

Progressive Corp.

Nov. '22 Earnings: Preserving capital for growth?

Growth is coming with less effort (expense ratio 18.0% vs. 20% pre-pandemic). PGR's pricing may appear more competitive as the insurer believes taking rates is behind it. Given PGR's premiums to surplus is near 3x and its negative marks, we are less surprised that the co. halted its annual dividend this year.

Another step in building capital: Recall, earlier this year PGR raised \$1.5bn in senior debt for general corporate uses (not debt pre-funding). This time, PGR is not declaring an annual dividend this year as it is evaluating its capital needs and wants to be best positioned for growth in 2023. That does not preclude PGR from continuing to make its quarterly dividends or to consider an annual dividend next year. While PGR's PIF growth for personal auto should continue increasing in 2023, we are not anticipating a return to low-teens PIF growth levels seen pre-pandemic (years when PGR was able to do both: grow and pay annual dividends).

"We are currently taking no additional actions to bring the (leverage) ratio below 30% and have no near-term plan or need for raising further capital."

- Tricia Griffith, CEO 3Q22 Earnings Call, Nov. 2, 2022

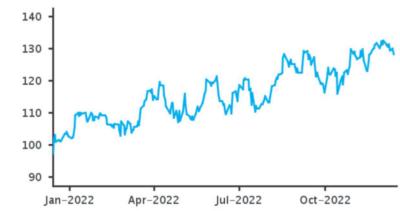
PGR tends to maintain underwriting leverage <3x. We think PGR's underwriting leverage remains ~2.9x as we saw LTM ending Sept. 30, 2022, vs. 2.8x in '21 and 2.7x in '20 & '19. We think underwriting leverage is a crude metric to inform RBC, and PGR has access to \$4.2bn of securities held in a non-insurance subsidiary. Still, given its actions to suspend its annual dividend this year, underwriting leverage may matter more than we thought. We also recognize that PGR's shareholders' equity has declined by 13% since YE '21, in large part reflecting approximately \$2.8bn of unrealized losses. While regulators do not take negative marks into account, S&P does. S&P's P&C sector outlook is negative, partly reflecting their view of reduced capital adequacy from these negative marks upon P&C insurers. PGR characterized its negative marks as "temporary" given its 2.7 year asset duration; still, rating agency pressure could be a factor.

| CORE

PGR	UNDERWEIGHT
	Unchanged
U.S. Insurance/Non-Life	POSITIVE
	Unchanged
Price Target	USD 109.00
	raised 5% from USD 104.00
Price (14-Dec-22)	USD 126.58
Potential Upside/Downside	-13.9%
Market Cap (USD mn)	74049
Shares Outstanding (mn)	585.00
Free Float (%)	99.70
52 Wk Avg Daily Volume (mn)	2.7
Dividend Yield (%)	0.32
Return on Equity TTM (%)	5.14
Current BVPS (USD)	24.41

Source: Bloomberg

Price Performance Exchange-NYSE
52 Week range USD 134.50-95.29



Source: IDC
Link to Barclays Live for interactive charting

U.S. Insurance/Non-Life

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PGR recognized positive personal auto PIF growth (+1.7% Nov. and +0.5% in Oct.) over the past two months despite an unusually low expense ratio (18% Nov. vs. 20% pre-pandemic). PGR's pricing may appear relatively more compelling to customers as it took rate increases on the earlier side, we already saw, which we think reflects the continuation of higher new business (new applications +20% in 3Q). As the pendulum swings back to growth, we worry that it may be challenging for PGR to operationally demonstrate the same restraint and turn down business when appropriate.

PGR's underlying loss ratio improved to 75.7% in Nov. from 77.6% in Oct. and 77.2% in Sept. PGR's expense ratio fell to 18.0% in Nov. from 18.3% in Oct. and remains below pre-pandemic levels (north of 20%). We do not think an expense ratio well below 20% (especially this month's 18.0%) is sustainable. PGR's underlying loss ratio three-month simple average of 76.8% has a way to go to return to pre-pandemic levels (~68%). We think auto insurers will approach rate adequacy in 2024 – to be sure, not a return to 2019 levels.

