The Progressive Corporation NYSE:PGR

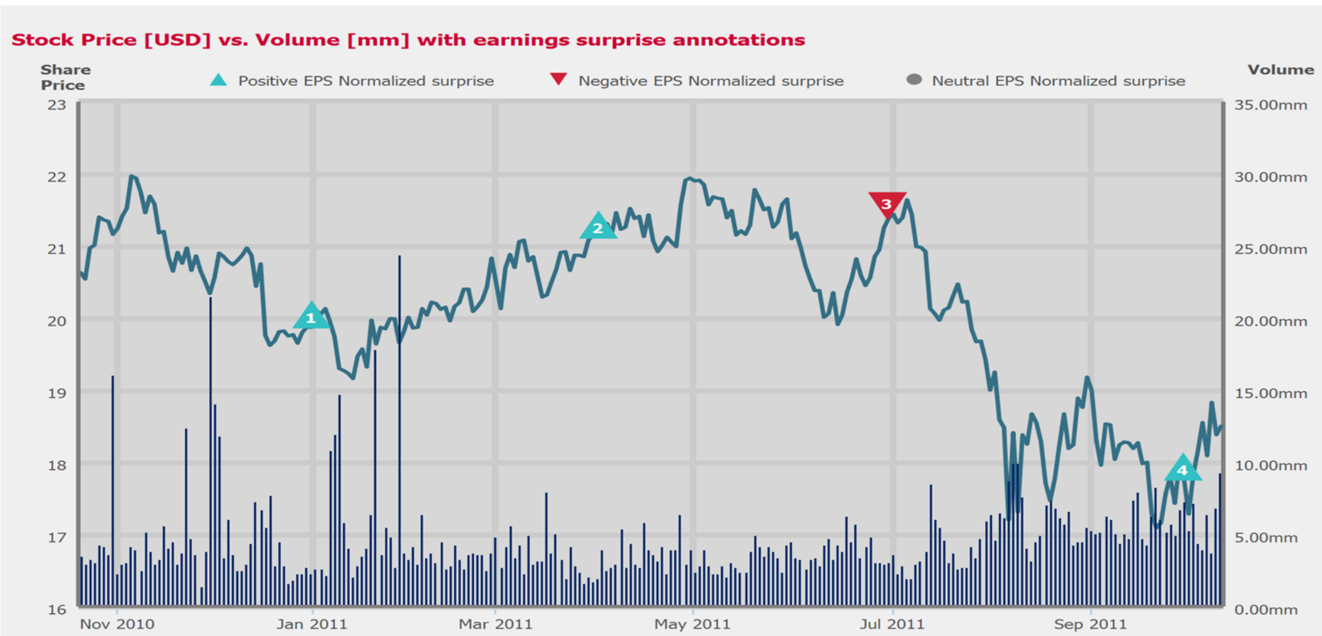
FQ4 2011 Earnings Call Transcripts

Thursday, March 01, 2012 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2011-			-FQ1 2012-	-FY 2011-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.35	0.40	14.29	0.39	1.46	1.48
Revenue (mm)	3576.94	3538.10	(1.09 %)	4094.83	15171.85	15146.60

Currency: USD
Consensus as of Feb-23-2012 7:56 AM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ4 2010	0.36	0.37	1 2.78 %
FQ1 2011	0.43	0.45	2 4.65 %
FQ2 2011	0.39	0.34	3 (12.82 %)
FQ3 2011	0.28	0.29	4 3.57 %

Call Participants

EXECUTIVES

Brian C. Domeck
Former Vice President

Glenn M. Renwick
Non-Executive Chairman

Matt Downing

ANALYSTS

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

Ian Gutterman
Adage Capital Management, L.P.

Josh Stirling
Sanford C. Bernstein & Co., LLC., Research Division

Joshua David Shanker
Deutsche Bank AG, Research Division

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Michael Zaremski
Crédit Suisse AG, Research Division

Vinay Gerard Misquith
Evercore ISI, Research Division

Presentation

Operator

Welcome to the Progressive Corporation's Investor Relations Conference Call. This conference call is also available via an audio webcast. [Operator Instructions] In addition, this conference is being recorded at the request of Progressive. If you have any objections, you may disconnect at this time. The company will not make detailed comments in addition to those provided in its annual report on Form 10-K and letter to shareholders, which have been posted to the company's website, and will use this conference call to respond to questions.

Acting as moderator for the call will be Matt Downing. At this time, I will turn the call over to Mr. Downing.

Matt Downing

Thank you, Wendy, and good morning, and welcome to Progressive's conference call. Participating on today's call are Glenn Renwick, our CEO; and Brian Domeck, our CFO. Also on the line is Bill Cody, our Chief Investment Officer. The call is scheduled to last about one hour.

As always, our discussions on this call may include forward-looking statements. These forward-looking statements are based on management's current expectations and are subject to many risks and uncertainties that could cause actual events and results to differ materially from those discussed during this call. Additional information concerning those risks and uncertainties is available in our 2011 annual report on Form 10-K, where you will find discussions of the risk factors affecting our businesses, Safe Harbor statements relating to forward-looking statements and other discussions of the risks, uncertainties and other challenges we face. Our documents can be found via the Investors page of our website, progressive.com.
We are now ready for -- to take our first question.

