

PROGRESSIVE CORP/OH/
Form 10-Q
November 05, 2015

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, 2015

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)

Ohio 34-0963169
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

6300 Wilson Mills Road, Mayfield Village, Ohio 44143
(Address of principal executive offices) (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

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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: 584,544,245 outstanding at September 30, 2015

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements.

The Progressive Corporation and Subsidiaries
Consolidated Statements of Comprehensive Income
(unaudited)

Periods Ended September 30, (millions—except per share amounts)	Three Months			Nine Months		
	2015	2014	% Change	2015	2014	% Change
Revenues						
Net premiums earned	\$5,070.6	\$4,540.1	12	\$14,732.7	\$13,455.9	9
Investment income	117.5	101.7	16	335.9	304.2	10
Net realized gains (losses) on securities:						
Net impairment losses recognized in earnings	(13.6)	(0.1)	NM	(23.2)	(0.1)	NM
Net realized gains (losses) on securities	(2.2)	38.3	(106)	116.4	198.1	(41)
Total net realized gains (losses) on securities	(15.8)	38.2	(141)	93.2	198.0	(53)
Fees and other revenues	79.3	75.9	4	227.9	223.1	2
Service revenues	23.1	15.0	54	63.6	38.8	64
Gains (losses) on extinguishment of debt	(0.9)	(4.8)	(81)	(0.9)	(4.8)	(81)
Total revenues	5,273.8	4,766.1	11	15,452.4	14,215.2	9
Expenses						
Losses and loss adjustment expenses	3,654.3	3,291.8	11	10,640.1	9,766.8	9
Policy acquisition costs	423.2	375.2	13	1,219.9	1,119.0	9
Other underwriting expenses	707.5	609.2	16	2,020.3	1,831.3	10
Investment expenses	4.9	3.9	26	15.9	14.0	14
Service expenses	20.4	13.5	51	56.8	36.1	57
Interest expense	34.5	30.7	12	101.9	87.0	17
Total expenses	4,844.8	4,324.3	12	14,054.9	12,854.2	9
Net Income						
Income before income taxes	429.0	441.8	(3)	1,397.5	1,361.0	3
Provision for income taxes	142.5	145.7	(2)	446.9	450.2	(1)
Net income	286.5	296.1	(3)	950.6	910.8	4
Net income attributable to noncontrolling interest (NCI), net of tax	8.2	0	NM	13.4	0	NM
Net income attributable to Progressive	\$278.3	\$296.1	(6)	\$937.2	\$910.8	3
Other Comprehensive Income (Loss), Net of Tax						
Changes in:						
Total net unrealized gains (losses) on securities	\$(130.1)	\$(65.1)	100	\$(244.5)	\$23.2	NM
Net unrealized gains (losses) on forecasted transactions	(0.4)	(0.7)	(43)	(9.4)	(2.3)	309
Foreign currency translation adjustment	(0.7)	(0.4)	75	(1.2)	0.1	NM
Other comprehensive income (loss)	(131.2)	(66.2)	98	(255.1)	21.0	NM
Other comprehensive (income) loss attributable to NCI	(1.6)	0	NM	1.2	0	NM
	\$145.5	\$229.9	(37)	\$683.3	\$931.8	(27)

Comprehensive income attributable to
Progressive

Computation of Net Income Per Share

Average shares outstanding - Basic	585.2	589.8	(1)	586.1	591.6	(1)
Net effect of dilutive stock-based compensation	3.9	3.9	0	3.7	4.1	(10)
Total equivalent shares - Diluted	589.1	593.7	(1)	589.8	595.7	(1)
Basic: Net income per share	\$0.48	\$0.50	(5)	\$1.60	\$1.54	4
Diluted: Net income per share	\$0.47	\$0.50	(5)	\$1.59	\$1.53	4
Dividends declared per share ¹	\$0	\$0		\$0	\$0	

NM = Not Meaningful

¹Progressive maintains an annual dividend program. See Note 8 - Dividends for further discussion.

See notes to consolidated financial statements.

