PROGRESSIVE CORP/OH/
Form 10-Q
May 06, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 1O-Q

(Mark One)

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended March 31, 2008

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:1-9518

THE PROGRESSIVE CORPORATION

(Exact name of registrant as specified in its charter)

Ohio	34-0963169
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer 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 þ 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. (Check one):

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o

(Do not check if a 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 o No þ

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 677,510,990 outstanding at March 31, 2008

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

The Progressive Corporation and Subsidiaries

Consolidated Statements of Income

(unaudited)

Three Months Ended March 31,	2008	2007	% Change
(millions except per share amounts)			
Revenues			
Net premiums earned	$ 3,390.0	$ 3,493.8	(3)
Investment income	159.3	163.5	(3)
Net realized gains on securities	32.2	23.3	38
Service revenues	4.4	6.2	(29)
Total revenues	3,585.9	3,686.8	(3)
Expenses			
Losses and loss adjustment expenses	2,484.0	2,400.5	3
Policy acquisition costs	339.5	355.2	(4)
Other underwriting expenses	384.3	371.5	3
Investment expenses	1.5	2.8	(46)
Service expenses	5.1	5.2	(2)
Interest expense	34.3	18.9	81
Total expenses	3,248.7	3,154.1	3
Net Income			
Income before income taxes	337.2	532.7	(37)
Provision for income taxes	97.8	169.2	(42)
Net income	$ 239.4	$ 363.5	(34)
Computation of Earnings Per Share			
Basic:			
Average shares outstanding	671.5	737.8	(9)
Per share	$ .36	$ .49	(28)
Diluted:			
Average shares outstanding	671.5	737.8	(9)
Net effect of dilutive stock-based compensation	5.8	7.5	(23)
Total equivalent shares	677.3	745.3	(9)

Per share	$ .35	$ .49	(28)

See notes to consolidated financial statements.

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The Progressive Corporation and Subsidiaries
Consolidated Balance Sheets
(unaudited)

	March 31, 2008	March 31, 2007	December 31, 2007
(millions)			
Assets			
Investments Available-for-sale, at fair value:			
Fixed maturities (amortized cost: $8,182.4, $10,244.6 and $9,135.6)	$ 8,120.7	$ 10,266.2	$ 9,184.9
Equity securities:			
Preferred stocks (cost: $2,635.7, $1,821.1 and $2,578.1)	2,121.5	1,846.1	2,270.3
Common equities (cost: $1,330.3, $1,479.2 and $1,361.0)	2,104.2	2,390.9	2,327.5
Short-term investments (amortized cost: $1,533.3, $594.3 and $382.4)	1,533.3	594.3	382.4
Total investments	13,879.7	15,097.5	14,165.1
Cash	8.5	9.9	5.8
Accrued investment income	125.8	151.9	142.1
Premiums receivable, net of allowance for doubtful accounts of $105.2, $111.8 and $118.1	2,503.2	2,633.3	2,395.1
Reinsurance recoverables, including $42.8, $53.5 and $47.6 on paid losses	322.2	393.6	335.1
Prepaid reinsurance premiums	66.9	88.7	69.8
Deferred acquisition costs	434.1	453.3	426.3
Income taxes	190.6		106.0
Property and equipment, net of accumulated depreciation of $621.2, $561.7 and $605.7	1,000.6	979.7	1,000.4
Other assets	185.2	203.8	197.4
Total assets	$ 18,716.8	$ 20,011.7	$ 18,843.1
Liabilities and Shareholders Equity			
Unearned premiums	$ 4,307.9	$ 4,487.1	$ 4,210.4
Loss and loss adjustment expense reserves	5,952.1	5,720.4	5,942.7
Accounts payable, accrued expenses and other liabilities	1,532.9	1,544.6	1,580.6
Income taxes		143.3	
Debt[1]	2,174.3	1,185.7	2,173.9
Total liabilities	13,967.2	13,081.1	13,907.6
Common Shares, $1.00 par value (authorized 900.0; issued 797.9, 798.5 and 798.1, including treasury shares of 120.4, 62.3 and 117.9)	677.5	736.2	680.2
Paid-in capital	846.3	850.3	834.8
Accumulated other comprehensive income:			

Net unrealized gains on securities	135.7	622.3	465.0
Net unrealized gains on forecasted transactions	27.1	7.2	27.8
Retained earnings	3,063.0	4,714.6	2,927.7
Total shareholders equity	4,749.6	6,930.6	4,935.5
Total liabilities and shareholders equity	$ 18,716.8	$ 20,011.7	$ 18,843.1

[1] Consists of 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 Cash Flows
(unaudited)

Three Months Ended March 31, (millions)	2008	2007
Cash Flows From Operating Activities		
Net income	$ 239.4	$ 363.5
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	23.8	26.2
Amortization of fixed maturities	69.9	66.0
Amortization of stock-based compensation	6.5	6.2
Net realized gains on securities	(32.2)	(23.3)
Net (gain) loss on disposition of property and equipment	.5	(.1)
Changes in:		
Premiums receivable	(108.1)	(135.1)
Reinsurance recoverables	12.9	40.2
Prepaid reinsurance premiums	2.9	.8
Deferred acquisition costs	(7.8)	(12.3)
Income taxes	92.7	146.4
Unearned premiums	97.5	152.1
Loss and loss adjustment expense reserves	9.4	(4.6)
Accounts payable, accrued expenses and other liabilities	25.4	30.9
Other, net	28.6	(20.9)
Net cash provided by operating activities	461.4	636.0
Cash Flows From Investing Activities		
Purchases:		
Fixed maturities	(473.0)	(1,607.2)
Equity securities	(244.8)	(422.7)
Short-term investments auction rate securities	(414.7)	(935.0)
Sales:		
Fixed maturities	1,376.1	1,158.2
Equity securities	101.5	360.4
Short-term investments auction rate securities	240.6	945.3
Maturities, paydowns, calls and other:		
Fixed maturities	120.4	112.8
Equity securities	34.9	
Net purchases of short-term investments other	(976.7)	(23.6)
Net unsettled security transactions	2.4	124.6
Purchases of property and equipment	(24.2)	(33.6)
Sale of property and equipment		1.2
Net cash used in investing activities	(257.5)	(319.6)
Cash Flows From Financing Activities		
Proceeds from exercise of stock options	9.1	6.5
Tax benefit from exercise/vesting of stock-based compensation	4.1	4.5

Dividends paid to shareholders[1]	(98.3)	
Acquisition of treasury shares	(116.1)	(323.1)
Net cash used in financing activities	(201.2)	(312.1)
Increase in cash	2.7	4.3
Cash, January 1	5.8	5.6
Cash, March 31	$ 8.5	$ 9.9

[1] Progressive maintains an annual dividend program. See *Note 8 Dividends* for further discussion.