Question and Answer

Operator

[Operator Instructions] Our first question today is from Mike Zaremski with Crédit Suisse.

Michael Zaremski
Crédit Suisse AG, Research Division

The 10-K cites 35,000 independent agencies. That's up from 30,000 in more recent years. Have the new agencies been a driver of the PIP growth? And I was curious also what your penetration rate is among independent agencies.

Glenn M. Renwick
Non-Executive Chairman

Mike, unfortunately, the answer's probably not a significant driver of growth. We obviously know agencies, agents, and we've always sort of held to a number that we could reasonably represent was a fair representation. But every so often, we take a more detailed census, and this is our change, our formal change to report. It's now -- 35,000 is more representative than 30,000, which we used for a long time. So it's a little bit more of a consistent PI change, and not representing a sudden shift or a sudden increase in agents. So no to the driver of additional volume, but our independent Agency channel, overall, has actually been doing quite nicely, so we're happy with that. But don't focus too much on the change of number. You'll see that number going forward as a much more representative number in our PR and general releases.

Michael Zaremski
Crédit Suisse AG, Research Division

Okay. And lastly, policy life expectancy had -- has been decreasing in Direct despite Snapshot and Home Advantage, which I believe are bigger contributors in that channel. Could you talk about that, and also what the driver of the increased life expectancy in Agency has been -- what's been behind that?

Glenn M. Renwick
Non-Executive Chairman

Sure. PHA and Snapshot both remained positive, so unfortunately, when you have questions like this, it tends to be little pieces of data and sometimes hard to connect the dots, so I'll try to do that as best I can. We had taken a significant -- and we talked about this in past calls -- significant rating action in Florida. Now I point out one state, and that -- you might say, "Well, just one state." Florida represents a significant chunk of our business, and therefore, it does matter. When those rate changes take place, which are very -- unfortunately, very necessary, they have a delayed effect on future renewals. And a large piece of the retrenchment on PLE, which we are certainly not happy with, is a result of our rate changes -- our necessary rate changes in Florida. We have sort of beaten ourselves up quite appropriately to see if there was anything that we were doing internally. And frankly, there were a few things that we were doing internally that also were destructive to our PLE. A couple of those were more specific to Direct than they were to Agency. So the results are as we report them, but I don't sense any systemic issue or major change between Direct or Agency. And as long as our rate levels remain adequate for, certainly our large states, I would expect to see those stats to reverse themselves and come back to the levels that they were at. That's not a -- anything other than my expectation, but the reason for the decline, primarily, a price shock. A little bit more accentuated in Direct, where we also had some things that we needed to fix with regard to build plans and some what we call onboarding activities, where we bring new customers onboard. Some things that we could do considerably better. All of those are either remediated or very close to remediation.

Michael Zaremski
Crédit Suisse AG, Research Division

And the -- and since you brought up Florida, the bills in the Florida House regarding PIP, and the Senate, would those be good for auto insurers like Progressive?

Glenn M. Renwick
Non-Executive Chairman

Though it's somewhat dangerous, I've made a career out of not speculating on political issues, but it's a very fair question. Florida PIP is not irrelevant relative to the state of the industry right now. So I'll say a couple of things. The House bill, I think, has more potential, from our perspective. Obviously, the people of Florida, the legislature will have to choose to do whatever they do. We do not tend to get particularly involved in legislative affairs. We offer our opinion and our experience and data where asked. The Senate bill does not do nearly as much as the House bill. And Florida has, since the Third and Fourth District Court ruling, changed a level of understanding of reimbursement for PIP that we thought was well expressed by the legislature in 2008, though now with these court rulings, something other than that, which is causing some degree of disruption. And frankly, we had made some moves to incorporate some language in our policy contract that we think puts us in a relatively better position than many. But the likelihood of reform, I'm not even going to give you a probability on that. I would tell you that if the House bill were the one to be ratified by the Senate [ph] and the Governor, then that would be more useful to us than the Senate bill.

Brian C. Domeck
Former Vice President

Mike, this is Brian. You had also asked a little bit about the drivers of the Agency policy life expectancy increasing. There's a number of reasons, but one of the reasons would be we were actually getting more quoting activity in the preferred market or subset of policyholders that have a tendency and norm to stay with us longer. So that is, for us, a very good thing. And our agents are now quoting us more for those preferred-type risks.

Operator

Our next question is from Josh Shanker with Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

My question relates -- I'm trying to figure out how good of a selector Snapshot is. I was wondering if you have any data you can share with us about the propensity or proportion of accidents -- 6-month customers or 1-year customers or 2-year customers -- what percentage of your accidents that you guys know come from new customers as opposed to legacy customers?

Glenn M. Renwick
Non-Executive Chairman

Josh, that is very knowable. I don't know that at the level of specificity I'd be comfortable answering right now. I'll tell you what, we will almost certainly be talking about Snapshot in a meaningful way at our next meeting. And so while you can reasonably assume, as we have -- we and others have indicated that new business loss ratios typically exceed the renewal loss ratios, and therefore, there is a propensity for higher frequency in the first term on the policy. But all of that's just rhetoric. I think that can be answered a little bit more specifically, and frankly, it's a reasonable question. So why don't we sort of take note of that and defer that to June, when I could give you a bit more of an answer that would be of some value to you.