Nov. operating EPS of \$0.54 beat our \$0.24 estimate, reflecting better underlying income and a \$40mn reduction of September's Hurricane Ian loss estimates. We had modeled catastrophe loss of \$42mn vs. PGR's -\$4mn.

PGR: Quarterly and Annual EPS (USD)

	2021	2022			2023			Change y/y	
FY Dec	Actual	Old	New	Cons	Old	New	Cons	2022	2023
Q1	1.72A	1.12A	1.12A	0.52A	0.97E	1.16E	1.64E	-35%	4%
Q2	0.71A	1.03A	1.03A	-0.94A	1.22E	1.22E	1.43E	45%	18%
Q3	0.14A	0.49A	0.49A	0.20A	1.45E	1.39E	1.42E	250%	184%
Q4	1.06A	0.88E	1.30E	1.45E	1.69E	1.65E	1.84E	23%	27%
Year	3.63A	3.53E	3.94E	3.82E	5.32E	5.41E	6.38E	9%	37%
P/E	34.9		32.1			23.4			

Consensus numbers are from Bloomberg received on 14-Dec-2022; 13:50 GMT

Source: Barclays Research

U.S. Insurance/Non-Life						POSITIVE	
Progressive Corp. (PGR)							UNDERWEIGHT
Income statement (\$mn)	2021A	2022E	2023E	2024E	CAGR	Price (14-Dec-2022)	USD 126.58
Net premiums earned	44,369	49,290	55,489	60,925	11.1%	Price Target	USD 109.00
Net investment income (NII)	861	1,228	1,546	1,687	25.1%	Why UNDERWEIGHT?	
Underwriting income	1,374	1,242	1,935	3,037	30.3%	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	2,132	2,314	3,180	4,227	25.6%		
Net income	3,324	903	3,180	4,227	8.3%		
Effective tax rate (%)	20.4	23.1	21.0	21.0	1.0%		
Combined ratio (%)	95.3	96.0	95.0	93.5	-0.6%		
Combined ratio (ex cats & py development) (%)	92.4	92.8	93.6	92.5	0.0%		
Per share data (\$)	2021A	2022E	2023E	2024E	CAGR		
EPS (adj)	3.63	3.94	5.41	7.19	25.6%		
EPS (reported)	5.66	1.53	5.41	7.19	8.3%		
DPS	1.90	0.40	2.65	2.65	11.7%		
BVPS	30.35	26.45	28.85	33.42	3.3%		
BVPS (ex AOCI)	30.28	31.28	33.68	38.25	8.1%		
Diluted shares (mn)	587	587	588	588	0.0%		
Balance sheet and capital return (\$mn)	2021A	2022E	2023E	2024E	CAGR		
Total investments	51,514	54,366	58,705	63,622	7.3%		
Common shareholders' equity (ex AOCI)	17,697	18,298	19,701	22,377	8.1%		
Share buybacks	223	54	227	0	-100.0%		
Dividends paid	1,109	234	1,550	1,550	11.8%		
Balance sheet and capital return metrics	2021A	2022E	2023E	2024E	Average		
Debt leverage (%)	21.2	25.4	24.0	21.8	23.1		
Financial leverage (%)	23.4	27.3	25.9	23.5	25.0		
Total capital return as a % of op. earnings	62.5	12.4	55.9	36.7	41.9		
Valuation metrics	2021A	2022E	2023E	2024E	Average		
P/BV (ex AOCI) (x)	4.18	4.05	3.76	3.31	3.82		
P/E (adj) (x)	34.9	32.1	23.4	17.6	27.0		
Dividend yield (%)	1.5	0.3	2.1	2.1	1.5		
ROE (%)	18.5	4.9	15.9	19.1	14.6		