See notes to consolidated financial statements.

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The Progressive Corporation and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited)

Note 1 ***Basis of Presentation*** These 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, 2007.

The consolidated financial statements reflect all normal recurring adjustments which, 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 March 31, 2008, are not necessarily indicative of the results expected for the full year.

Note 2 ***Investments*** The composition of the investment portfolio at March 31 was:

($ in millions)	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	% of Total Fair Value
2008					
Fixed maturities[1]	$ 8,182.4	$ 118.2	$ (179.9)	$ 8,120.7	58.5%
Equity securities:					
Preferred stocks[2]	2,635.7	3.5	(506.9)	2,121.5	15.3
Common equities	1,330.3	793.8	(19.9)	2,104.2	15.2
Short-term investments:					
Auction rate municipal obligations	174.1			174.1	1.2
Other short-term investments	1,359.2			1,359.2	9.8
Total short-term investments	1,533.3			1,533.3	11.0
Total portfolio[2, 3]	$13,681.7	$ 915.5	$ (706.7)	$13,879.7	100.0%
2007					
Fixed maturities	$10,244.6	$ 79.2	$ (57.6)	$10,266.2	68.0%
Equity securities:					
Preferred stocks[2]	1,821.1	36.4	(12.3)	1,846.1	12.2
Common equities	1,479.2	915.0	(3.3)	2,390.9	15.8
Short-term investments:					
Auction rate municipal obligations	158.3			158.3	1.1
Other short-term investments	436.0			436.0	2.9
Total short-term investments	594.3			594.3	4.0
Total portfolio[2,3]	$14,139.2	$ 1,030.6	$ (73.2)	$15,097.5	100.0%

1 Includes $1.1 million of gains on our open interest rate swap position, as well

as $44.7 million of collateral in the form of Treasury Notes that were delivered to the counterparty on our open credit default swaps. See the *Derivative Instruments* section in *Management s Discussion and Analysis of Financial Condition and Results of Operations* for further discussion.

2 At March 31, 2008 and 2007, the fair value included a $10.8 million net realized loss and a $.9 million net realized gain, respectively, on certain hybrid securities (discussed below).

3 Includes net unsettled security acquisitions of $79.4 million and $166.5 million at March 31, 2008 and 2007, respectively.

Our fixed-maturity securities include debt securities and redeemable preferred stocks. The preferred stock portfolio includes nonredeemable preferred stocks and certain hybrid securities. At March 31, 2008 and 2007, our preferred stock portfolio included $149.7 million and $59.4 million, respectively, of perpetual preferred stocks that have call features with fixed-rate coupons (i.e., hybrid securities), whereby the change in value of the call features is a component of the overall change in value of the preferred stocks. Our other short-term investments include Eurodollar deposits, commercial paper and other investments which are expected to mature within one year. The auction rate securities we hold are high-quality municipal obligations which we believe currently have sufficient demand in the marketplace to clear all auctions. In the event of a failed auction, each of these securities will pay an after-tax interest rate of 10% or higher. Common equities include common stock and other risk investments (i.e., private equity investments and limited partnership interests in private equity and mezzanine funds).

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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 change in fair value of the hybrid securities and derivative instruments is recorded as a component of net realized gains (losses) on securities.

During the first quarter 2008, we wrote-down $52.5 million in securities determined to have an other-than-temporary decline in fair value. The write-downs included $42.7 million in preferred stocks, $6.9 million of common equities and $2.9 million of fixed-maturity asset-backed securities. All of these write-downs were the result of fundamental issues with the underlying issuers.

Note 3 *Fair Value* We adopted Statement of Financial Accounting Standards (SFAS) 157, Fair Value Measurements, in the first quarter 2008, as it applies to our financial assets and liabilities. SFAS 157 defines fair value, establishes a framework for measuring fair value, establishes a fair value hierarchy based on inputs used to measure fair value and expands disclosure about fair value measurements. Adopting this statement does not have an effect on our financial condition, cash flows or results of operations.

In accordance with SFAS 157, we have categorized our financial instruments, based on the degree of subjectivity inherent in the valuation technique, into a fair value hierarchy of three levels as follows:

Level 1: Inputs are unadjusted, quoted prices in active markets for identical instruments at the measurement date (e.g., U.S. Government securities and active exchange-traded equity securities).

Level 2: Inputs (other than quoted prices included within Level 1) that are observable for the instrument either directly or indirectly. This includes: (i) quoted prices for similar instruments in active markets, (ii) quoted prices for identical or similar instruments in markets that are not active, (iii) inputs other than quoted prices that are observable for the instruments and (iv) inputs that are derived principally from or corroborated by observable market data by correlation or other means. (Examples include certain corporate and municipal bonds and certain preferred stocks).

Level 3: Inputs that are unobservable. Unobservable inputs reflect the reporting entity s subjective evaluation about the assumptions market participants would use in pricing the financial instrument (e.g., certain structured securities and privately held investments).