Joshua David Shanker
Deutsche Bank AG, Research Division

Okay. Let me try and ask it in another way which is less -- more direct. It seems that this quarter, Progressive opened up a pretty wide gap in terms of underwriting profitability compared with the competitors, yet we assume the average Snapshot customer is probably a lower-premium-per-policy customer than the average general pool customer. What might -- if you guys wanted to speculate, what might be accounting for this?

Glenn M. Renwick
Non-Executive Chairman

Okay, all right. Perhaps I was looking for the statistical answer to your other one as opposed to general. Let me try to give you...

Joshua David Shanker
Deutsche Bank AG, Research Division

I will take it, by the way, if you have it.

Glenn M. Renwick
Non-Executive Chairman

Well, we have it. I just didn't have it top of mind. Let me try to answer your question, but give you several different points that are valuable. I think it's a little dangerous to jump to most recently reported results and use one explanation for their -- the deltas. I mean, I see the industry results as well as you do. Let me tell you one of the most important things that is happening with Snapshot. First of all, our units that we're shipping in Snapshot continue to increase. We have not seen a plateauing of that. So this is not, as in some cases, we come up and others come up with ideas that seem good, but they don't really hunt. Clearly, Snapshot is something that is definitely commercial grade. There's no question about that in terms of the units that we're shipping, the customers showing interest and the percent of new customers that this is affecting, specifically in Direct, and with the slight climb now in Agency. And I mentioned some of that in my letter. The most important thing to me is that the loss results match with the pricing. Your assessment that, frankly, we are giving relatively large discounts is an important assessment. It is extremely dangerous to give large discounts unless you have a very high certainty that you're matching the true loss costs. So now that we've developed a reasonable track record, and there has been some tuning -- but I would say tuning, not sort of mega-refinement -- to our discount structure, we are becoming very comfortable that we are matching our loss results with the pure -- or the pure premium is being matched, and things look good there. So we will continue. As you will see in some of our other statistics, it is possible that average premiums will decline for a little bit. The issue is are we matching the loss costs with our price. Answer so far, and so far is a reasonably good measure, yes. Are we seeing other things that we hope to get from that? The customers that are coming to us are disproportionately relative to other non-UBI -- and I called UBI here as Snapshot, usage-based insurance. They typically have prior insurance. We are seeing a grouping of customers who typically get higher levels of discounts tend to be -- or tend to have a higher propensity to come from carriers that are, let's just say, the 3 that are larger than us. We will get a higher percentage of those customers in the higher-discount tiers than we might in the lower-discount tiers or in non-usage space. We have now credible data that those who come to us through Snapshot and get a discount are experiencing a meaningful increase in retention. We're not going to give out those specific numbers, but when I say meaningful, it's not 10 basis points.

We're finding that our advertising that we had -- actually, I'll say we even struggled a little bit in our earliest versions of advertising to try to get people to understand what the Snapshot concept was and the relative ease with which they could install the unit. We've probably had a couple that were not as effective. Two of our more recent commercials have helped with that a great deal, and a lot of the mystery and sort of concern seems to have gone away. A couple other things that I can throw in as -- since Snapshot surely is on people's mind is that the algorithm -- and I tried to reference some of this in my shareholders letter, the algorithm will continually be a work in progress for us. Obviously, we don't change it all the time, but we're always doing R&D to figure out new things. And it is very clear to us that more data, a better ability to analyze it, different uses of the components that we can now measure -- we mentioned some of those at the last IR meeting -- are actually going to contribute to a revised algorithm in the future. And I suspect that, that will continue for quite some time, as we get to use this data in more and more intelligent ways. We've also referenced in the shareholder letter that the intellectual property that we have has been reviewed and upheld at the patent office, including the issuance of a further patent, which is very, very directly describing what we're doing in the marketplace. So we're very thrilled with that. So Snapshot, in general, is working very well, and I'd say it's commercial grade. And loss results have matched with the pricing, and that gives us a great deal of confidence to keep pushing on this.

Operator

Our next question is from Matthew Heimmermann with JPMC.

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

I guess just on Snapshot, and I apologize if you've covered this before, but can you give us a -- and this is really following up on the letter where you talked about kind of the Agency distribution having kind of embraced this at a lesser rate than Direct customers. But I would just be curious, this -- is the Snapshot customer a customer that is predisposed to be a Direct customer more so than an Agency customer? I'm just trying to think about if that customer is more likely to be a Direct customer, is -- does that mean they're more likely to be somebody who would be attractive to Progressive anyways? I'm just trying to think about that dynamic as we think about the penetration of the product over time.

