares outstanding	626.9	655.8	(4)	640.5	659.2	(3)
Per share	\$.24	\$.40	(40)	\$ 1.18	\$ 1.17	2
Diluted:						
Average shares outstanding	626.9	655.8	(4)	640.5	659.2	(3)

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Net effect of dilutive stock-based compensation	4.5	5.4	(17)	4.3	5.2	(17)
Total equivalent shares	631.4	661.2	(5)	644.8	664.4	(3)
Per share	\$.24	\$.40	(40)	\$ 1.18	\$ 1.16	2
Dividends declared per share¹	\$ 0	\$ 0		\$ 0	\$ 0	

NM = Not Meaningful

¹ Progressive maintains an annual dividend program. See *Note 9 Dividends* for further discussion.

See notes to consolidated financial statements.

The Progressive Corporation and Subsidiaries

Consolidated Balance Sheets

(unaudited)

(millions)	September 30,		December 31,
	2011	2010	2010
Assets			
Investments Available-for-sale, at fair value:			
Fixed maturities (amortized cost: \$11,531.9, \$11,727.3, and \$11,630.8)	\$ 11,815.6	\$ 12,085.8	\$ 11,850.0
Equity securities:			
Nonredeemable preferred stocks (cost: \$493.6, \$610.6, and \$601.3)	873.0	1,189.4	1,157.6
Common equities (cost: \$1,391.5, \$1,014.7, and \$1,021.7)	1,599.5	1,285.3	1,425.0
Short-term investments (amortized cost: \$1,699.7, \$1,815.5, and \$1,090.8)	1,699.7	1,815.5	1,090.8
Total investments	15,987.8	16,376.0	15,523.4
Cash	170.3	155.0	158.9
Accrued investment income	98.3	107.3	109.3
Premiums receivable, net of allowance for doubtful accounts of \$117.0, \$109.5, and \$114.9	3,086.0	2,858.6	2,738.4
Reinsurance recoverables, including \$36.5, \$34.4, and \$37.4 on paid losses and loss adjustment expenses	798.1	685.2	741.5
Prepaid reinsurance premiums	81.8	97.8	88.1
Deferred acquisition costs	458.1	450.5	417.2
Income taxes	298.5	164.6	189.0
Property and equipment, net of accumulated depreciation of \$561.7, \$560.1, and \$564.3	910.9	932.0	932.6
Other assets	254.5	197.6	251.9
Total assets	\$ 22,144.3	\$ 22,024.6	\$ 21,150.3
Liabilities and Shareholders Equity			
Unearned premiums	\$ 4,830.1	\$ 4,711.0	\$ 4,353.8
Loss and loss adjustment expense reserves	7,256.8	6,953.4	7,071.0
Accounts payable, accrued expenses, and other liabilities	1,797.2	1,689.2	1,718.4
Debt ¹	2,443.9	1,957.8	1,958.2
Total liabilities	16,328.0	15,311.4	15,101.4
Common Shares, \$1.00 par value (authorized 900.0; issued 797.7, 797.7, and 797.7, including treasury shares of 177.1, 134.3, and 135.3)	620.6	663.4	662.4
Paid-in capital	986.7	977.0	1,007.1
Retained earnings	3,632.4	4,273.6	3,595.7
Accumulated other comprehensive income (loss), net of tax:			
Net non-credit related OTTI losses, adjusted for valuation changes	(6.3)	(3.1)	(1.8)
Other net unrealized gains (losses) on securities	572.2	785.8	769.1
Total net unrealized gains (losses) on securities	565.9	782.7	767.3
Net unrealized gains on forecasted transactions	8.7	15.4	14.7
Foreign currency translation adjustment	2.0	1.1	1.7
Total accumulated other comprehensive income (loss)	576.6	799.2	783.7
Total shareholders equity	5,816.3	6,713.2	6,048.9
Total liabilities and shareholders equity	\$ 22,144.3	\$ 22,024.6	\$ 21,150.3

¹ Consists of both short- and long-term debt. *See Note 4 Debt.*
See notes to consolidated financial statements.