The composition of the investment portfolio as of March 31, 2008, was:

	Fair Value			
(millions)	Level 1	Level 2	Level 3	Total
Fixed maturities	$ 320.0	$ 7,644.8	$ 155.9	$ 8,120.7
Preferred stocks	952.7	1,168.8		2,121.5
Common equities	2,090.5		13.7	2,104.2
Short-term investments:				
Auction rate municipal obligations[1]		174.1		174.1
	$ 3,363.2	$ 8,987.7	$ 169.6	12,520.5
Short-term investments: Other[2]				1,359.2
Total portfolio				$ 13,879.7

[1] These securities are backed by municipal obligations with

a maturity of 14 years or greater. Due to the short-term nature of auction rate securities (generally 7-49 days between auctions), these securities are valued at cost, which approximates fair value.

[2] These securities are not subject to fair value measurement since they are cash equivalents (e.g., mature within one business day); therefore, we report these securities at cost, which approximates fair value.

We currently have no material financial liabilities that would require categorization.

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The following table shows a reconciliation of the December 31, 2007 balance and the March 31, 2008 balance for fair value measurements using significant unobservable (Level 3) inputs:

	Level 3 Fair Value			
(millions)	Fixed Maturities	Preferred Stocks	Common Equities	Total
Fair value at December 31, 2007	$ 119.4	$ 115.6	$ 13.7	$ 248.7
Calls/maturities/paydowns	(1.8)			(1.8)
Transfers in (out) [1]	46.7	(115.6)		(68.9)
Change in valuation	(8.4)			(8.4)
Fair value at March 31, 2008	$ 155.9	$	$ 13.7	$ 169.6

[1] Represents movement between the fair value hierarchy levels during the first quarter 2008, reflecting changes in the inputs used to measure fair value during the period.

There were no purchases, sales or realized gains/losses associated with the Level 3 securities during the first quarter 2008.

Note 4 ***Debt*** Debt at March 31 consisted of:

(millions)	2008		2007	
	Carrying Value	Fair Value	Carrying Value	Fair Value
6.375% Senior Notes due 2012	$ 348.6	$ 372.1	$ 348.3	$ 366.0
7% Notes due 2013	149.2	164.3	149.1	163.3
6 5/8% Senior Notes due 2029	294.5	295.3	294.4	321.1
6.25% Senior Notes due 2032	394.0	374.4	393.9	410.1
6.70% Fixed-to-Floating Rate Junior Subordinated Debentures due 2067	988.0	876.0		
Total	$ 2,174.3	$ 2,082.1	$ 1,185.7	$ 1,260.5

Note 5 ***Supplemental Cash Flow Information*** We did not make any income tax payments in the first quarter 2008, compared to $19.0 million paid during the first quarter 2007, which represented a final estimated payment for 2006. Total interest paid was $21.1 million for both the three months ended March 31, 2008 and 2007. Non-cash activity includes changes in net unrealized gains (losses) on investment securities.

Note 6 ***Segment Information*** Our Personal Lines segment writes insurance for private passenger automobiles and recreational vehicles. Our Commercial Auto segment writes primary liability and physical damage insurance for automobiles and trucks owned by small businesses in the specialty truck and business auto markets. Our other indemnity businesses primarily include writing professional liability insurance for community banks and managing a small amount of run-off business. Our service businesses include providing insurance-related services, primarily providing policy issuance and claims adjusting services for Commercial Auto Insurance Procedures/Plans (CAIP), which are state-supervised plans serving the involuntary market. All revenues are generated from external customers.

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Following are the operating results for the three months ended March 31:

	2008		2007	
(millions)	Revenues	Pretax Profit (Loss)	Revenues	Pretax Profit (Loss)
Personal Lines				
Agency	$ 1,846.0	$ 114.5	$ 1,934.9	$ 175.8
Direct	1,094.0	41.9	1,091.9	124.4
Total Personal Lines[1]	2,940.0	156.4	3,026.8	300.2
Commercial Auto	444.7	25.9	461.3	65.8
Other indemnity	5.3	(.1)	5.7	.6
Total underwriting operations	3,390.0	182.2	3,493.8	366.6
Service businesses	4.4	(.7)	6.2	1.0
Investments[2]	191.5	190.0	186.8	184.0
Interest expense		(34.3)		(18.9)
Consolidated total	$ 3,585.9	$ 337.2	$ 3,686.8	$ 532.7

1 Private passenger automobile insurance accounted for 91% of the total Personal Lines segment net premiums earned in the first quarters of 2008 and 2007, respectively; our special lines products accounted for the balance of the Personal Lines net premiums earned.

2 Revenues represent recurring investment income and net

realized gains (losses) on securities; pretax profit is net of investment expenses.

Progressive s management uses underwriting margin and combined ratio as primary measures of underwriting profitability. The underwriting margin is the pretax underwriting profit (loss) expressed as a percentage of net premiums earned (i.e., revenues). Combined ratio is the complement of the underwriting margin. Following are the underwriting margins/combined ratios for our underwriting operations for the three months ended March 31:

	2008		2007	
	Underwriting Margin	Combined Ratio	Underwriting Margin	Combined Ratio
Personal Lines				
Agency	6.2%	93.8	9.1%	90.9
Direct	3.8	96.2	11.4	88.6
Total Personal Lines	5.3	94.7	9.9	90.1
Commercial Auto	5.8	94.2	14.3	85.7
Other indemnity[1]	NM	NM	NM	NM
Total underwriting operations	5.4	94.6	10.5	89.5

[1] Underwriting margins/combined ratios are not meaningful (NM) for our other indemnity businesses due to the low level of premiums earned by, and the variability of losses in, such businesses.

Note 7 ***Comprehensive Income*** Total comprehensive income (loss) was $(90.6) million and $388.7 million for the quarters ended March 31, 2008 and 2007, respectively.

Note 8 ***Dividends*** In January 2008, Progressive paid dividends of $98.3 million, or $.145 per common share, pursuant to a December 2007 declaration by the Board of Directors under our annual variable dividend policy.