Glenn M. Renwick
Non-Executive Chairman

Yes, that's a good question. I think that calls for some speculation, which in this case I'll give you mine, and that's what it is, so... I don't think the customer per se is necessarily someone who has a proclivity for one distribution or another. Most people want to be rated in their insurance for sort of who they are and how their driving behaviors reflect or could reflect in the premium. So I really don't sense that there's a structural reason why somebody would feel differently if they went to an agent versus direct as to their personal comfort with having their insurance rate reflect their driving behavior. I think that's pretty much uniform. Why -- the reason I made the comment I made, and having had a lot of years with agents is recognizing that as small business people, changes come to them. Some stick, some don't stick. I think agents in general -- and actually sort of probably would put myself in this category if I were one of them -- I want to see something get a little bit more of a permanency and a maturity to it before I put that on my customers, knowing that I'm the one that has to go back later and say "Oh no, it didn't work. The company changed their minds," and I have to rewrite or do whatever." So I think there is a period where agents want to just get a greater confidence that this is something that they can rely on, and that they can offer to their customers with some degree of certainty that it's going to be in place for a period of time. Our ability to do that and use our Direct channel as a leading indicator to test that and prove that proposition is actually terrific, because then we can go back to agents and sort of say "Hey, look, here's our data. I think you can start to feel a little more confident." And we're already starting to see -- it's still small, but as I predicted, and I'm happy to give you meaningful updates without necessarily specific percentages as the year develops, but I'll be surprised if we don't see the Agency adoption of this somewhat come up to parallel the Direct adoption simply because it's really a consumer benefit and doesn't have specifics to distributions.

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

Okay, that's helpful. And then the other issue I was trying to get my arms around was just around the Home Advantage product, from the standpoint -- and I don't if this works to your benefit or detriment or maybe it doesn't matter. But obviously, Homeowners is now -- from an industry perspective is seeing a ton of pricing pressure. And it doesn't look like this is likely to be a one-year phenomenon, as a lot of folks in the industry feel like the product is structurally underpriced and the CAT experience of last year and late 2010 have probably weighed on that a bit. So I guess my question is, we -- your providers, do you get -- do you feel like what they're likely to do on the rate side is going to be in line with the industry or more or less aggressive? And how do you see their relative rate need or actions affecting the take-up rate for that product for the preferred customer, multiproduct customer?

Glenn M. Renwick
Non-Executive Chairman

Yes. The carriers that we work with were all -- none of them were immune to the issues from last year, period. It'd be silly to suggest otherwise. However, to a degree I think that they were probably on the lesser side of that, which is nice for them. And they will need to react. That's clearly their decision to make, but they will need to react. And in fact, if we go back to the very first question that was asked about Direct and a little bit of policy life expectancy, there's probably a touch in there where we've seen some rate increases for our PHA that has changed their relationship in auto. So this is not something that is -- not intertwined, but all of our carriers are on top of it. We get nothing from them that suggests that they are any more concerned than any other reasonable homeowners company. And while they're taking some rate need, it looks like in all cases we have open and viable markets. And the good here relative to being able to offer that is far greater than the concern around rate. In fact, I want them to take rate because they're no use to me if they're not viable and profitable in meeting their own standards. And what's probably more important is that, frankly, you're going to see a lot of customers experience changes in their homeowners rates, which is potentially another shock that forces people into the marketplace in general to shop. So while there is some negative on the balance sheet here, there's actually a fair amount of positive from our perspective that we have multiple carriers. They're all open for business. In fact, we've added a couple of carriers, and we'll talk about that later. And our PHA strategy continues for us to be a very viable strategy. It continues to open up more of that preferred customer coming in through Direct and where we can offer it, through agents. Brian already mentioned, they're coming in through the Agency channel as well. And our retention continues to be great. So a long-winded way of saying, yes, they're affected. Yes, they'll take rates. Clearly there's a negative to that. It is important that they do that. They do it in a way that is meaningful for them and keeps them in business. My suspicion is we'll pick up something on the other side of the balance sheet there as other companies need to take rate and perhaps people reevaluate both their auto and homeowners package.

Operator

Our next question is from Josh Stirling with Sanford Bernstein.

Josh Stirling
Sanford C. Bernstein & Co., LLC., Research Division

So fourth quarter growth picked up in both channels. It would be helpful, just in line with your commentary around Snapshot, if you could give us a sense of how much Snapshot might be contributing to the recent year growth. And just sort of more generally, you've talked about your advertising is starting to work, and I'm wondering if we primarily should be seeing this as something that would actually drive inbound quotes in sort of greater response rates in Direct and online.

Glenn M. Renwick
Non-Executive Chairman

Josh, to the Agency channel, I would say very modest. I can't give you a quantification of it, but I would not say Snapshot was the driver of the independent Agency channel growth, which we saw nicely in the fourth quarter. I would suggest to you there that, that is probably more a result of other people's rate actions. And as agents are in the position to sort of see those almost on a daily basis when they hit, that they can change their placement or possibly even renewals. All right? [ph] That's a bigger driver that -- as you know, that is a comparative rating environment. So when there are rate changes, that sort of comes through very quickly, and agents can arbitrage to whichever carrier they think is appropriate as they're representing them. I'm sure they feel good about them, so if you have a rate that's beneficial, you're likely to get some business. I think we're benefiting more from that. With regard to Direct, I don't think there's any question that -- as I said earlier, when I try to put a few data points out there about Snapshot, our advertising for Snapshot in what we call sort of rivals in work on [ph] Flo, where Flo is actually sort of transposed into individual cars as a metaphor for the Snapshot device, that seems to have worked. Along with a little bit of reality built into our advertising, where we see someone plug the device in and say "That was pretty easy." Surprisingly, that would seem easier in retrospect than they do when we're planning, but those clearly suggested to people that Snapshot is something that they should try. How much new business we get from Snapshot versus other advertising is very difficult. And while I could sort of ramble on, I'm not going to sort of say I can measure that specifically. I would say the likelihood of someone coming to Progressive and then showing interest in Snapshot -- just remember, they get a quote and then decide to take the device -- that seems to have been -- as I said, the unit shipment on that continues to go up. We haven't seen the plateau on that, so the level of consumer acceptance is very high. And as we showed in our fourth quarter results, our new prospects seem to be starting to gain some momentum. But I think that's more of a combination of both product, advertising and possibly even rate from other companies or perhaps people getting renewals with an increase.