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

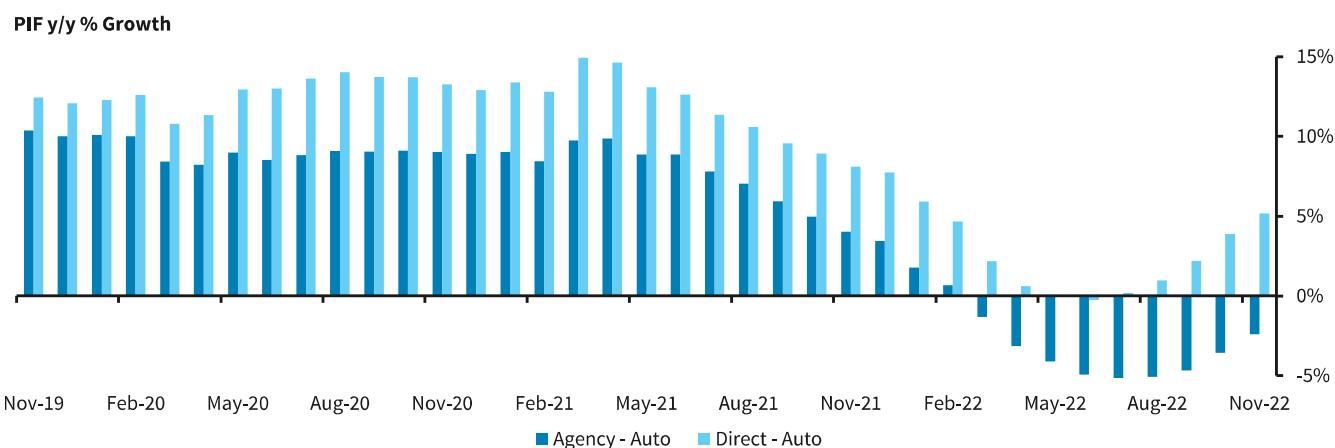


PIF Growth Spotlight

PGR reported personal auto PIF y/y growth of +1.7% in Nov. (in line with our estimate of +1.7%), as compression in auto agency (-2.4% vs. our -2.3%) is more than offset by growth in auto direct (+5.2% vs. our 5.0%).

As PIF declines remain more evident in agency, we expect PGR's customer mix to continue to shift toward direct over time. To recap, direct represents 57% of personal auto PIF in Nov. '22.

FIGURE 1. PIF growth y/y in Nov. with agent (-2.4%) and direct (+5.2%)

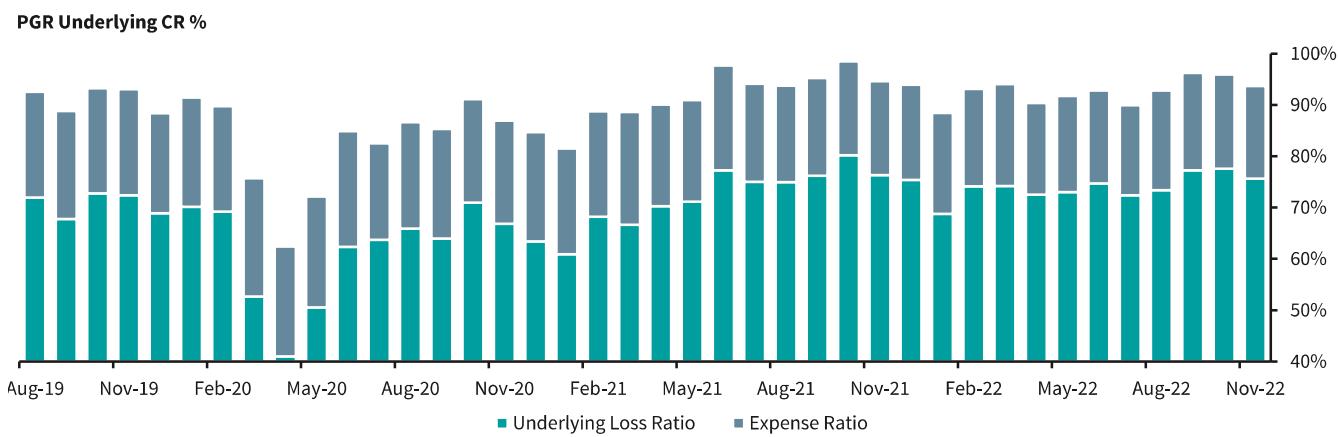


Source: Barclays Research, Company Data.