Progressive maintains a policy of paying an annual variable dividend, payable shortly after the close of each year. This annual dividend will be based on a target percentage of after-tax underwriting income, multiplied by a companywide performance factor (Gainshare factor). The Gainshare factor can range from zero to two and will be determined by comparing our operating performance for the year to certain predetermined profitability and growth objectives approved by the Board. This dividend program is consistent with the variable cash incentive program currently in place for our employees.

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For 2008, the Board established that the variable dividend will be based on 20% of after-tax underwriting profit. Through the first quarter 2008, the Gainshare factor was .58. Since the final factor will be determined based on our results for the full year, the final factor may vary significantly from the factor of any interim period. While the declaration of the dividend remains within the Board s discretion, the Board is expected to declare the 2008 annual dividend in December 2008 with a record date in January 2009 and payment shortly thereafter. However, if the Gainshare factor is zero or if our after-tax comprehensive income (which includes net investment income as well as both realized gains and losses in securities and the change in unrealized gains and losses during the period) is less than after-tax underwriting income, no dividend will be paid.

Note 9 ***Litigation*** One or more of The Progressive Corporation s insurance subsidiaries are named as a defendant in various lawsuits arising out of their insurance operations. All legal actions relating to claims made under insurance policies are considered in establishing our loss and loss adjustment expense reserves.

In addition, various Progressive entities are named as a defendant in a number of class action or individual lawsuits, the outcomes of which are uncertain at this time. These cases include those alleging damages as a result of our total loss evaluation methodology or handling, use of consumer reports (such as credit reports) in underwriting and related notice requirements under the federal Fair Credit Reporting Act, charging betterment in first party physical damage claims, the adjusting of personal injury protection and medical payment claims, the use of automated database vendors or products to assist in evaluating certain bodily injury claims, policy implementation and renewal procedures and cases challenging other aspects of our claims and marketing practices and business operations.

We plan to contest the outstanding suits vigorously, but may pursue settlement negotiations where appropriate. In accordance with accounting principles generally accepted in the United States of America (GAAP), we have established accruals for lawsuits as to which we have determined that it is probable that a loss has been incurred and we can reasonably estimate our potential exposure. Pursuant to GAAP, we have not established reserves for those lawsuits where the loss is not probable and/or we are currently unable to estimate our potential exposure. If any one or more of these lawsuits results in a judgment against or settlement by us in an amount that is significantly in excess of the reserve established for such lawsuit (if any), the resulting liability could have a material effect on our financial condition, cash flows and results of operations.

For a further discussion on our pending litigation, see Item 3-Legal Proceedings in our Annual Report on Form 10-K for the year ended December 31, 2007.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

I. OVERVIEW

For the first quarter 2008, The Progressive Corporation s insurance subsidiaries generated underwriting profitability of 5.4%. Companywide policies in force increased 3% on a year-over-year basis, while net premiums written and earned decreased 4% and 3%, respectively. For the first quarter 2008, net income was $239.4 million, or $.35 per share, compared to $363.5 million, or $.49 per share, for the same period last year. The year-over-year decrease in premiums and net income primarily reflects the impact of our prior rate decreases.

Our aggregate premium growth measures, both written and earned, were down for the first quarter 2008, compared to the same period last year, despite increases in policies in force. Premium growth can be explained by some combination of new business applications (i.e., issued policies), premium per policy and retention. On a quarter over prior-year quarter basis, companywide new business applications decreased 7%, while renewal applications increased 3%. New business acquisition continues to be a challenge, especially in our Agency business. Year-over-year, we have seen an overall decrease in average written premium per auto policy of 5%. As we begin to raise rates to meet our loss cost inflation expectations, we expect to see premiums per policy increase.

Our effort to increase customer retention continues to be one of our most significant initiatives and we are starting to see the benefits. Policy life expectancy, which is an estimate of the average length of time that a policy will remain in force before cancellation or non-renewal, is one measure of customer retention. The policy life expectancy for our Agency and Direct auto business has been on a continuing upward trend over the past few quarters and is now about 9% and 11% higher, respectively, than the same measure a year ago.

Policies in force, our primary growth metric, increased 3% on a companywide basis since the first quarter last year. We experienced policy growth in Personal Auto, Special Lines and Commercial Auto. Direct auto, which represents about 38% of our auto policies in force, grew 7%, while the Agency auto business declined 2%. Our fastest personal auto growth area continues to be in our Internet-produced business.

With our first quarter 2008 profit margin of 5.4%, we are now near our profitability goal of an aggregate underwriting margin of 4%. We realize that there may be some variance around this target, at both the product and state levels and even in the short term at the aggregate level. Nevertheless, this remains our long-term goal, and we will react quickly to change rates if frequency or severity trends vary from our expectations.

Our loss ratios for the quarter were impacted by both the reduction in average earned premiums as well as higher severity trends and unfavorable prior accident year development. We are continuing to experience favorable accident frequency trends, but to a lesser extent than we saw in prior years. For the first quarter 2008, our underwriting margin was reduced by 1 point of unfavorable reserve development, compared to .9 points of favorable development in the first quarter 2007.

We are beginning to see efficiency gains as a result of the organizational changes made during the second half of 2007. Bringing our Agency and Direct businesses together under one Personal Lines organization and streamlining this group, along with our information technology area, has allowed us to reduce the redundancy that developed in areas such as product design, management and policy servicing, as well as improve our ability to execute on our most significant challenges. These changes have contributed to a 5% increase in the number of companywide policies in force per employee on a year-over-year basis.

We have made no substantial changes in the allocation of our investment portfolio during the quarter. Our investment portfolio produced a fully taxable equivalent total return of (2)%, with negative total returns for the quarter in both fixed-income securities and common stocks. We continued to keep our credit quality high and exposure to interest rate risk low. At March 31, 2008, the fixed-income portfolio duration was 2.3 years with a weighted average credit quality of AA-.