Josh Stirling
Sanford C. Bernstein & Co., LLC., Research Division

Got it. I guess the one -- that's very helpful. The one follow-up I would make to -- I think this is -- in fairness, you probably already answered it. This is in part related to Josh's question. But it appears from what you said and what you guys have published publicly is that you're getting better than the average mix, and there's clearly sort of a better -- the calibration is positive on the selection side, then with retention in the long run, it should make sense. The question, though, is investors are short-term animals, and so we're all sort of trying to figure out -- isn't this, in the near term, I'd say the next 12 months, 24 months as you guys roll this out, should we be thinking about this as margin-neutral, dilutive or is it perhaps even accretive as we think about sort of the power of this model?

Glenn M. Renwick
Non-Executive Chairman

I won't comment on your tone, but let me comment on sort of what I think is the [ph] -- should be responsible. It's accretive in number of customers. And I'm not being disrespectful in that answer. I think what I really need to focus on, Progressive needs to focus on, is more and more customers all the time and at the right premium. So when we offer these discounts, we would not clearly take a book of business and say "Gee, let's just offer a big discount to it." That would be bullish. This has to be able to generate more customers, potentially -- and as I indicated earlier, the mix seems to be suggesting more than potential, a set of customers that we might not otherwise have gotten. I believe fully that this is so profound in terms of rating that is offering a level of segmentation that heretofore hasn't really been seen. Perhaps credit was the last thing that even came close to that. And as this gets traction, and we're not talking about just a few people, it will build on itself by reputation. And my suspicion is that the volume, as long as we're priced at our targets -- we have not changed our targets in any way shape or form. We'll accommodate Snapshot or we'll just say "Hey, we'll subsidize for a while," or any of those sort of things. So I wouldn't be looking for change in margin based simply on Snapshot. As I said earlier, you might be looking and use some caution in interpreting average low -- average written premium. So we may have a new business coming on at an average written premium lower than we previously did. That doesn't worry me nearly as much as it would be if we weren't matching loss costs with the premium.

Brian C. Domeck
Former Vice President

Josh, this is Brian. What I would add on is certainly there's the new customer traction. There's also the long-term benefit of keeping them longer, which we clearly have seen even in our initial data that those who receive a discount and participate get -- stay with us longer. So there is the long-term premium gains. And the pricing segmentation is very important, and we are always trying to price towards actual loss costs. And I think as we get closer and closer to those in terms of having those be reflective of what we believe loss costs will be, and if we can out-segment our competition and have greater pricing accuracy, I think in the long term, we win on that front. The -- and it's just continuing our emphasis on price segmentation, pricing skills, having a low cost strategy. And if we do both, we think our prices in the marketplace will be very competitive going forward.

Glenn M. Renwick
Non-Executive Chairman

One other element, of course, that goes into the combined ratio is the expense ratio. So we fully appreciate and understand average written premium. I'd love to have that be higher because that gives me greater leverage on expenses. But as Brian indicated, retention is a much more powerful animal there, both to expense ratio and frankly, to long-term margin. So I will tell you -- you might be best thinking of margin as neutral because we're not compromising at all. The upside to margin may very well relate more to the retention story.

Operator

Our next question is from Vinay Misquit with Evercore Partners.

Vinay Gerard Misquith
Evercore ISI, Research Division

The first question, just to follow up on Snapshot, just wanted to clarify the economics of the business. So for the existing customers who already have a Progressive insurance policy, wouldn't that be margin-dilutive for the good customers? And can you really raise rates for those drivers who you identify as being bad drivers? And then for the new customers also, wouldn't the Snapshot mean lower margins for the best drivers? And can you really raise rates or charge higher pricing for the bad drivers?

