

Progressive Corp.

May 23' Earnings: 16.3% Expense Ratio Is a Record Low and Less Sustainable over Long Term

Five consecutive months of adverse PYD on mounting severity implies step level change. Loss picks (while up from April) should show even more conservatism to be more in tandem on what we are seeing within PYD.

Expense Ratio Record Low: PGR's 16.3% expense ratio in May hit a record low, following 16.9% in April '23 and 17.3% in Dec. '22. A more sustainable expense ratio for PGR is >20%.

Fatigue on FL Legislation as a Driver of PYD: PGR cited FL legislation once again as a driver of adverse PYD, we assumed that was "once and done." PGR also appears to be the lone insurer citing this FL issue, which gives us pause. Unlike 1Q adverse PYD were PGR cited higher auto property and physical damage, the key drivers of adverse PYD for April and May were bodily injury and PIP. In general, we are cautious about Progressive's undeterred stance with respect to social inflation. Peers vocalize more concerns about higher attorney representations more than PGR, especially on the commercial auto side. Conversely, we continue to expect severity pressures to lead to adverse PYD, and model a 20% haircut in the preceding months in our forecast period (i.e., 3.7 pts in June and 3.0 pts in July, etc.)

Combined ratio (i.e., bottom line) missed our estimates

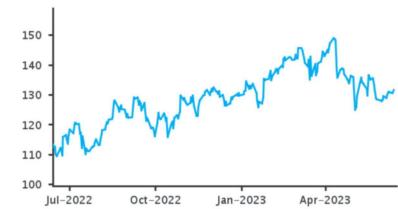
PGR's combined ratio of 99.0% missed our estimated 95.9% and was above management's 96% target (Personal Lines at 99.8% vs our estimated 94.7%, Commercial Lines at 97.6% vs our estimated 96.9%, and Property at 91.4% vs our estimated 112.0%).

- PGR reported a fifth consecutive month of **unfavorable PYD** of \$207.6mn (vs. \$94.9mn estimate) or 4.6pts on the loss ratio (vs. our 2.1 pt estimate). This follows 6.5 pts, 3.5 pts, 3.4 pts, and 2.6 pts of unfavorable PYD in January, February, March, and April, respectively.
 - We estimate that adverse PYD hurt the personal lines auto loss ratio by 5.0 pts, as personal auto represented 85% of total PYD due to FL claims and higher severity (PIP and BI). Commercial auto made up 20% of the unfavorable PYD (or 5.5 pts) due to claims brought forward ahead of FL reform implementation. Property had a favorable development (5% of PYD) due to actuarial changes.
- PGR's **underlying loss ratio** of 73.2%, was slightly worse than our estimated 73.1%. PGR took \$172.2mn of actuarial adverse adjustments, or 3.8 pts. We would have expected a

| CORE

PGR	UNDERWEIGHT
	Unchanged
U.S. Insurance/Non-Life	POSITIVE
	Unchanged
Price Target	USD 120.00
	lowered -2% from USD 123.00
Price (13-Jun-23)	USD 131.68
Potential Upside/Downside	-8.9%
Market Cap (USD mn)	77072
Shares Outstanding (mn)	585.30
Free Float (%)	99.70
52 Wk Avg Daily Volume (mn)	2.6
Dividend Yield (%)	0.30
Return on Equity TTM (%)	5.03
Current BVPS (USD)	27.97
Source: Bloomberg	

Price Performance Exchange-NYSE
52 Week range USD 149.87-108.64



Source: IDC
[Link to Barclays Live for interactive charting](#)

U.S. Insurance/Non-Life

Tracy Benguigui

+1 212 526 1561
tracy.benguigui@barclays.com
BCI, US

Alex Barenklau
+1 212 526 1021
alexander.barenklau@barclays.com
BCI, US

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higher loss pick given the company's concerns about severity and needing to take rate. We question if PGR's loss picks are too optimistic and would be subject to re-estimates (i.e., unfavorable PYD) in future periods.

- PGR's **expense ratio** was 16.3% in May vs. 17.1% in Apr, and 21.1% in Mar. We estimated a 18.3% expense ratio. To recap, PGR's pre-pandemic expense ratio ran just north of 20%.
- PGR reported **catastrophe losses** of \$220mn vs our \$108mn estimate.