The Progressive Corporation and Subsidiaries
Consolidated Balance Sheets
(unaudited)

(millions)	September 30, 2015	2014	December 31, 2014
Assets			
Investments - Available-for-sale, at fair value:			
Fixed maturities (amortized cost: \$15,539.6, \$13,090.0, and \$13,374.2)	\$ 15,622.1	\$ 13,269.4	\$ 13,549.2
Equity securities:			
Nonredeemable preferred stocks (cost: \$652.4, \$532.8, and \$590.4)	775.6	763.3	827.5
Common equities (cost: \$1,487.0, \$1,278.4, and \$1,289.2)	2,483.9	2,379.4	2,492.3
Short-term investments (amortized cost: \$2,132.0, \$2,671.1, and \$2,149.0)	2,132.0	2,671.1	2,149.0
Total investments	21,013.6	19,083.2	19,018.0
Cash	194.5	90.6	108.4
Accrued investment income	103.6	81.9	87.3
Premiums receivable, net of allowance for doubtful accounts of \$153.3, \$143.6, and \$152.2	4,139.8	3,705.6	3,537.5
Reinsurance recoverables, including \$46.1, \$39.4, and \$46.0 on paid losses and loss adjustment expenses	1,415.0	1,165.9	1,231.9
Prepaid reinsurance premiums	221.7	92.3	85.3
Deferred acquisition costs	590.8	488.3	457.2
Property and equipment, net of accumulated depreciation of \$758.8, \$715.9, and \$731.0	1,024.1	954.0	960.6
Goodwill	446.4	1.6	1.6
Intangible assets, net of accumulated amortization of \$31.8, \$0.6, and \$0.6	510.5	11.3	11.3
Other assets	275.0	251.3	288.5
Total assets	\$29,935.0	\$25,926.0	\$25,787.6
Liabilities			
Unearned premiums	\$6,971.9	\$5,777.0	\$5,440.1
Loss and loss adjustment expense reserves	9,827.2	8,728.4	8,857.4
Net deferred income taxes	85.7	57.4	98.9
Dividends payable	0	0	404.1
Accounts payable, accrued expenses, and other liabilities	2,431.0	2,263.6	1,893.8
Debt ¹	2,714.3	2,164.3	2,164.7
Total liabilities	22,030.1	18,990.7	18,859.0
Redeemable noncontrolling interest (NCI)	442.9	0	0
Shareholders' Equity			
Common Shares, \$1.00 par value (authorized 900.0; issued 797.6, including treasury shares of 213.0, 208.4, and 209.8)	584.6	589.2	587.8
Paid-in capital	1,197.3	1,169.9	1,184.3
Retained earnings	4,910.9	4,203.5	4,133.4
Accumulated other comprehensive income, net of tax:			
Net unrealized gains (losses) on securities	777.4	970.2	1,021.9
Net unrealized gains (losses) on forecasted transactions	(7.9) 1.8	1.5

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Foreign currency translation adjustment	(1.5) 0.7	(0.3)
Accumulated other comprehensive (income) loss attributable to noncontrolling interest	1.2	0	0	
Total accumulated other comprehensive income	769.2	972.7	1,023.1	
Total shareholders' equity	7,462.0	6,935.3	6,928.6	
Total liabilities, redeemable NCI, and shareholders' equity	\$29,935.0	\$25,926.0	\$25,787.6	

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

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The Progressive Corporation and Subsidiaries
Consolidated Statements of Changes in Shareholders' Equity
(unaudited)

Nine months ended September 30, (millions — except per share amounts)	2015	2014
Common Shares, \$1.00 Par Value		
Balance, Beginning of period	\$587.8	\$595.8
Treasury shares purchased	(6.3)	(9.6)
Net restricted equity awards issued/vested/(forfeited)	3.1	3.0
Balance, End of period	\$584.6	\$589.2
Paid-In Capital		
Balance, Beginning of period	\$1,184.3	\$1,142.0
Tax benefit from vesting of equity-based compensation	15.0	12.8
Treasury shares purchased	(12.9)	(18.7)
Net restricted equity awards (issued)/(vested)/forfeited	(3.1)	(3.0)
Amortization of equity-based compensation	45.9	38.4
Reinvested dividends on restricted stock units	(0.1)	(1.6)
Adjustment to carrying amount of noncontrolling interest	(31.8)	0
Balance, End of period	\$1,197.3	\$1,169.9
Retained Earnings		
Balance, Beginning of period	\$4,133.4	\$3,500.0
Net income attributable to Progressive	937.2	910.8
Treasury shares purchased	(155.7)	(206.4)
Cash dividends declared on common shares	0	1.1
Reinvested dividends on restricted stock units	0.1	1.6
Other, net	(4.1)	(3.6)
Balance, End of period	\$4,910.9	\$4,203.5
Accumulated Other Comprehensive Income, Net of Tax		
Balance, Beginning of period	\$1,023.1	\$951.7
Attributable to noncontrolling interest	1.2	0
Other comprehensive income (loss)	(255.1)	21.0
Balance, End of period	\$769.2	\$972.7
Total Shareholders' Equity	\$7,462.0	\$6,935.3