Glenn M. Renwick
Non-Executive Chairman

I've answered this many times. Do you want to take a shot at that? All right. You ask a very, very, very important question, and one that I am going to answer as best I can for you. And it may be that this is one that requires a little bit more graphical support, so our next meeting might be even a better opportunity to do it. First of all, our existing customers are written under a contract that goes on, so we're not going to all our existing customers and changing their rate. That -- we simply don't have the data to do that. We don't have the driving scores. So when you implement anything, as much as we might like it to be different, when you implement something, you have to draw a line in the sand and say people going forward will be in this contract and get advantage at this price. We have no idea of the driving score of our installed base of customers, and they're not showing any great propensity to reevaluate or come back or whatever. They are free to do that. We do have some endorsement behavior, where someone says -- they see it on television and say, "I like that." And of course, we will never withhold that from any customer. But that really is not a big issue. But if you extrapolated that and took a discount across the entire book, then we know what the outcome of that would be. With regard to new customers, we'll keep it relatively simple. And I said in my letter that I was no longer going to give the specific numbers, but let's say x customers come to us and try Snapshot and we offer no discount. X is considerably smaller than y here. Y would be customers that come to us, try Snapshot and get some level of discount. Those customers, we're obviously very happy with. The x customers, if 0 was the right answer, then we're indifferent. We would have sold them the policy at that anyway. But there is a good chance it wasn't 0, it would've been in our estimation plus-z. We understand plus-z. We understand that we have to price this in total to balance out both with the current book and the level of discount we give new customers. So we want to be able to give as much as possible, but we recognize we have a factor that we're not pricing for [ph], and over time, that will balance out. I would tell you that -- a way I've described it, and I don't know that it's worked particular well, but I've described it as D [ph] is important, but it is raining in the ocean, and we can make that up on a relatively small adjustment to the pricing we give across the book or in the discount structure. Hopefully that helps. If not, we will try in a more elaborate way in June.

Vinay Gerard Misquith
Evercore ISI, Research Division

That's certainly very helpful. My second question was on the new apps decline, and that declined by 2% last year. Just curious about whether that was more related to Progressive being more disciplined than peers. And are you seeing peers now raising rates as we saw, except in the fourth quarter of last year? And also curious just to what you're seeing with your largest direct competitor in terms of raising rates.

Glenn M. Renwick
Non-Executive Chairman

Yes -- and Vinay, I'd certainly like to say discipline, but that's for you to decide. I have a little grid that is put together here -- I see Matt puts it together -- that is sort of growth and profitability. And obviously, you're all familiar with those kinds of grid and being in the top right, or in this case, is the place where you're growing and have great profitability. I once animated that grid because obviously everything depends on time frames, and it's amazing how few stay in that sector and how many go in and out of that sector. So the one thing I'd say to you is that growth and profitability clearly are an ordered pair.

It's not always clear the time frame in which they're ordered. So we believe that we had rates that were appropriately set for most of the year. We did see some favorable development that probably was more than we expected. Nonetheless, we had the discipline to stay with those rates. In the early part of the year, we think shopping behavior was down, and we may not have had quite the conversion rate that we could have had, but that discipline seemed to pay off as we went closer into the fourth quarter and trends, which we think we had priced for, were being realized by others. Across the board, it seems that there is more propensity for rate increases than decreases. And as I mentioned before, it's possibly one of the reasons we're seeing an increase in volume in the fourth quarter. Did I get most of your question?

Vinay Gerard Misquith
Evercore ISI, Research Division

Yes. One last thing, if I may. Your marketing spend and technology spend was up, especially within the Direct segment. Do you expect that to be on a rising trend, or you expect the expense ratio within the Direct segment to tick down this year versus last year?

Glenn M. Renwick
Non-Executive Chairman

You want to take that, Brian?

Brian C. Domeck
Former Vice President

I can speak towards the advertising spend. We do plan to continue to increase advertising spend, but that is always subject to our own assessment of the yield on that spend, and we've talked about that a fair number of times. But currently, we're pleased with the yield in terms of acquisition costs and cost per sale, as well as some of the other what we might call brand health measures of consideration and preference, et cetera. So right now, we feel good about our ad spend and we do plan to continue to have that increase. It may not increase certainly at the pace that it had 2 or 3 or 4 years ago, but we still plan to increase it. But we will always reevaluate that. And on the technology front, that's one area within our company that we actually have a pretty disciplined approach in terms of budgeting and allocation of resources, both labor and capital. And while that is expected to increase a little bit in 2012, we're keeping pretty good tabs on that, and it's likely to increase at a lower rate than our premium growth is.

Vinay Gerard Misquith
Evercore ISI, Research Division

Okay, so this is a follow-up. Do you expect there to be a small amount of -- expenses should decline this year versus last year because of that reason?

Brian C. Domeck
Former Vice President

Well, that technology cost would be across all business groups, so it could also show up in commercial or Agency, so it wouldn't only be in Direct. The other thing that I'd point out, at least in the first 6 months of this year, remember, and we've noted this, that due to the change in accounting for deferred acquisition costs, we will have in the first 6 months approximately $25 million of costs that are no longer deferred. Most of that shows up in the Direct channel expense ratio. Not all, but the vast majority of it shows up in the Direct channel expense ratio. So early in the year, you might see a level that might not be the same as towards the end of the year.

Operator

Our next question is from Michael Nannizzi with Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Just a couple questions. On Snapshot. So if I'm insured by another company, can I just call Progressive up and say, "I want Snapshot," and have it sent to me and become a Progressive policyholder under Snapshot right away?