Top-line growth (Policies in Force and Net Investment Income) underperformed our expectations

Personal auto PIF grew +0.7% sequentially (May '23 vs. Apr '23), below the previous +1.9% sequential print (Apr '23 vs. Mar '23). On an annualized basis, that would imply PIF growth of 8% though we do not expect monthly growth to be constant over 12 months; in fact, it continued to decelerate by month. On a y/y basis, PGR recognized +14.3% personal auto PIF growth.

PGR's pre-tax net investment income (ex expenses) this month was \$154mn vs. our \$142mn estimate, reflecting a 3.2% pre-tax annualized book yield.

May operating EPS of \$0.23 missed our \$0.41 estimate, reflecting a higher combined ratio due to worse-than-expected PYD and catastrophes losses.

PGR: Quarterly and Annual EPS (USD)

FY Dec	2022	2023			2024			Change y/y	
	Actual	Old	New	Cons	Old	New	Cons	2023	2024
Q1	1.12A	0.65A	0.65A	0.75A	1.79E	1.66E	2.04E	-42%	155%
Q2	1.03A	1.14E	0.89E	1.15E	1.77E	1.76E	1.82E	-14%	98%
Q3	0.49A	1.53E	1.41E	1.48E	1.85E	1.81E	1.78E	188%	28%
Q4	1.47A	1.87E	1.94E	1.95E	2.04E	2.01E	2.28E	32%	4%
Year	4.11A	5.19E	4.89E	5.24E	7.46E	7.24E	7.91E	19%	48%
P/E	32.0		26.9			18.2			

Consensus numbers are from Bloomberg received on 14-Jun-2023; 12:50 GMT

Source: Barclays Research

U.S. Insurance/Non-Life						POSITIVE	
Progressive Corp. (PGR)							UNDERWEIGHT
Income statement (\$mn)	2022A	2023E	2024E	2025E	CAGR	Price (13-Jun-2023)	USD 131.68
Net premiums earned	49,241	57,186	63,107	68,844	11.8%	Price Target	USD 120.00
Net investment income (NII)	1,260	1,868	2,208	2,478	25.3%	Why UNDERWEIGHT?	
Underwriting income	1,342	1,221	2,537	3,024	31.1%	Our call on PGR takes a longer term view. PGR may need to hold more capital to support an evolving business mix, which could lower ROEs. Likewise, we struggle to see how PGR could return to its historical PIF growth rate, as the company cut rates early during the pandemic and is now playing catch up, which is proving tough to gain approval from regulators.	
Operating income	2,415	2,871	4,244	4,910	26.7%		
Net income	694	2,915	4,244	4,910	91.9%		
Effective tax rate (%)	21.8	20.7	21.0	21.0	-1.2%		
Combined ratio (%)	95.8	96.3	94.5	94.1	-0.6%		
Combined ratio (ex cats & py development) (%)	92.6	91.1	92.7	92.3	-0.1%		
Per share data (\$)	2022A	2023E	2024E	2025E	CAGR		
EPS (adj)	4.11	4.89	7.24	8.39	26.8%		
EPS (reported)	1.18	4.98	7.26	8.42	92.2%		
DPS	0.40	2.55	2.65	2.65	87.8%		
BVPS	26.32	29.29	33.68	34.14	9.1%		
BVPS (ex AOCI)	31.01	33.28	37.67	38.14	7.1%		
Diluted shares (mn)	587	587	586	586	0.0%		
Balance sheet and capital return (\$mn)	2022A	2023E	2024E	2025E	CAGR		
Total investments	53,548	61,479	66,167	66,674	7.6%		
Common shareholders' equity (ex AOCI)	18,140	19,464	21,990	22,248	7.0%		
Share buybacks	63	99	171	171	39.3%		
Dividends paid	234	1,492	1,547	1,544	87.6%		
Balance sheet and capital return metrics	2022A	2023E	2024E	2025E	Average		
Debt leverage (%)	25.5	25.7	23.4	23.2	24.5		
Financial leverage (%)	27.5	27.5	25.1	24.9	26.3		
Total capital return as a % of op. earnings	12.3	55.4	40.5	34.9	35.8		
Valuation metrics	2022A	2023E	2024E	2025E	Average		
P/BV (ex AOCI) (x)	4.25	3.96	3.50	3.45	3.79		
P/E (adj) (x)	32.0	26.9	18.2	15.7	23.2		
Dividend yield (%)	0.3	1.9	2.0	2.0	1.6		
ROE (%)	3.8	14.8	19.5	19.8	14.5		