There are 20.0 million Serial Preferred Shares authorized; no such shares are issued or outstanding.

There are 5.0 million Voting Preference Shares authorized; no such shares have been issued.

See notes to consolidated financial statements.

The Progressive Corporation and Subsidiaries

Consolidated Statements of Cash Flows

(unaudited) (millions)

Nine months ended September 30,

Cash Flows From Operating Activities

	2015	2014
Net income	\$950.6	\$910.8
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	76.1	71.8
Amortization of intangible assets	31.2	0
Amortization of fixed-income securities	71.2	59.5
Amortization of equity-based compensation	45.9	38.4
Net realized (gains) losses on securities	(93.2	) (198.0
Net (gains) losses on disposition of property and equipment	0.5	4.2
(Gains) losses on extinguishment of debt	0.9	4.8
Changes in:		
Premiums receivable	(573.2	) (394.9
Reinsurance recoverables	(128.8	) (75.7
Prepaid reinsurance premiums	10.1	(17.4
Deferred acquisition costs	(69.0	) (40.7
Income taxes	(92.1	) 82.1
Unearned premiums	982.7	602.4
Loss and loss adjustment expense reserves	705.8	248.7
Accounts payable, accrued expenses, and other liabilities	218.7	333.1
Other, net	22.1	28.4
Net cash provided by operating activities	2,159.5	1,657.5
Cash Flows From Investing Activities		
Purchases:		
Fixed maturities	(7,106.7	) (5,774.5
Equity securities	(461.3	) (250.7
Sales:		
Fixed maturities	3,639.8	4,342.0
Equity securities	251.8	500.2
Maturities, paydowns, calls, and other:		
Fixed maturities	2,469.4	1,714.5
Equity securities	12.0	14.2
Net sales (purchases) of short-term investments	60.4	(1,397.9
Net unsettled security transactions	118.6	96.7
Purchases of property and equipment	(86.6	) (73.6
Acquisition of ARX Holding Corp., net of cash acquired	(752.7	) 0
Acquisition of additional shares of ARX Holding Corp.	(12.6	) 0
Sales of property and equipment	8.7	4.5
Net cash used in investing activities	(1,859.2	) (824.6
Cash Flows From Financing Activities		
Tax benefit from vesting of equity-based compensation	15.0	12.8
Proceeds from debt issuance	382.0	344.7
Payment of debt	(13.6	) 0
Reacquisition of debt	(18.4	) (48.9
Dividends paid to shareholders ¹	(403.6) (892.6
Acquisition of treasury shares	(174.9) (234.7

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Net cash used in financing activities	(213.5)	(818.7)
Effect of exchange rate changes on cash	(0.7)	1.3)
Increase in cash	86.1		15.5	
Cash, January 1	108.4		75.1	
Cash, September 30	\$194.5		\$90.6	

¹Progressive maintains an annual dividend program. See Note 8 - 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, a mutual insurance company affiliate, and a limited partnership investment affiliate. During the second quarter 2015, Progressive acquired a controlling interest in ARX Holding Corp. (ARX), which wholly owns or controls insurance and non-insurance subsidiaries and affiliates. As of September 30, 2015, Progressive owns 69.1% of the outstanding capital stock of ARX. All of Progressive's other subsidiaries and affiliates are wholly owned or controlled.