Underlying loss ratio improving

PGR's underlying loss ratio improved to 75.7% in Nov. from 77.6% in Oct. and 77.2% in Sept. PGR's expense ratio of 18.0% in Nov. has declined relative to its run rate. Collectively, PGR's underlying combined ratio of 93.7% has improved from 95.9% in Oct. and 96.2% in Sept., but is worse than 92.9% in August.

FIGURE 2. Nov. '22 underlying loss ratio of 75.7% (vs. 77.4% Barclays) and expense ratio of 18.0% (vs. 19.5% Barclays)

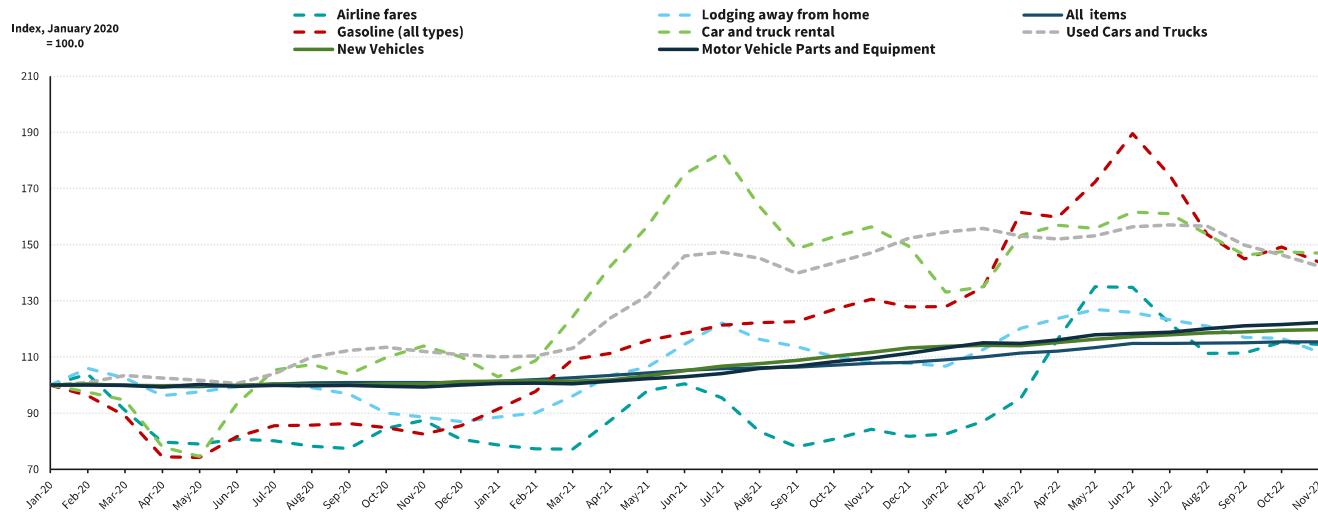


Source: Barclays Research, Company Data.

Inflation: Focus on Absolute Levels

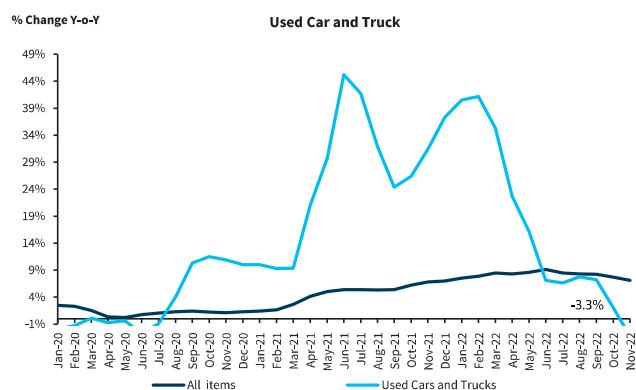
The Consumer Price Index (CPI) for All Urban Consumers rose 7.1% over the 12 months from Nov. 2021 to Nov. 2022. Used car and truck CPI trails all items at -3.3% vs. 2.0% in Oct. Our focus is on an absolute basis where used car pricing remains significantly elevated (see Figure 3).