Note: FY End Dec
Source: Company data, Bloomberg, Barclays Research

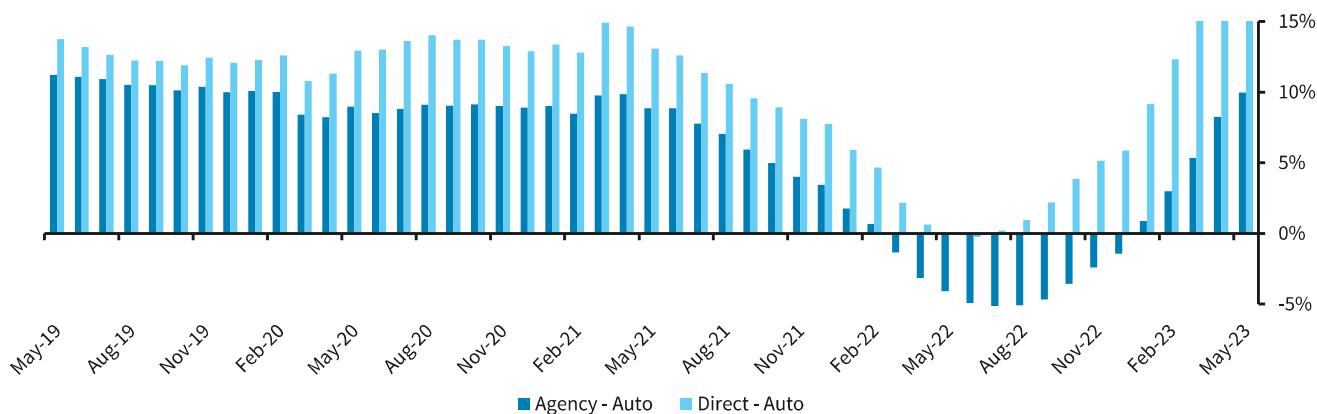


PIF Growth Spotlight

PGR reported personal auto PIF y/y growth of +14.3% in May (below our estimate of +15.2%), as auto agency PIF (+10.0% vs. our +10.6%) and auto direct (+17.8% vs. our 19.0%) underperformed our estimates.

FIGURE 1. PIF growth y/y in May with agent (+10.0%) and direct (+17.8%)

PIF y/y % Growth



Source: Barclays Research, Company Data

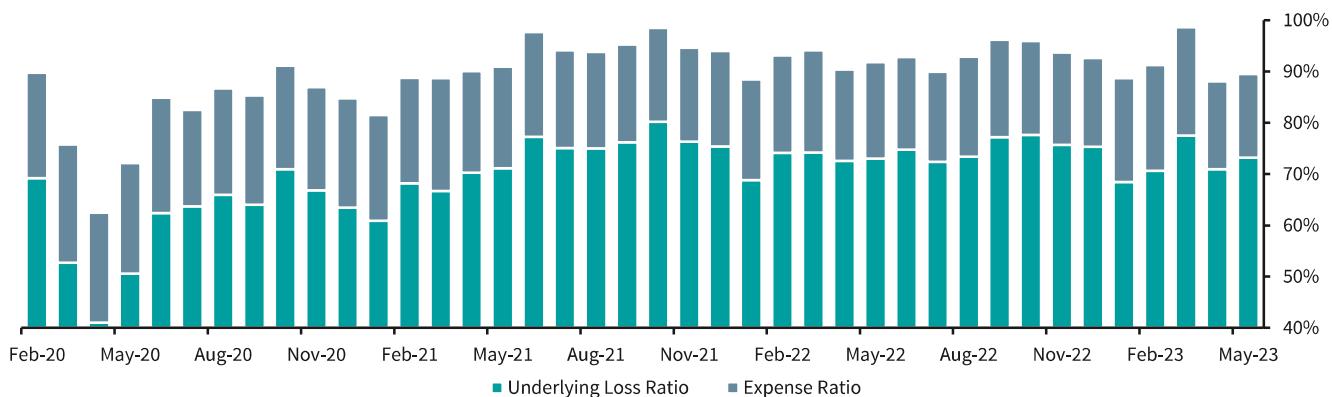
Underlying combined ratio - Lower expense ratio is less sustainable over the long term