During the quarter, our pretax net unrealized gains on investment securities declined $506.6 million from year-end 2007, bringing our total net unrealized gains to $208.8 million at March 31, 2008. The decrease was primarily related to our financial sector preferred stocks, which comprise approximately two-thirds of our preferred stock holdings. The unrealized losses on these securities reflect the market-related issues associated with the disruption in the sub-prime mortgage and other credit markets. In addition, consistent with our process for reviewing securities with declines in fair value, during the quarter, we recognized $52.5 million of losses on securities determined to be other-than-temporarily impaired. For each of the securities, we determined that fundamental issues existed for the issuer in addition to the effects of current market conditions, and it was not clear at that time that we would hold the securities for a period of time necessary to recover a substantial portion of their values. We will continue to be diligent in our process for reviewing such securities.

II. FINANCIAL CONDITION

A. Capital Resources and Liquidity

We believe we have sufficient capital resources, cash flows from operations and borrowing capacity to support our current and anticipated growth, scheduled principal and interest payments on our debt, expected dividends and other capital requirements. Our existing debt covenants do not include any rating or credit triggers.

Progressive s insurance operations create liquidity by collecting and investing premiums from new and renewal business in advance of paying claims. For the three months ended March 31, 2008 and 2007, operations generated a positive cash flow of $461.4 million and $636.0 million, respectively. The decrease primarily reflects the lower income earned during the period. During the first quarter 2008, we repurchased 6.5 million of our common shares at a total cost of $116.1 million (average cost of $17.75 per share).

During the quarter, we also paid dividends of $98.3 million, or $.145 per common share, pursuant to a December 2007 declaration by the Board of Directors under our annual variable dividend policy.

B. Commitments and Contingencies

During the first quarter 2008, we completed construction of one new service center that provides our concierge level of claims service, which replaced a previously leased service center location. In total, we have 54 centers in 41 metropolitan areas across the United States serving as our primary approach to damage assessment and coordination of vehicle repairs at authorized repair facilities in these markets. Throughout the remainder of 2008 and in 2009, we expect to construct four new service centers, of which two centers will replace existing leased facilities.

There is currently no other significant construction under way. We own additional land in both Colorado Springs, Colorado and Mayfield Village, Ohio for possible future development; both properties are near current corporate operations.

All such construction projects have been, and will continue to be, funded through operating cash flows.

Off-Balance-Sheet Arrangements

Our off-balance-sheet leverage includes derivative positions, open investment funding commitments and operating leases and purchase obligations. See the *Derivative Instruments* section of this Management s Discussion and Analysis for a summary of our derivative activity since year-end 2007. There have been no material changes in the other off-balance-sheet items since the discussion in the notes to the financial statements in Progressive s Annual Report on Form 10-K for the year ended December 31, 2007.

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Contractual Obligations

During the first quarter 2008, our contractual obligations have not changed materially from those discussed in our Annual Report on Form 10-K for the year ended December 31, 2007.

We entered into two contracts to expand our brand building efforts during the quarter. In January 2008, we entered into a 16-year contract for the ballpark naming rights and a sponsorship deal with the Cleveland Indians Major League Baseball team. Over the contract term, Progressive will pay an average of approximately $3.6 million per year. In addition, in March 2008, we announced our title sponsorship of the Progressive Insurance Automotive X PRIZE competition. The Automotive X PRIZE is a two and one half year international competition designed to inspire a new generation of safe, low emissions vehicles capable of achieving the equivalent of at least 100 miles per gallon in fuel efficiency. The total cost of the sponsorship is expected to be approximately $12.5 million, which includes the prize for the winning team as well as the funding of some operational expenses over the course of the competition.

III. RESULTS OF OPERATIONS UNDERWRITING

A. Growth

	Three Months Ended March 31,		
(millions)	2008	2007	% Change
NET PREMIUMS WRITTEN			
Personal Lines			
Agency	$ 1,868.8	$ 1,988.6	(6)
Direct	1,160.0	1,161.6	
Total Personal Lines	3,028.8	3,150.2	(4)
Commercial Auto	457.2	490.8	(7)
Other indemnity	4.4	5.7	(23)
Total underwriting operations	$ 3,490.4	$ 3,646.7	(4)
NET PREMIUMS EARNED			
Personal Lines			
Agency	$ 1,846.0	$ 1,934.9	(5)
Direct	1,094.0	1,091.9	
Total Personal Lines	2,940.0	3,026.8	(3)
Commercial Auto	444.7	461.3	(4)
Other indemnity	5.3	5.7	(7)
Total underwriting operations	$ 3,390.0	$ 3,493.8	(3)

Net premiums written represent the premiums generated from policies written during the period less any premiums ceded to reinsurers. Net premiums earned, which are a function of the premiums written in the current and prior periods, are earned as revenue over the life of the policy using a daily earnings convention. The decrease in premiums primarily reflects the impact of the prior rate decreases we had taken.

Policies in force represents all policies under which coverage is in effect as of the dates specified.

	At March 31,		
(thousands)	2008	2007	% Change
POLICIES IN FORCE			

Personal Lines			
Agency Auto	4,442.6	4,521.8	(2)
Direct Auto	2,679.4	2,502.8	7
Total Auto	7,122.0	7,024.6	1
Special Lines[1]	3,151.8	2,928.6	8
Total Personal Lines	10,273.8	9,953.2	3
Commercial Auto	545.4	514.7	6

[1] Includes insurance for motorcycles, recreational vehicles, mobile homes, watercraft, snowmobiles and similar items, as well as a personal umbrella product.