The Progressive Corporation and Subsidiaries

Consolidated Statements of Cash Flows

(unaudited)

Nine months ended September 30, (millions)	2011	2010
Cash Flows From Operating Activities		
Net income	\$ 758.8	\$ 769.1
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	65.3	62.4
Amortization of fixed-income securities	174.7	172.9
Amortization of stock-based compensation	36.4	35.2
Net realized (gains) losses on securities	(73.1)	(18.2)
Net (gain) loss on disposition of property and equipment	7.8	(1.2)
Net (gain) loss on extinguishment of debt	.1	(6.4)
Changes in:		
Premiums receivable	(347.6)	(403.8)
Reinsurance recoverables	(56.6)	(120.4)
Prepaid reinsurance premiums	6.3	(28.5)
Deferred acquisition costs	(40.9)	(48.3)
Income taxes	.9	64.2
Unearned premiums	476.3	538.1
Loss and loss adjustment expense reserves	185.8	300.4
Accounts payable, accrued expenses, and other liabilities	278.9	362.3
Other, net	22.2	.1
Net cash provided by operating activities	1,495.3	1,677.9
Cash Flows From Investing Activities		
Purchases:		
Fixed maturities	(5,208.0)	(3,515.7)
Equity securities	(424.0)	(453.7)
Sales:		
Fixed maturities	4,057.2	2,448.1
Equity securities	264.8	153.6
Maturities, paydowns, calls, and other:		
Fixed maturities	1,107.4	912.9
Net purchases of short-term investments - other	(608.8)	(736.9)
Net unsettled security transactions	(14.2)	47.2
Purchases of property and equipment	(53.3)	(39.5)
Sales of property and equipment	1.9	7.6
Net cash used in investing activities	(877.0)	(1,176.4)
Cash Flows From Financing Activities		
Proceeds from exercise of stock options	6.8	14.4
Tax benefit from exercise/vesting of stock-based compensation	2.7	6.0
Proceeds from debt issuance	491.9	0
Reacquisition of debt	(12.7)	(214.3)
Dividends paid to shareholders ¹	(263.6)	(108.2)
Acquisition of treasury shares	(832.1)	(205.5)
Net cash used in financing activities	(607.0)	(507.6)

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Effect of exchange rate changes on cash	.1	.4
Increase (decrease) in cash	11.4	(5.7)
Cash, January 1	158.9	160.7
Cash, September 30	\$ 170.3	\$ 155.0

¹ Progressive maintains an annual dividend program. See *Note 9 Dividends* for further discussion.

See notes to consolidated financial statements.

The Progressive Corporation and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited)

Note 1 Basis of Presentation The consolidated financial statements include the accounts of The Progressive Corporation, its subsidiaries, and a mutual company affiliate. All of the subsidiaries and the mutual company affiliate are wholly owned or controlled. The consolidated financial statements reflect all normal recurring adjustments that, in the opinion of management, were necessary for a fair statement of the results for the interim periods presented. The results of operations for the period ended September 30, 2011, are not necessarily indicative of the results expected for the full year. These consolidated financial statements and the notes thereto should be read in conjunction with Progressive's audited financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2010.

Note 2 Investments The following tables present the composition of our investment portfolio by major security type consistent with our internal classification, which represents how we manage, monitor, and measure the portfolio:

(\$ in millions)	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Net Realized Gains (Losses) ¹	Fair Value	% of Total Fair Value
September 30, 2011						
Fixed maturities:						
U.S. government obligations	\$ 2,921.7	\$ 129.1	\$ (.1)	\$ 0	\$ 3,050.7	19.1 %
State and local government obligations	1,930.6	56.4	(1.1)	0	1,985.9	12.4
Corporate debt securities	2,680.2	86.4	(10.4)	5.2	2,761.4	17.3
Residential mortgage-backed securities	471.3	9.4	(36.5)	0	444.2	2.8
Commercial mortgage-backed securities	1,826.2	43.2	(9.7)	0	1,859.7	11.6
Other asset-backed securities	1,265.5	14.8	(1.3)	.7	1,279.7	8.0
Redeemable preferred stocks	436.4	20.1	(22.5)	0	434.0	2.7
Total fixed maturities	11,531.9	359.4	(81.6)	5.9	11,815.6	73.9
Equity securities:						
Nonredeemable preferred stocks	493.6	387.4	(2.6)	(5.4)	873.0	5.5
Common equities	1,391.5	288.4	(80.4)	0	1,599.5	10.0
Short-term investments:						
Other short-term investments	1,699.7	0	0	0	1,699.7	10.6
Total portfolio ^{2,3}	\$ 15,116.7	\$ 1,035.2	\$ (164.6)	\$.5	\$ 15,987.8	100.0 %