PGR's underlying combined ratio of 89.5% in May deteriorated from 88.1% in Apr. and 98.6% in Mar. driven by a worse underlying loss ratio of 73.2% (vs. 71.0% in Apr.) somewhat offset by a lower expense ratio (16.3% in May vs 17.1% in Apr. and 21.1% in Mar.) While we were expecting a lower-than-typical expense ratio, **PGR's 16.3% expense ratio in May hit a record low.**

The construction of PGR's underlying combined ratio is different than pre-pandemic. To recap, PGR's pre-pandemic underlying loss ratio stood at ~68% and expense ratio ran just north of 20%. We think a reversion to this pre-pandemic composition would be positive for the stock.

FIGURE 2. May '23 underlying loss ratio of 73.2% (vs. 73.1% Barclays) and expense ratio of 16.3% (vs. 18.3% Barclays)

PGR Underlying CR %



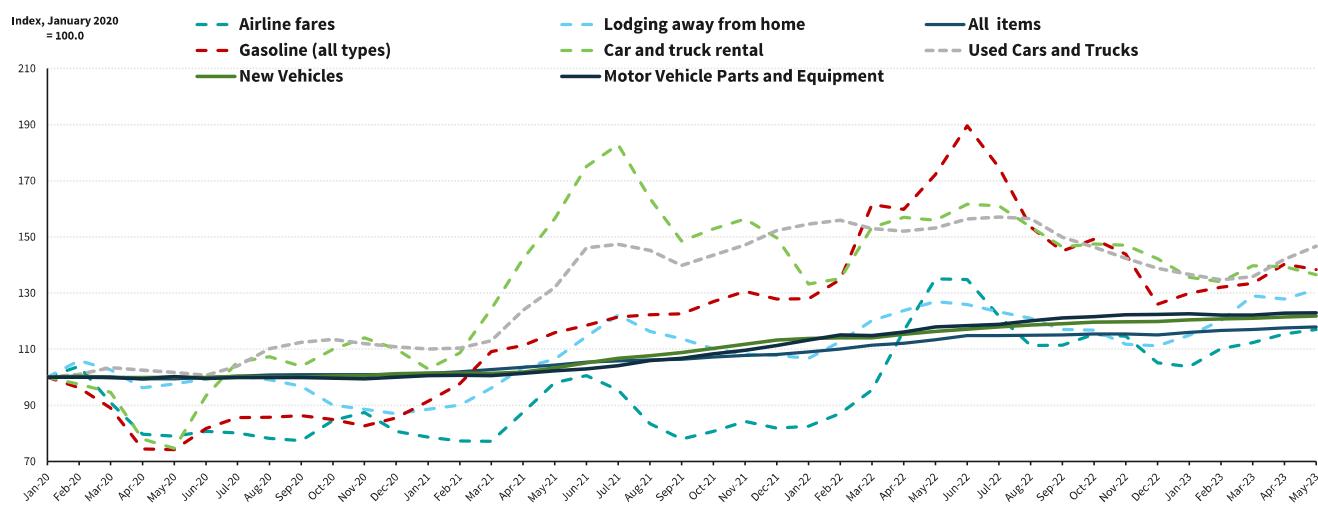
Source: Barclays Research, Company Data

Inflation: Focus on Absolute Levels

Our focus is on an absolute basis, where used car pricing remains elevated (see Figure 4). Likewise, if we compare used car & truck pricing to Jan '19 levels, it is up 41.6% vs. all items at 20.8%. We pay lesser attention to the Consumer Price Index (CPI) for All Urban Consumers, which rose 4.0% over the 12 months from May 2022 to May 2023. Used car and truck CPI trails all items at -4.2% in May vs. -6.6% in Apr.

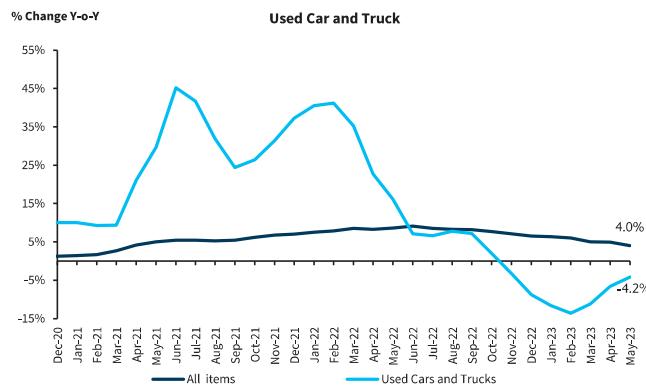
Manheim pricing was -2.7% m/m and -7.6% y/y. More importantly, if we compare May '23 to May '19, Manheim pricing is still up 47.4%. Compounded auto pricing during that period has not caught up – not anywhere close. There is still significant rate catch-up needed to see that inflection point. It will be like an “x”; loss costs go down, then pricing goes up – where the two intersect in our view can take a bit longer, especially given how long it is taking auto pricing to actually “earn” in.