Glenn M. Renwick
Non-Executive Chairman

Yes, Michael. Let me describe the way it works. What you do is you could call us up, go online, go to an agent, same as any other way that you would approach us. You would get a quote based on all of the measures that we would use and previously have used and develop a rate. Let's just say for now, $500, sake of argument. You would then get asked "Would you like to try to improve your rate through the use of Snapshot?" You would say yes in this case, and we would give you a device i.e. we would give it to you in the mail, and you would follow up within a few days, and you would install it in your vehicle. We would know the moment you install it. And in return, you get to be able to see exactly what data is relevant to you on a website. And after 30 days of usage, we would say, "Michael, based on your driving behavior that we've observed and the things that are important to us, we think that you could be due a 17% discount. And here's the deal we're going to make with you. We'll actually give you that 17% discount for the remaining term of your policy." We write 6-month policies, and at this stage, you've had a 30-day measurement period and probably a few days of some mail and stuff, so that maybe we're 35 or 40 days into the policy. So we would then give you that discount for the remaining part of your policy. We would continue to observe your driving behavior through the chip that you've installed, and we would require that you keep it installed. And at the end of that policy period, or actually, the required number of days that we offer you a renewal price at the expiration of your policy, we would then tell you, "Hey, that 17%," -- is that what I said? Okay. "That 17% looks good," or we go, "It wasn't as good as we thought. It's really 15%," or maybe, "It's a little better than we thought. 21%." Now I'm not being convenient in suggesting that. The fact is it doesn't change very much, so we want people to know that it's not like we're going to give you 17% and then say, "6 months, so it's really 3%." We would do that if that's what it said, but that does not seem to be the behavior that we observe, so you would then get a renewal quote that would reflect the longer period of observation that we've made. At that point, we would say, "That unit, by the way, has some value to us. You're obligated to return it to us," and that would become inventory for us to recycle to the next person at Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

I see. Okay. Fair enough. I guess on Snapshot a little bit more. So the first stage of Snapshot, kind of to think about -- I mean, following to, I think, both Joshes' questions earlier is sort of taking premium per PIF down as you convert full fare customers, your own customers, and then the next stage is once you normalize for these lower sort of aggregate margins on this cohort that you're now charging a discount to but where retention is better, I mean, is that kind of how to think about the stages of profitability coming -- or the impact of profitability from Snapshot?

Glenn M. Renwick
Non-Executive Chairman

I think that is fair. Let me go one step further, that ultimately, if we have greater insight into the true cost that individual should be paying and are willing to allow those that should be paying less to pay less, yes, we would have our retention. But those who should be paying more and are not, eventually, that will have to get recognized in the industry. Let's just assume losses are neither created nor destroyed. We're just trying to price to the individuals proportionate to their contribution to those losses. So if -- I'll say it again, if pure premium customers leave other companies and come to us, it is then likely they have been left with higher pure premium customers, and those rates will need -- their rates will need to reflect that at some point in time. So think about this as sort of a -- interjecting a very new variable, which is hugely disruptive, doesn't change the losses, but it reallocates the premiums.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Okay, great. And just one last one on -- a question before was Direct. I think you said in the K, ad spending was up, quotes, new apps and life expectancy in Direct were down in '11. But then you mentioned also that in 4Q on a year-over-year basis, some of those trends saw an inflection, so an improvement. We don't really -- we can't really see that in the K or the discussion. Can you kind of talk about that stub period, 4Q, and kind of how these metrics changed versus the trend they showed on an annual basis?

Glenn M. Renwick
Non-Executive Chairman

Yes, you are correct. You're not going to see PLE measures changed quickly. They are quite glacial changes, and that's by nature the way we measure them, and so on and so forth. I think I would just reiterate there, it really is the -- more stabilization of rate in Florida versus a shock. One of the things that I'd like --- I'd love to be able to avoid at all cost is shocking our customers, our base of customers with a rate change that is, let's say, greater than 5%. That's a shock generally to consumers, and we did that. Would had to do that. Others are doing it, and perhaps they're doing it a little bit even as we speak. I don't expect but can't eliminate the possibility that we have other changes that we need to make. And as we start to measure our PLE for customers that are now renewing or renewing into the new rate revisions that they've come in through, we should expect to see that policy life expectancy grow. And obviously, in the state of Florida, our average premiums will grow because we've taken rate. We also see overall a little bit of an increase in severities across the board. I don't think that's new. Most companies are probably seeing much the same thing. Relatively tolerable in bodily injury and a little faster than we've seen for some time in the physical damage and collision coverages. Frequency still tends to be a little bit on the downside. Personally, I get nervous about frequency. That can change quickly. Severity tends to be pretty reasonable and real when you see it. Gas prices might change a few things in the next month or 2. Who knows.

Brian C. Domeck
Former Vice President

The only other thing I'd add to that, at least as it relates to the Direct channel, we are seeing more recently an increase in our conversion rate and -- which is fueling some of the new business growth. So whether that is reflective of our rates relative to other rates in the marketplace, I suspect so. I don't know all the rate changes that other folks have taken, but as you've seen in the industry, combined ratios have gone up for many carriers. So I suspect it's a combination of our rates relative to others in the marketplace has improved our conversion rate a fair amount, particularly in Direct. And some of the growth in both channels, whereas some of it is a reflection of either rate changes we've taken or competitors' rate changes. Because it's not necessarily every individual state is at these elevated levels. There are some states and subset states that are growing quite nicely.