FIGURE 3. CPI Indexed to Jan. '20



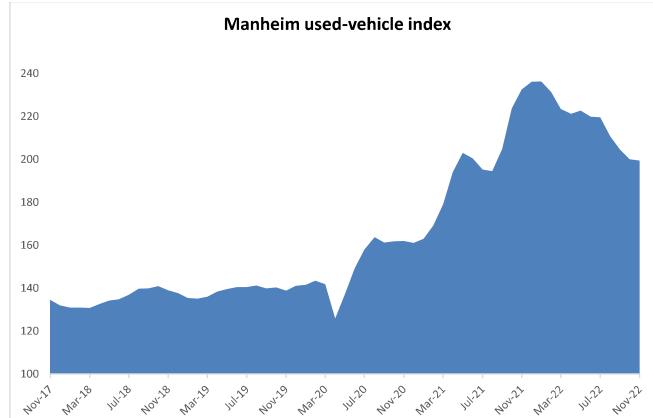
Source: Barclays Research, U.S. Bureau of Labor Statistics

FIGURE 4. CPI: Used Car and Truck (y/y -3.3% in Nov. '22)



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

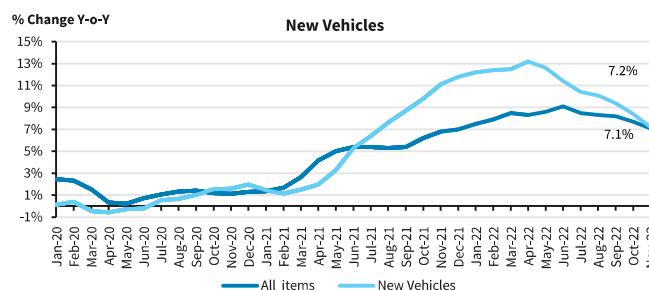
FIGURE 5. Manheim used car prices (y/y -14.2% in Nov. '22)



Source: Barclays Research, Bloomberg, Manheim

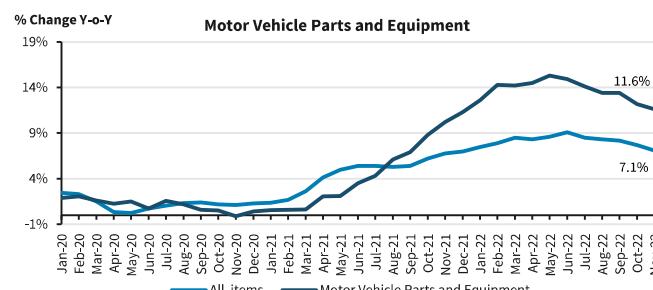
The new vehicle CPI index rose 7.2% y/y (vs. 8.4% in Oct.) and Motor Vehicle Parts and Equipment CPI index rose 11.6% y/y (vs. 12.2% in Oct.).

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

Valuation

Our PT of \$109 (up from \$104) is based on 20x our '23E EPS and 3.2x '23E BVPS (ex AOCI). Multiples are unchanged.

Model Updates:

We typically base our loss ratio expectations on a rolling 3-month average. We also reflected PGR's intent to not pay an annual dividend this year.

Updated EPS: '22E from \$3.53 to \$3.94. '23E from \$5.32 to \$5.41.

Variance Tables – Nov. '22

FIGURE 8. Variance Analysis - Nov. '22

Summary Details		M/M		Y/Y		Barclays Est.	
(in \$mn, except per share)	Nov '22	Oct '22	% Change	Nov '21	% Change	Nov '22	% Var.
Net premiums written	\$3,699	\$5,187	-29%	\$3,289	12%	\$3,854	-4%
Net investment income	\$122	\$118	4%	\$72	69%	\$117	4%
Combined Ratio	92.2%	95.9%	(370 bps)	91.9%	30 bps	97.9%	(575 bps)
Combined Ratio ex cats and PYD	93.7%	95.9%	(225 bps)	94.6%	(95 bps)	96.9%	(322 bps)
Operating EPS	\$0.54	\$0.40	36%	\$0.46	16%	\$0.24	127%
Book value per share (ex. AOCL)	\$0.0	\$0.00	2.2%	\$31.2	-2%	\$30.6	1%