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We are working to further develop the Progressive brand to help spur growth. In addition, during the quarter, we announced the hiring of a Chief Marketing Officer to help guide us in our marketing and brand-building efforts.
To analyze growth, we review new policies, rate levels and the retention characteristics of our books of business. During the first quarter, we experienced the following growth in new and renewal applications:

	Growth Over Prior Year Quarter			
	Personal Lines		Commercial Auto	
	2008	2007	2008	2007
New applications	(8)%	1%	(3)%	(2)%
Renewal applications	3%	3%	3%	7%

Total auto written premium per policy decreased 5% in the first quarter 2008 and 3% in the first quarter 2007, compared to the same period in the prior year. Our current pricing levels are closely aligned with our profitability targets. We, along with many of our competitors, are returning to more traditional levels of profitability, which, we expect, will require that we increase rates to meet our loss cost inflation expectations. We are ready to react quickly, and as often as necessary, should our expectations change.
Another important element affecting growth is customer retention. One measure of customer retention is policy life expectancy, which is an estimate of the average length of time that a policy will remain in force before cancellation or non-renewal. Efforts at increasing growth from customer retention have continued to produce positive outcomes. Our policy life expectancy measures for our Agency and Direct private passenger auto products have been on a continuing upward trend and are now approximately 9% and 11% higher, respectively, than the same measures a year ago. In our Commercial Auto Business, the policy life expectancy remained relatively flat since the end of 2007, but is lower than levels achieved in the first quarter 2007. Realizing the importance that retention has on our ability to grow profitably, we continue to place increased emphasis on competitive pricing and other retention initiatives for our current customers.

B. Profitability

Profitability in our underwriting operations is defined by pretax underwriting profit, which is calculated as net premiums earned less losses and loss adjustment expenses, policy acquisition costs and other underwriting expenses. We also use underwriting profit margin, which is underwriting profit expressed as a percentage of net premiums earned, to analyze our results. For the three months ended March 31, our underwriting profitability was follows:

	2008		2007	
	Underwriting Profit		Underwriting Profit	
(millions)	$	Margin	$	Margin
Personal Lines				
Agency	$ 114.5	6.2%	$ 175.8	9.1%
Direct	41.9	3.8	124.4	11.4
Total Personal Lines	156.4	5.3	300.2	9.9
Commercial Auto	25.9	5.8	65.8	14.3
Other indemnity[1]	(.1)	NM	.6	NM
Total underwriting operations	$ 182.2	5.4%	$ 366.6	10.5%

[1] Underwriting margins are not meaningful (NM) for our other indemnity

businesses due to the low level of premiums earned by, and the variability of losses in, such businesses.

The year-over-year decrease in underwriting profitability primarily reflects the impact of our recent rate reductions, as well as recognizing unfavorable prior accident year development in the first quarter 2008, compared to favorable development for the same period last year.

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Further underwriting results for our Personal Lines Business, including its channel components, the Commercial Auto Business and other indemnity businesses, were as follows:

	Three Months Ended March 31,		
Underwriting Performance[1]	2008	2007	Change
Personal Lines Agency			
Loss & loss adjustment expense ratio	72.5	69.9	2.6 pts.
Underwriting expense ratio	21.3	21.0	.3 pts.
Combined ratio	93.8	90.9	2.9 pts.
Personal Lines Direct			
Loss & loss adjustment expense ratio	74.7	68.1	6.6 pts.
Underwriting expense ratio	21.5	20.5	1.0 pts.
Combined ratio	96.2	88.6	7.6 pts.
Total Personal Lines			
Loss & loss adjustment expense ratio	73.4	69.3	4.1 pts.
Underwriting expense ratio	21.3	20.8	.5 pts.
Combined ratio	94.7	90.1	4.6 pts.
Commercial Auto			
Loss & loss adjustment expense ratio	73.2	65.5	7.7 pts.
Underwriting expense ratio	21.0	20.2	.8 pts.
Combined ratio	94.2	85.7	8.5 pts.
Total Underwriting Operations[2]			
Loss & loss adjustment expense ratio	73.3	68.7	4.6 pts.
Underwriting expense ratio	21.3	20.8	.5 pts.
Combined ratio	94.6	89.5	5.1 pts.
Accident year-Loss & loss adjustment expense ratio	72.3	69.6	2.7 pts.

1 Ratios are expressed as a percentage of net premiums earned.

2 Combined ratios for the other indemnity businesses are

not presented separately due to the low level of premiums earned by, and the variability of losses in, such businesses. For the three months ended March 31, 2008 and 2007, these businesses generated an underwriting profit (loss) of $(.1) million and $.6 million, respectively.

Losses and Loss Adjustment Expenses (LAE)

	Three Months Ended March 31,	
(millions)	2008	2007
Change in net loss and LAE reserves	$ 17.5	$ 16.7
Paid losses and LAE	2,466.5	2,383.8
Total incurred losses and LAE	$ 2,484.0	$ 2,400.5

Claims costs, our most significant expense, represent payments made, and estimated future payments to be made, to or on behalf of our policyholders, including expenses needed to adjust or settle claims. These costs include an estimate for costs related to assignments, based on current business, under state-mandated automobile insurance programs. Claims costs are defined by loss severity and frequency and are influenced by inflation and driving patterns, among other factors. Accordingly, estimated changes in these factors are taken into account when we establish premium rates and loss reserves. Results would differ if different assumptions were made.

During the first quarter 2008, we experienced an increase in total personal auto paid severity (i.e., average cost per claim) of about 1.5%, compared to the first quarter 2007, driven by an increase in our bodily injury coverage in the 6-9% range.

We experienced a modest decline in auto accident frequency in the first quarter 2008, compared to the first quarter last year, across most coverages. We cannot predict the degree or direction of frequency change that we will experience in the future. We continue to analyze trends to distinguish changes in our experience from external factors, such as changes in the number of vehicles per household and greater vehicle safety, versus those resulting from shifts in the mix of our business.

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The table below presents the actuarial adjustments implemented and the loss reserve development experienced for the three months ended March 31:

(millions)	2008	2007
ACTUARIAL ADJUSTMENTS		
Favorable/(Unfavorable)		
Prior accident years	$ (8.1)	$ 29.1
Current accident year	(.1)	1.8
Calendar year actuarial adjustment	$ (8.2)	$ 30.9
PRIOR ACCIDENT YEARS DEVELOPMENT		
Favorable/(Unfavorable)		
Actuarial adjustment	$ (8.1)	$ 29.1
All other development	(24.5)	1.2
Total development	$ (32.6)	$ 30.3
(Increase) decrease to calendar year combined ratio	(1.0) pts.	.9 pts.