FIGURE 3. CPI Indexed to January '20



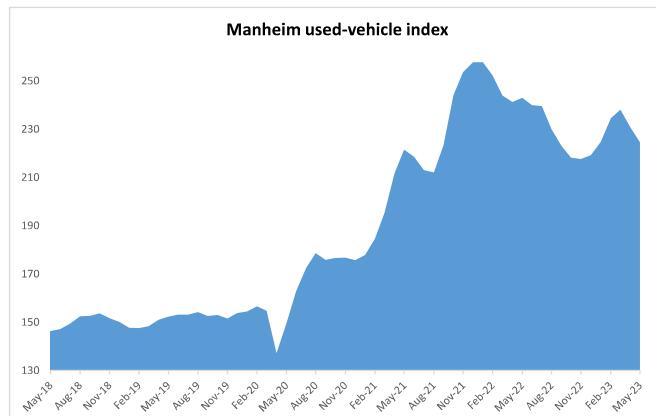
Source: Barclays Research, U.S. Bureau of Labor Statistics

FIGURE 4. CPI: Used Car and Truck (y/y -4.2% in May '23)



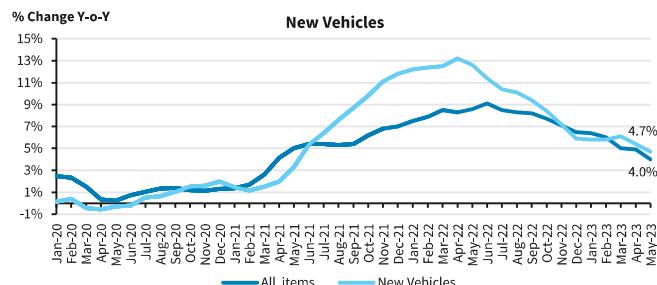
Source: Barclays Research, U.S. Bureau of Labor Statistics

FIGURE 5. Manheim Used Car Prices (-7.6% y/y in May '23)

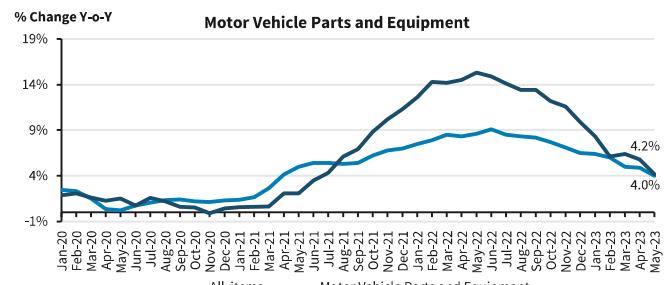


Source: Barclays Research, Bloomberg, Manheim

The new vehicle CPI index rose 4.7% y/y in May (down compared to the 5.4% increase in April) and Motor Vehicle Parts and Equipment CPI index rose 4.2% y/y (vs. 5.8% in April). However, comparing May '23 vs. Jan '19, new vehicles and car parts rose 21.9% and 25.3%, respectively.