(\$ in millions)	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Net Realized Gains (Losses) ¹	Fair Value	% of Total Fair Value
September 30, 2010						
Fixed maturities:						
U.S. government obligations	\$ 3,411.7	\$ 110.0	\$ 0	\$ 0	\$ 3,521.7	21.5 %
State and local government obligations	1,865.1	67.8	(.6)	0	1,932.3	11.8
Corporate debt securities	2,392.6	109.3	(1.2)	5.1	2,505.8	15.3
Residential mortgage-backed securities	576.8	14.4	(24.5)	0	566.7	3.4
Commercial mortgage-backed securities	1,801.0	72.3	(5.7)	0	1,867.6	11.4
Other asset-backed securities	1,077.2	16.5	(1.7)	(.2)	1,091.8	6.7
Redeemable preferred stocks	602.9	26.0	(29.0)	0	599.9	3.7
Total fixed maturities	11,727.3	416.3	(62.7)	4.9	12,085.8	73.8

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Equity securities:						
Nonredeemable preferred stocks	610.6	580.0	0	(1.2)	1,189.4	7.3
Common equities	1,014.7	279.6	(9.0)	0	1,285.3	7.8
Short-term investments:						
Other short-term investments	1,815.5	0	0	0	1,815.5	11.1
Total portfolio ^{2,3}	\$ 15,168.1	\$ 1,275.9	\$ (71.7)	\$ 3.7	\$ 16,376.0	100.0 %

(\$ in millions)	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Net Realized Gains (Losses) ¹	Fair Value	% of Total Fair Value
December 31, 2010						
Fixed maturities:						
U.S. government obligations	\$ 3,203.2	\$ 56.3	\$ (16.9)	\$ 0	\$ 3,242.6	20.9 %
State and local government obligations	1,955.5	43.0	(9.4)	0	1,989.1	12.8
Corporate debt securities	2,579.0	78.1	(13.3)	2.3	2,646.1	17.0
Residential mortgage-backed securities	567.1	17.8	(21.3)	0	563.6	3.6
Commercial mortgage-backed securities	1,772.1	66.9	(6.9)	0	1,832.1	11.8
Other asset-backed securities	1,063.9	12.4	(2.2)	(.1)	1,074.0	6.9
Redeemable preferred stocks	490.0	29.6	(17.1)	0	502.5	3.3
Total fixed maturities	11,630.8	304.1	(87.1)	2.2	11,850.0	76.3
Equity securities:						
Nonredeemable preferred stocks	601.3	560.2	0	(3.9)	1,157.6	7.5
Common equities	1,021.7	406.5	(3.2)	0	1,425.0	9.2
Short-term investments:						
Other short-term investments	1,090.8	0	0	0	1,090.8	7.0
Total portfolio^{2,3}	\$ 14,344.6	\$ 1,270.8	\$ (90.3)	\$ (1.7)	\$ 15,523.4	100.0 %

¹ Represents net holding period gains (losses) on certain hybrid securities (discussed below).

² At September 30, 2011, we had \$60.5 million of net unsettled security transactions included in other assets, compared to \$46.3 million at December 31, 2010; at September 30, 2010, we had \$54.9 million of net unsettled security transactions included in other liabilities.

³ The total fair value of the portfolio at September 30, 2011 and 2010, and December 31, 2010 included \$1.7 billion, \$1.6 billion, and \$2.2 billion, respectively, of securities held in a consolidated, non-insurance subsidiary of the holding company, net of any unsettled security transactions.

Our other short-term investments include Eurodollar deposits, commercial paper, reverse repurchase transactions, and other investments that are expected to mature within one year.