NPW by Segment		M/M		Y/Y		Barclays Est.	
(in \$mn, except per share)	Nov '22	Oct '22	% Change	Nov '21	% Change	Nov '22	% Var.
Personal lines-agent	\$1,384	\$1,847	-25%	\$1,218	14%	\$1,365	1.4%
Personal lines-direct	\$1,571	\$2,086	-25%	\$1,337	17%	\$1,579	-0.5%
Total Personal Lines	\$2,955	\$3,933	-25%	\$2,555	15.7%	\$2,944	0.4%
Commercial Business & Other	\$552	\$1,051	-47%	\$555	0%	\$721	-23%
Property	\$192	\$203	-5%	\$180	7%	\$189	2%
Total Written Premiums	\$3,699	\$5,187	-29%	\$3,289	12%	\$3,854	-4%

CR by Segment		M/M		Y/Y		Barclays Est.	
(in \$mn, except per share)	Nov '22	Oct '22	% Change	Nov '21	% Change	Nov '22	% Var.
Total Personal Lines	91.8%	97.4%	(560 bps)	93.8%	(200 bps)	99.3%	(746 bps)
Personal lines-agent	92.8%	99.0%	(620 bps)	94.4%	(160 bps)	99.0%	(620 bps)
Personal lines-direct	91.0%	96.0%	(500 bps)	93.2%	(220 bps)	98.0%	(700 bps)
Commercial Business & Other	95.7%	91.9%	380 bps	89.4%	630 bps	92.8%	290 bps
Property	83.9%	84.4%	(50 bps)	71.0%	1290 bps	97.0%	(1310 bps)

Source: Barclays Research estimates, Company Data.

Model Summary

FIGURE 9. Model Summary (pg. 1)

(\$ in mn, except per share data)	2019	2020	2021	2022E	2023E	2024E
Net premiums written	37,578	40,569	46,405	51,156	58,487	65,868
Revenues:						
Net premiums earned	36,192	39,262	44,369	49,290	55,489	60,925
Investment income	1,042	937	861	1,228	1,546	1,687
Total net realized gains (losses) on securities	1,029	1,630	1,509	(1,501)	-	-
Fees and other revenues	564	604	692	726	832	914
Service revenues	195	226	271	304	333	366
Total revenues	39,022	42,658	47,702	50,048	58,201	63,892
Expenses:						
Losses and loss adjustment expenses	25,471	25,122	33,628	38,184	41,704	44,512
Total underwriting expenses	7,998	8,843	9,368	9,864	11,850	13,377
Policyholder credit expense	-	1,077	-	-	-	-
Investment expenses	25	20	26	25	31	34
Service expenses	179	206	253	298	305	335
Interest expense	190	217	219	243	251	251
Total expenses	33,862	35,485	43,492	48,840	54,142	58,508
Underwriting Income	2,724	5,297	1,374	1,242	1,935	3,037
Income before income taxes	5,160	7,173	4,210	1,208	4,060	5,384
Provision for income taxes	1,180	1,469	859	279	853	1,131
Other comp (income) loss att. to NCI	(10)	-	-	-	-	-
Net income	3,970	5,705	3,351	930	3,207	4,253
Less: Preferred stock dividends	27	27	27	27	27	26
Net income to common shareholders	3,943	5,678	3,324	903	3,180	4,227
ATX total net realized gains (losses) on sec	813	1,288	1,192	(1,187)	-	-
Other	-	-	-	(225)	-	-
Operating income to common shareholders	3,130	4,390	2,132	2,314	3,180	4,227
Operating EPS	\$5.33	\$7.47	\$3.63	\$3.94	\$5.41	\$7.19
Net EPS	\$6.72	\$9.66	\$5.66	\$1.53	\$5.41	\$7.19
Net Written Premiums (y/y %)	15.2%	8.0%	14.4%	10.2%	14.3%	12.6%
Net Earned Premiums (y/y %)	17.0%	8.5%	13.0%	11.1%	12.6%	9.8%

Source: Barclays Research estimates, Company Data.