FIGURE 6. CPI % Change (Y-o-Y): New Vehicles

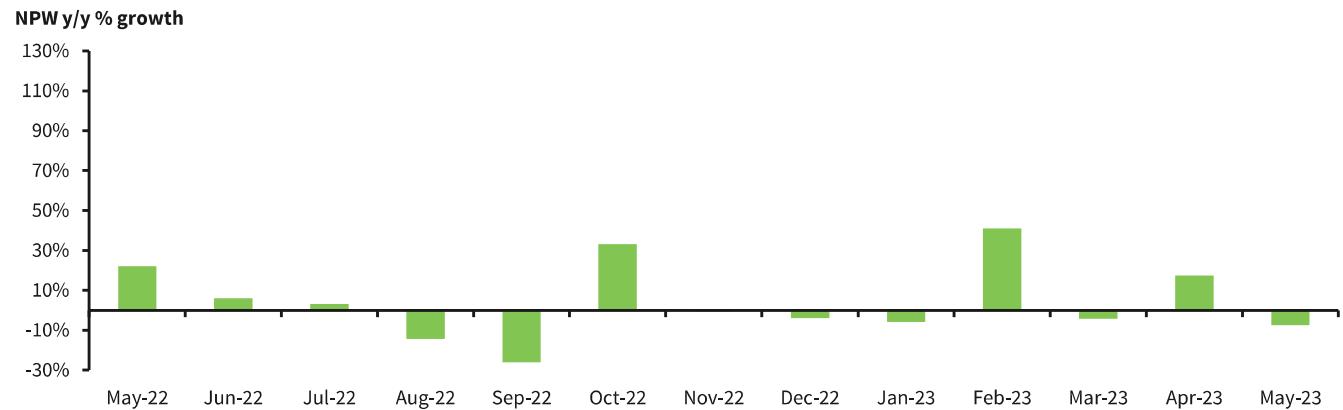
Source: Barclays Research, U.S. Bureau of Labor Statistics

FIGURE 7. CPI % Change (Y-o-Y): Motor Vehicle Parts and Equipment

Source: Barclays Research, U.S. Bureau of Labor Statistics

Commercial NPW Decreased 7.5% (y/y), or Up 6% ex TNC

TNC once again obscures Commercial NPW growth: Reported commercial premium growth was down ~7.5% in May '23 and up 6% excluding TNC commercial premiums. The decrease was due to monthly mileage adjustment for TNC.

FIGURE 8. Commercial NPW growth (monthly)

Source: Barclays Research, Company Data

Valuation

Our PT of \$120 (was \$123) is based on 16.5x (unchanged) our new '24E EPS and 3.20x (unchanged) '24E BVPS (ex AOCI).

Model Updates:

We increase our loss ratio expectations to reflect lower expense ratio and the continuation of adverse PYD reflecting higher severity expectations. Lastly, we are using a 3-month average AYLR as a starting point in June.

Debt raise: In May, PGR raised \$500mn in senior unsecured notes (due in 2033) at a fixed coupon of 4.95%. PGR intends to use the proceeds for general corporate purposes. We have raised our interest expense following the raise by ~6mn/quarter and ~\$25mn annually.

FIGURE 9. Debt Activity

PGR (in \$mns)						
Debt Activity	Debt Type	Issue Size/Outstanding	Coupon	Incr. Int exp/ Monthly	Incr. Int exp/ QTR	Incr. Int exp/ Annual
New Raise	Sr Unsecured	\$500.0	4.950%	\$2.06	\$6.19	\$24.75
Incremental interest exp.				\$2.06	\$6.19	\$24.75

Source: Barclays Research, Company Data

Updated Operating EPS: We revise '23E from \$5.19 to \$4.89 and '24E from \$7.46 to \$7.24.

Variance Tables – May ‘23

FIGURE 10. Variance Analysis - May ‘23

Summary Details		M/M			Y/Y		Barclays Est.	
(in \$mn, except per share)		May '23A	Apr '23	% Change	May '22	% Change	May '23	% Var.
Net premiums written	\$4,321	\$6,075	-29%	\$3,724	16%	\$4,481	-4%	
Net investment income	\$154	\$142	8%	\$92	68%	\$142	8%	
Combined Ratio	99.0%	97.9%	110 bps	96.5%	250 bps	95.9%	311 bps	
Combined Ratio ex cats and PYD	89.5%	88.1%	141 bps	91.8%	(233 bps)	91.4%	(191 bps)	
Operating EPS	\$0.23	\$0.30	-26%	\$0.27	-17%	\$0.41	-44%	
Book value per share (ex. AOCI)	\$32.1	\$32.02	0.2%	\$30.4	6%	\$32.3	-1%	