Total development consists both of actuarial adjustments and all other development. The actuarial adjustments represent the net changes made by our actuarial department to both current and prior accident year reserves based on regularly scheduled reviews. All other development represents claims settling for more or less than reserved, emergence of unrecorded claims at rates different than reserved and changes in reserve estimates on specific claims. Although we believe that the development from both the actuarial adjustments and all other development generally results from the same factors, as discussed below, we are unable to quantify the portion of the reserve adjustments that might be applicable to any one or more of those underlying factors.

As reflected in the table above, we experienced unfavorable development in the first quarter 2008, compared to favorable development in the first quarter 2007. Nearly half of the total 2008 development related to the 2007 accident year. The total prior year loss reserve development experienced in the three-month period ended March 31, 2008, which increased the reported combined ratio by 1.0 point, was unfavorable in our Commercial Auto Business and had a slightly favorable impact in our Personal Lines Business.

Prior accident year development typically reflects the changes in our estimate of severity from what we originally expected when establishing the reserves. For the first quarter 2007, and to a lesser extent in the first quarter 2008, our Personal Lines Business experienced favorable development, while the Commercial Auto Business experienced unfavorable development in both periods. The unfavorable reserve development in Commercial Auto was driven by an increase in the number of late reported claims in both 2008 and 2007 and, for the first quarter 2008, we also experienced an increase in the estimated severity on these late reported claims.

We continue to focus on our loss reserve analysis, attempting to enhance accuracy and to further our understanding of our loss costs. A detailed discussion of our loss reserving practices can be found in our *Report on Loss Reserving Practices*, which was filed in a Form 8-K on June 28, 2007.

Underwriting Expenses

We are starting to see efficiency gains as a result of the reorganization we announced during the latter part of 2007. Nevertheless, other underwriting expenses and policy acquisition costs as a percentage of premiums earned increased .5 points in the first quarter 2008, compared to the same period last year, primarily due to increased advertising in the Direct channel, as well as our lower premium per policy.

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C. Personal Lines

	Growth 2008 vs. 2007 First Quarter
Net premiums written	(4)%
Net premiums earned	(3)%
Policies in force	3%

Progressive s Personal Lines Business writes insurance for private passenger automobiles and recreational vehicles, and represented 87% of our total net premiums written in the first quarter 2008, compared to 86% in the first quarter 2007. We currently write our Personal Lines products in 49 states and our personal auto product in the District of Columbia; we expanded our private passenger auto offerings into Massachusetts in May 2008.

Private passenger auto represents 93% of our total Personal Lines net premiums written, with the special lines products (e.g., motorcycles, watercraft and RV s) making up the balance. Compared to the first quarter last year, policies in force grew 1% in auto and 8% in special lines. During the same period, net premiums written declined 4% for auto and 3% for special lines, reflecting our recent rate decreases.

Total Personal Lines generated a 94.7 combined ratio, compared to a 90.1 in the first quarter 2007, primarily reflecting our recent rate reductions and less favorable prior accident year development in 2008 than in 2007. During the first quarters of both 2008 and 2007, the special lines results had a favorable effect on the total Personal Lines combined ratio of approximately 3 points, because the special lines vehicles are typically used less in the colder weather months.

The Personal Lines Business is comprised of the Agency business and the Direct business.

The Agency Business

	Growth 2008 vs. 2007 First Quarter
Net premiums written	(6)%
Net premiums earned	(5)%
Auto: policies in force	(2)%
new applications	(12)%
renewal applications	%

The Agency business includes business written by the more than 30,000 independent insurance agencies that represent Progressive, as well as brokerages in New York and California. In the first quarter 2008, we saw new Agency auto application growth in 20 states, including Florida and Texas, two of our largest volume states. However, some of our other big states have not yet seen this growth. In particular, beginning in the latter part of 2007 and into 2008, we restricted writing new business in certain unprofitable areas of New York and California, thus hindering our overall Agency auto growth. During the first quarter 2008, we were able to increase our controls and began to lift some of the restrictions in these areas of concern. In addition, written premium per policy on total Agency auto business was down 4% on a quarter over prior-year quarter basis, driven primarily by a decrease in written premium per policy on renewal business.

For the first three months of 2008, the total rate of conversion (i.e., converting a quote to a sale) was down on an increase in the number of Agency auto quotes. Within the Agency business, we are continuing to see a shift from traditional agent quoting to quotes generated through third-party comparative rating systems, where the conversion rate is lower.

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The Direct Business

	Growth 2008 vs. 2007 First Quarter
Net premiums written	%
Net premiums earned	%
Auto: policies in force	7%
new applications	%
renewal applications	8%

The Direct business includes business written directly by Progressive online and over the phone. For the first three months of 2008, we experienced an increase in new Direct auto applications in 30 states, although only one of our top five volume states saw an increase. Internet sales continue to be the most significant source of new business that is initiated in the Direct channel.

Written premium per policy for total Direct auto was down 6% in the first quarter 2008, compared to the prior year period; decreases in written premium per policy on both new and renewal business contributed to the total decrease. The overall Direct business conversion rate decreased during the quarter on an increased number of total quotes; the conversion rate for Internet-initiated business was relatively flat, while phone-initiated business was down compared to the first quarter last year.

D. Commercial Auto

	Growth 2008 vs. 2007 First Quarter
Net premiums written	(7)%
Net premiums earned	(4)%
Policies in force	6%
New applications	(3)%
Renewal applications	3%

Progressive s Commercial Auto Business writes primary liability and physical damage insurance for automobiles and trucks owned by small businesses, with the majority of our customers insuring three or fewer vehicles. For both the first three months of 2008 and 2007, the Commercial Auto Business represented about 13% of our total net premiums written. The Commercial Auto Business is primarily distributed through independent agents, but we are starting to see growth in the direct channel. The Commercial Auto Business operates in the specialty truck and business auto markets. The specialty truck commercial auto market, which accounts for slightly more than half of our total Commercial Auto premiums and approximately 40% of the vehicles we insure in this business, includes dump trucks, logging trucks, tow trucks, local cartage and other short-haul commercial vehicles. The remainder is in the business auto market, which includes autos, vans and pick-up trucks used by artisans, such as contractors, landscapers and plumbers, and a variety of other small businesses.