Included in our fixed-maturity and equity securities are hybrid securities, which are reported at fair value:

(millions)	September 30, 2011	September 30, 2010	December 31, 2010
Fixed maturities:			
Corporate debt securities	\$ 234.8	\$ 133.9	\$ 176.4
Other asset-backed securities	16.4	14.8	14.9
Total fixed maturities	251.2	148.7	191.3
Equity securities:			
Nonredeemable preferred stocks	15.1	55.5	52.8
Total hybrid securities	\$ 266.3	\$ 204.2	\$ 244.1

Certain corporate debt securities are accounted for as hybrid securities since they were acquired at a substantial premium and contain a change-of-control put feature that permits the investor, at its sole option once the change of control is triggered, to put the security back to the issuer at a 1% premium to par. Due to this change-of-control put option and the substantial market premium paid, there is a potential that the election to put, upon the occurrence of a change in control, could result in the investment not returning substantially all of the original investment. The one hybrid security held in the asset-backed portfolio was acquired at a deep discount to par due to a failing auction, and contains a put option (derivative feature) that allows the investor to put that security back to the auction at par. If the auction is restored, this embedded derivative has the potential to more than double our initial investment yield. The hybrid securities in our nonredeemable preferred stock portfolio are perpetual preferred stocks that have call features with fixed-rate coupons, whereby the change in value of the call features is a component of the overall change in value of the preferred stocks.

Our securities are reported at fair value, with the changes in fair value of these securities (other than hybrid securities and derivative instruments) reported as a component of accumulated other comprehensive income, net of deferred income taxes. The changes in fair value of the hybrid securities and derivative instruments are recorded as a component of net realized gains (losses) on securities.

Gross Unrealized Losses As of September 30, 2011, we had \$84.2 million of gross unrealized losses in our fixed-income portfolio (i.e., fixed-maturity securities and nonredeemable preferred stocks) and \$80.4 million in our common equities. We currently do not intend to sell the fixed-income securities and determined that it is more likely than not that we will not be required to sell these securities for the period of time necessary to recover their cost bases. In addition, we may retain the common stocks to maintain correlation to the Russell 1000 Index. If our strategy was to change and these securities were determined to be other-than-temporarily impaired, we would recognize a write-down in accordance with our stated policy.

The following tables show the composition of gross unrealized losses by major security type and by the length of time that individual securities have been in a continuous unrealized loss position:

(millions)	Total	Gross	Less than 12 Months		12 Months or Greater	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
September 30, 2011						
Fixed maturities:						
U.S. government obligations	\$ 125.3	\$ (.1)	\$ 125.3	\$ (.1)	\$ 0	\$ 0
State and local government obligations	154.3	(1.1)	126.0	(.7)	28.3	(.4)
Corporate debt securities	466.3	(10.4)	327.2	(7.7)	139.1	(2.7)
Residential mortgage-backed securities	320.7	(36.5)	79.6	(4.1)	241.1	(32.4)
Commercial mortgage-backed securities	429.9	(9.7)	342.8	(7.0)	87.1	(2.7)
Other asset-backed securities	169.0	(1.3)	165.3	(.9)	3.7	(.4)
Redeemable preferred stocks	233.8	(22.5)	85.0	(.9)	148.8	(21.6)
Total fixed maturities	1,899.3	(81.6)	1,251.2	(21.4)	648.1	(60.2)
Equity securities:						
Nonredeemable preferred stocks	20.5	(2.6)	20.5	(2.6)	0	0
Common equities	420.2	(80.4)	407.3	(76.6)	12.9	(3.8)
Total equity securities	440.7	(83.0)	427.8	(79.2)	12.9	(3.8)
Total portfolio	\$ 2,340.0	\$ (164.6)	\$ 1,679.0	\$ (100.6)	\$ 661.0	\$ (64.0)

(millions)	Total		Less than 12 Months		12 Months or Greater	
	Fair Value	Gross Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<u>September 30, 2010</u>						
Fixed maturities:						
U.S. government obligations	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
State and local government obligations	101.4	(.6)	89.0	(.2)	12.4	(.4)
Corporate debt securities	96.7	(1.2)	48.0	(.2)	48.7	(1.0)
Residential mortgage-backed securities	283.3	(24.5)	46.0	(.7)	237.3	(23.8)
Commercial mortgage-backed securities	189.4	(5.7)	114.7	(.6)	74.7	(5.1)
Other asset-backed securities						