NPW by Segment		M/M			Y/Y		Barclays Est.	
(in \$mn, except per share)		May '23A	Apr '23	% Change	May '22	% Change	May '23	% Var.
Personal lines-agent	\$1,651	\$2,266	-27%	\$1,338	23%	\$1,671	-1.2%	
Personal lines-direct	\$1,782	\$2,526	-29%	\$1,482	20%	\$1,912	-6.8%	
Total Personal Lines	\$3,433	\$4,792	-28%	\$2,820	21.7%	\$3,582	-4.2%	
Commercial Business & Other	\$636	\$1,040	-39%	\$688	-8%	\$667	-5%	
Property	\$252	\$243	4%	\$217	16%	\$232	9%	
Total Written Premiums	\$4,321	\$6,075	-29%	\$3,724	16%	\$4,481	-4%	

CR by Segment		M/M			Y/Y		Barclays Est.	
(in \$mn, except per share)		May '23A	Apr '23	% Change	May '22	% Change	May '23	% Var.
Total Personal Lines	99.8%	96.2%	360 bps	96.1%	370 bps	94.7%	509 bps	
Commercial Business & Other	97.6%	93.1%	450 bps	88.2%	940 bps	96.9%	75 bps	
Property	91.4%	154.0%	(6260 bps)	132.0%	(4060 bps)	112.0%	(2060 bps)	

Source: Barclays Research estimates, Company Data

Model Summary

FIGURE 11. Model Summary (pg. 1)

(\$ in mn, except per share data)	2019	2020	2021	2022	2023E	2024E	2025E
Net premiums written	37,578	40,569	46,405	51,081	60,580	65,462	71,588
Revenues:							
Net premiums earned	36,192	39,262	44,369	49,241	57,186	63,107	68,844
Investment income	1,042	937	861	1,260	1,868	2,208	2,478
Total net realized gains (losses) on securities	1,029	1,630	1,509	(1,912)	55	-	-
Fees and other revenues	564	604	692	722	868	947	1,033
Service revenues	195	226	271	299	329	379	413
Total revenues	39,022	42,658	47,702	49,611	60,306	66,641	72,768
Expenses:							
Losses and loss adjustment expenses	25,471	25,122	33,628	38,123	44,794	46,794	50,691
Total underwriting expenses	7,998	8,843	9,368	9,777	11,171	13,776	15,130
Policyholder credit expense	-	1,077	-	-	-	-	-
Investment expenses	25	20	26	24	27	32	34
Service expenses	179	206	253	297	328	347	379
Interest expense	190	217	219	244	267	276	276
Total expenses	33,862	35,485	43,492	48,689	56,586	61,225	66,509
Underwriting Income	2,724	5,297	1,374	1,342	1,221	2,537	3,024
Income before income taxes	5,160	7,173	4,210	922	3,720	5,415	6,259
Provision for income taxes	1,180	1,469	859	201	772	1,137	1,314
Other comp (income) loss att. to NCI	(10)	-	-	-	-	-	-
Net income	3,970	5,705	3,351	721	2,948	4,278	4,945
Less: Preferred stock dividends	27	27	27	27	33	34	34
Net income to common shareholders	3,943	5,678	3,324	694	2,915	4,244	4,910
ATX total net realized gains (losses) on sec	813	1,288	1,192	(1,496)	43	-	-
Other	-	-	-	(225)	-	-	-
Operating income to common shareholders	3,130	4,390	2,132	2,415	2,871	4,244	4,910
Operating EPS	\$5.33	\$7.47	\$3.63	\$4.11	\$4.89	\$7.24	\$8.39
Net EPS	\$6.72	\$9.66	\$5.66	\$1.18	\$4.98	\$7.26	\$8.42
Net Written Premiums (y/y %)	15.2%	8.0%	14.4%	10.1%	18.6%	8.1%	9.4%
Net Earned Premiums (y/y %)	17.0%	8.5%	13.0%	11.0%	16.1%	10.4%	9.1%

Source: Barclays Research estimates, Company Data

FIGURE 12. Model Summary (pg. 2)