Beginning April 1, 2015, we consolidated 100% of ARX's financial information into our results of operations, financial condition, and cash flows. The minority shareholders of ARX retain a 30.9% interest in the operating results of ARX. These interests are reflected in our comprehensive income statements as "Net income/Other comprehensive income attributable to noncontrolling interest (NCI)."

As part of a related stockholders' agreement, Progressive has the ability to "call" the remaining outstanding shares to achieve 100% ownership in ARX by the end of the second quarter of 2021. In addition, the minority ARX shareholders have the right to "put" their ARX shares to Progressive by that date. Since these securities are redeemable upon the occurrence of an event that is not solely within the control of Progressive, we have recorded the redeemable noncontrolling interest as mezzanine equity on our consolidated balance sheets. The redeemable noncontrolling interest was initially recorded at fair value of \$411.5 million, representing the minority shares at the net acquisition price adjusted for the fair value of the put and call rights. The value of the put and call rights on the acquisition date was based on an internally developed modified binomial model. Subsequent changes to the redeemable noncontrolling interest are based on the maximum redemption value at the end of the reporting period, as determined in accordance with the stockholders' agreement.

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, 2015, 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, 2014.

Included in other assets in the consolidated balance sheets are properties that are considered "held for sale." The fair value of these properties, less the estimated cost to sell them, was \$8.7 million at September 30, 2015 and December 31, 2014, and \$13.4 million at September 30, 2014.

Note 2 Investments — 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.

The following tables present the composition of our investment portfolio by major security type, consistent with our classification of 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, 2015						
Fixed maturities:						
U.S. government obligations	\$2,028.2	\$10.1	\$0	\$0	\$2,038.3	9.7 %
State and local government obligations	3,025.0	47.1	(4.2)	0	3,067.9	14.6
Foreign government obligations	19.3	0	0	0	19.3	0.1
Corporate debt securities	3,797.4	23.4	(21.4)	0.1	3,799.5	18.1
Residential mortgage-backed securities	1,801.8	26.2	(18.4)	(0.2)	1,809.4	8.6
Agency residential pass-through obligations	112.2	0.1	(0.4)	0	111.9	0.5
Commercial mortgage-backed securities	2,641.4	31.1	(9.3)	0.4	2,663.6	12.7
Other asset-backed securities	1,859.3	4.1	(1.5)	0.5	1,862.4	8.9
Redeemable preferred stocks	255.0	17.6	(22.8)	0	249.8	1.2
Total fixed maturities	15,539.6	159.7	(78.0)	0.8	15,622.1	74.4
Equity securities:						
Nonredeemable preferred stocks	652.4	138.3	(14.8)	(0.3)	775.6	3.7
Common equities	1,487.0	1,031.9	(35.0)	0	2,483.9	11.8
Short-term investments	2,132.0	0	0	0	2,132.0	10.1
Total portfolio ^{2,3}	\$19,811.0	\$1,329.9	\$(127.8)	\$0.5	\$21,013.6	100.0 %

(\$ in millions)	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Net Realized Gains (Losses) ¹	Fair Value	% of Total Fair Value
September 30, 2014						
Fixed maturities:						
U.S. government obligations	\$3,033.2	\$33.6	\$(3.9)	\$0	\$3,062.9	16.0 %
State and local government obligations	2,124.2	49.5	(0.9)	0	2,172.8	11.4
Foreign government obligations	20.2	0	0	0	20.2	0.1
Corporate debt securities	2,501.8	30.7	(13.1)	(0.3)	2,519.1	13.2
Residential mortgage-backed securities	1,460.6	36.9	(10.1)	(0.9)	1,486.5	7.8
Commercial mortgage-backed securities	2,143.8	33.8	(5.1)	0	2,172.5	11.4
Other asset-backed securities	1,546.0	5.0	(0.6)	0.2	1,550.6	8.1
Redeemable preferred stocks	260.2	28.8	(4.2)	0	284.8	1.5
Total fixed maturities	13,090.0	218.3	(37.9)	(1.0)	13,269.4	69.5
Equity securities:						
Nonredeemable preferred stocks	532.8	218.4	(7.2)	19.3	763.3	4.0
Common equities	1,278.4	1,107.7	(6.7)	0	2,379.4	12.5
Short-term investments	2,671.1	0	0			