FIGURE 10. Model Summary (pg. 2)

(\$ in mn, except per share data)	2019	2020	2021	2022E	2023E	2024E
<u>Underwriting Margins</u>						
Loss and LAE ratio	70.4%	64.0%	75.8%	77.5%	75.2%	73.1%
Expense ratio	20.5%	21.0%	19.6%	18.5%	19.9%	20.5%
Combined ratio	90.9%	85.0%	95.3%	96.0%	95.0%	93.5%
Catastrophes pretax	552	880	1,310	1,646	776	625
Cat pts	1.5%	2.2%	3.0%	3.3%	1.4%	1.0%
PYD pretax (negative is unfavorable PYD)	(232)	(195)	5	48	-	-
PYD pts	-0.6%	-0.5%	0.0%	0.1%	0.0%	0.0%
Underlying loss ratio	68.2%	61.2%	72.8%	74.2%	73.8%	72.0%
Underlying combined ratio	88.8%	82.2%	92.4%	92.8%	93.6%	92.5%
<u>Share information</u>						
Shares beginning period	583.2	584.6	585.2	584.4	585.0	585.0
Shares issued	3	2	2	(15)	2	-
Shares Repurchased	1	1	2	(16)	2	-
Common Shares Outstanding, end of period	584.6	585.2	584.4	585.0	585.0	585.0
Weighted average shares - basic	583.8	584.9	584.7	584.6	585.0	585.0
Dilution	3.1	2.5	2.3	2.3	2.7	2.7
Weighted average shares - diluted	586.9	587.4	587.0	586.9	587.7	587.7
<u>Shareholders' equity and returns</u>						
Common shareholders' equity ex AOCI	12,612	15,613	17,697	18,298	19,701	22,377
Average common shareholders' equity ex AOCI	11,423	14,113	16,655	17,998	19,000	21,039
Book Value Per Share to common ex AOCI	\$21.57	\$26.68	\$30.28	\$31.28	\$33.68	\$38.25
Operating return on avg. common SHE ex AOCI	27.4%	31.1%	12.8%	12.9%	16.7%	20.1%
Trailling twelve month average ROCE (as reported)	31.3%	35.6%	18.5%	4.9%	15.9%	19.1%

Source: Barclays Research estimates, Company Data.

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Progressive Corp. (PGR, 14-Dec-2022, USD 126.58), Underweight/Positive, CD/CE/J/K/M

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Stock Rating

Overweight - The stock is expected to outperform the unweighted expected total return of the industry coverage universe over a 12-month investment horizon.

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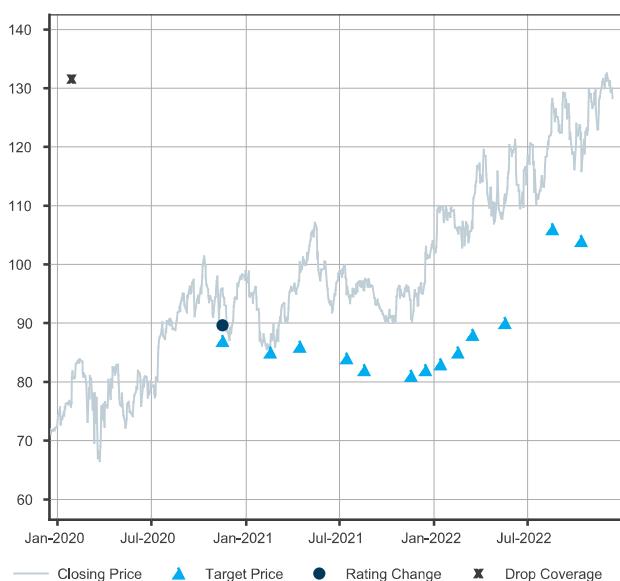
Stock Rating: **UNDERWEIGHT**

Industry View: **POSITIVE**

USD 126.58 (14-Dec-2022)

Rating and Price Target Chart - USD (as of 14-Dec-2022)

Currency=USD



Source: IDC, Barclays Research

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

Publication Date	Closing Price*	Rating	Adjusted Price Target
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
22-Jan-2020	76.16	Coverage Dropped	

On 14-Dec-2019, prior to any intra-day change that may have been published, the rating for this security was Overweight, and the adjusted price target was 85.00.

Source: Bloomberg, Barclays Research

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