(\$ in mn, except per share data)	2019	2020	2021	2022	2023E	2024E	2025E
<u>Underwriting Margins</u>							
Loss and LAE ratio	70.4%	64.0%	75.8%	77.4%	78.3%	74.2%	73.6%
Expense ratio	20.5%	21.0%	19.6%	18.4%	18.0%	20.3%	20.5%
Combined ratio	90.9%	85.0%	95.3%	95.8%	96.3%	94.5%	94.1%
Catastrophes pretax	552	880	1,310	1,667	1,360	930	1,020
Cat pts	1.5%	2.2%	3.0%	3.4%	2.4%	1.5%	1.5%
PYD pretax (negative is unfavorable PYD)	(232)	(195)	5	86	(1,629)	(197)	(212)
PYD pts	-0.6%	-0.5%	0.0%	0.2%	-2.8%	-0.3%	-0.3%
Underlying loss ratio	68.2%	61.2%	72.8%	74.2%	73.1%	72.4%	71.8%
Underlying combined ratio	88.8%	82.2%	92.4%	92.6%	91.1%	92.7%	92.3%
<u>Share information</u>							
Shares beginning period	583.2	584.6	585.2	584.4	584.9	584.9	583.7
Shares issued	3	2	2	1	1	-	-
Shares Repurchased	1	1	2	1	1	1	1
Common Shares Outstanding, end of period	584.6	585.2	584.4	584.9	584.9	583.7	583.3
Weighted average shares - basic	583.8	584.9	584.7	584.6	585.0	584.2	584.0
Dilution	3.1	2.5	2.3	2.3	2.1	2.1	2.1
Weighted average shares - diluted	586.9	587.4	587.0	586.9	587.1	586.3	586.1
<u>Shareholders' equity and returns</u>							
Common shareholders' equity ex AOCI	12,612	15,613	17,697	18,140	19,464	21,990	22,248
Average common shareholders' equity ex AOCI	11,423	14,113	16,655	17,918	18,802	20,727	22,119
Book Value Per Share to common ex AOCI	\$21.57	\$26.68	\$30.28	\$31.01	\$33.28	\$37.67	\$38.14
Operating return on avg. common SHE ex AOCI	27.4%	31.1%	12.8%	13.5%	15.3%	20.5%	22.2%
Trailling twelve month average ROCE (as reported)	31.3%	35.6%	18.5%	3.8%	14.8%	19.5%	19.8%

Source: Barclays Research estimates, Company Data

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Progressive Corp. (PGR, 13-Jun-2023, USD 131.68), Underweight/Positive, CD/CE/J/K/M

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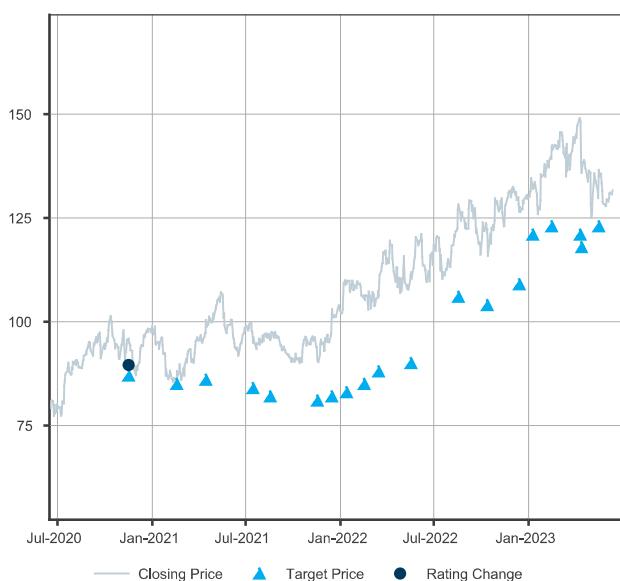
Stock Rating: **UNDERWEIGHT**

Industry View: **POSITIVE**

USD 131.68 (13-Jun-2023)

Rating and Price Target Chart - USD (as of 13-Jun-2023)

Currency=USD



Source: IDC, Barclays Research

[Link to Barclays Live for interactive charting](#)

Publication Date	Closing Price*	Rating	Adjusted Price Target
17-May-2023	129.76		123.00
14-Apr-2023	138.21		118.00
11-Apr-2023	149.00		121.00
15-Feb-2023	139.27		123.00
09-Jan-2023	134.61		121.00
14-Dec-2022	126.58		109.00
13-Oct-2022	121.40		104.00
18-Aug-2022	122.49		106.00
18-May-2022	111.19		90.00
16-Mar-2022	107.31		88.00
16-Feb-2022	105.78		85.00
13-Jan-2022	109.85		83.00
15-Dec-2021	97.14		82.00
17-Nov-2021	90.73		81.00
18-Aug-2021	95.57		82.00
15-Jul-2021	94.95		84.00
15-Apr-2021	100.40		86.00
17-Feb-2021	86.25		85.00
16-Nov-2020	95.90	Underweight	87.00

Source: Bloomberg, Barclays Research

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