We currently write our Commercial Auto Business in 49 states; we do not write Commercial Auto in Hawaii or the District of Columbia. For the first quarter 2008, total written premium per policy decreased 6%, driven primarily by a decrease in written premium per policy on renewal business.

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E. Other Indemnity

Progressive s other indemnity businesses, which represent less than 1% of our net premiums written, primarily include writing professional liability insurance for community banks and a small amount of run-off business. The underwriting profit (loss) in these businesses may fluctuate widely due to the low premium volume, variability in losses, and the run-off nature of some of these products.

F. Service Businesses

Our service businesses provide insurance-related services and represent less than 1% of our total revenues. Our principal service business is providing policy issuance and claims adjusting services for the Commercial Auto Insurance Procedures/Plans (CAIP), which are state-supervised plans serving the involuntary market. The decrease in service revenues reflects the continuing cyclical downturn in the involuntary commercial auto market.

G. Income Taxes

As reported in the balance sheets, income taxes are comprised of net income taxes payable and net deferred tax assets and liabilities. A deferred tax asset/liability is a tax benefit/expense that will be realized in a future tax return. At March 31, 2008 and December 31, 2007, our income taxes were in a net asset position, compared to a net liability position at March 31, 2007. The movement to a net asset position is due primarily to a decrease in our net unrealized gains on securities as well as lower pretax income. The increase in the net income tax asset balance since year-end 2007 is also due to lower net unrealized gains, but is partially offset by an increase in our current income taxes payable, due to the fact that the first quarter estimated payments were not due until April 15.

There has been no material changes in our uncertain tax positions during the quarter ended March 31, 2008.

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IV. RESULTS OF OPERATIONS INVESTMENTS

A. Portfolio Allocation

The composition of the investment portfolio at March 31 was:

($ in millions)	Fair Value	% of Total Portfolio	Duration (years)	Rating[5]
2008				
Fixed maturities[1]	$ 8,120.7	58.5%	2.7	AA
Preferred stocks[2]	2,121.5	15.3	2.4	A-
Short-term investments:				
Auction rate municipal obligations	174.1	1.2	<1	AA
Other short-term investments	1,359.2	9.8	<1	AA+
Total short-term investments	1,533.3	11.0	<1	AA+
Total fixed-income securities	11,775.5	84.8	2.3	AA-
Common equities	2,104.2	15.2	na	na
Total portfolio[2,3,4]	$13,879.7	100.0%	2.3	AA-
2007				
Fixed maturities	$10,266.2	68.0%	3.3	AA+
Preferred stocks[2]	1,846.1	12.2	1.3	A-
Short-term investments:				
Auction rate municipal obligations	158.3	1.1	<1	AA+
Other short-term investments	436.0	2.9	<1	A+
Total short-term investments	594.3	4.0	<1	AA-
Total fixed-income securities	12,706.6	84.2	2.9	AA
Common equities	2,390.9	15.8	na	na
Total portfolio[2,3,4]	$15,097.5	100.0%	2.9	AA

na = not applicable

[1] Includes $1.1 million of gains on our open interest rate swap position, as well as $44.7 million of collateral in the form of Treasury Notes that were delivered to the counterparty on our open credit default

swaps. See the *Derivative Instruments* section below for further discussion.

[2] At March 31, 2008 and 2007, the fair value included a $10.8 million net realized loss and a $.9 million net realized gain, respectively, on certain hybrid securities. See *Note 2 Investments* for further discussion.

[3] Includes net unsettled security acquisitions of $79.4 million and $166.5 million at March 31, 2008 and 2007, respectively.

[4] March 31, 2008 and 2007 totals include $1.8 billion and $2.4 billion, respectively, of securities in the portfolio of a consolidated, non-insurance subsidiary of the holding company.

[5] Credit quality ratings are assigned by nationally recognized securities rating organizations. To calculate the weighted average credit quality ratings, we weight individual securities based on fair value and assign a numeric score of 0-5, with non-investment-grade

and non-rated securities assigned a score of 0-1. To the extent the weighted average of the ratings falls between a AAA and AA+, we assigned an internal rating of AAA-.

Unrealized Gains and Losses

As of March 31, 2008, our portfolio had $208.8 million of pretax net unrealized gains, recorded as part of accumulated other comprehensive income, compared to $957.4 million at March 31, 2007 and $715.4 million at December 31, 2007. During the first quarter 2008, the fixed-income portfolio s valuation decreased $314.0 million, primarily the result of a decline in the fair value of our preferred stock portfolio due to the continued disruption in the financial sector (see more detailed discussion below). The common stock portfolio had a decrease of $192.6 million reflecting the negative return of the broad equity markets. See *Note 2 Investments* for further break out of our gross unrealized gains and losses.

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Fixed-Income Securities

The fixed-income portfolio includes fixed-maturity securities, short-term investments and preferred stocks. This portfolio s duration was 2.3 years at March 31, 2008, compared to 3.5 years at December 31, 2007 and 2.9 years at March 31, 2007. The fixed-maturity securities and short-term securities, as reported on the balance sheets at March 31, were comprised of the following:

($ in millions)	2008		2007	
Investment-grade fixed maturities: [1]				
Short/intermediate term	$9,199.3	95.3%	$10,385.8	95.6%
Long term	178.6	1.8	184.9	1.7
Non-investment-grade fixed maturities[2]	276.1	2.9	289.8	2.7
Total	$9,654.0	100.0%	$10,860.5	100.0%

[1] Long term includes securities with expected liquidation dates of 10 years or greater. Asset-backed securities are reported at their weighted avera