Operator

Our next question is from Meyer Shields with Stifel, Nicolaus.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Glenn, earlier you, I, think qualified -- clarified, I should say, the agency count increase from 30,000 to 35,000 as just a revised reporting number but not really a stat increase in the number of agents. I'm wondering whether Allstate's relationship termination was a little bit more than 1,000 agents in the fourth quarter. Is that a stepped [ph] change? Will that matter at all to independent agency companies?

Glenn M. Renwick
Non-Executive Chairman

Yes, it does, and I recognize my answer there might seem strange, but we just -- we've used 30,000 for an awful long time, and a few of us were asking is that -- should we really go back and see exactly what the number we should use? So that number -- that answer was exactly that. You're asking now is the change or are other changes that are being reported from Allstate having any effect on the IA channels. I would tell you, to my knowledge, which I think is pretty decent, not in large enough numbers to really talk about here. But have we had agents come and ask us for appointments as independent agents to continue their professional careers? Yes.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Okay, that's exactly what I was looking for. Second question, I guess you mentioned again in the letter or in the annual report that Australia is not yet a significant component to revenues. Is that going to change anytime soon?

Glenn M. Renwick
Non-Executive Chairman

As a significant part of revenues?

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Yes.

Glenn M. Renwick
Non-Executive Chairman

No. No, it really isn't. And I don't mean to be avoiding anything there, but frankly, the revenues -- this is pointing out a lot of things for us, which is all fine. But I would really encourage you as analysts to one, take me at my word and I'll tell you anything that really is appropriate to tell with Australia, with volume or anything like that. But this is truly, at this point, a rounding era for most of what we're talking about. Having said that, that doesn't mean it's not something that we take seriously and important. Clearly, the indications that I've thought [ph] in profit, not necessarily just to promote our own position, but just how difficult it is to establish brand, get a flow of customers, match your advertising with your average premium, be able to be comfortable that your policy life expectancy is a measurable and reliable number. Those are critically important to a direct business, and I can't stress how important they are. And surprisingly, we're finding things in Australia that we found in 1992 when we started Direct in United States, and they take a long time to be able to go from a standing start to something meaningful. But the premium in Australia is really less than $10 million, so -- and likely not to exceed that in great proportion this year. So we won't really be spending a lot of time talking about something that is not much more than a valuable R&D investment for us at this point in time.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

No, understood. Is that consistent with your expectations, say, 3 years ago?

Glenn M. Renwick
Non-Executive Chairman

Probably a little slower, but I haven't found anything that is shocking me. Probably calibration, we were a little more optimistic on certain measures than is turning out to be the case. But surely, nothing that is sort of like "Wow! How do we miss that?" kind of thing, not at all. And this is one where we have to have some patience.

Operator

Our next question is from Alison Jacobowitz with Bank of America Merrill Lynch.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

I guess 2 sort of follow-up questions, because a lot has been discussed. The one is, if I'm remembering correctly, I think in the shareholder letter you mentioned being virtually profitable in nearly all states. I know you've been talking about Florida a little bit here and there, but I was wondering if you can give us an update on that. And then to the extent you're comfortable, the trends that seem to have reached an inflection in the 4Q that you talk about, can you talk a bit about what you're seeing early in 2012, and maybe particularly, how it relates to the app growth in Direct being slower than you would have liked last year?

Glenn M. Renwick
Non-Executive Chairman

Sure. Do you want to take profitability by states? Just as Brian sort of thinks through this issue there, we think of 2 different measures: one is 96, our target; and two, profitability being 100 combined.

Brian C. Domeck
Former Vice President

Yes, in terms of profitability, certainly in 2010, we acknowledged that we had some profit concerns in some of our large states. And we took corrective actions, and many of those, which we mentioned in the past, were states that have the personal injury protection coverage, where we saw loss trends accelerating. We took pretty significant corrective actions in all of those states where we effectively raised rates a fair amount and that contributed to lower new application production in early parts of 2011. We then became much more comfortable with our rate level in these large states, including Florida and New York and New Jersey. The one state where we still have some fairly significant concerns in terms of profitability, the state I would mention would be Michigan, where we still have not been able to achieve an underwriting profit. We're still -- we've taken significant corrective actions, but we still may have a ways to go there. But certainly in the interim we have taken lots of rate there and new business production has fallen off as a result. The other state that had been of mention previously was Massachusetts, and we're pleased to report that that is getting -- in 2011, it was very close to being profitable on a calendar year basis for the year, and we feel good about our rate level there and look to be able to see that state growing again. Having said all of that, I would say we always need to stay vigilant in some of these pretty high volatile states. Florida being one of them. New York being another. Michigan will always be on our watch and monitoring lists. The loss trends and the environments tend to be very volatile, and we've seen this not only over the last 3 years, but if you go back 10 years or 15 years, these tend to be very volatile markets, where combined ratios for us in the industry have come up and down. Corrective actions, and so we need to sort of remain vigilant there. As Glenn talked about earlier in the conversation, it's one thing to be growing. It's another thing to be profitable, but having the ordered pair of both profitable growth, it's -- you have work diligently on that. So we feel good about our aggregate rate level. In the last year, our rate change has been relatively modest across the marketplace. Rate change in our last 12 months is something like plus-1% on -- in aggregate. But I'm certain there will be individual states where we'll have to take more corrective actions, but that's part of our discipline and what we try to do each and every day.

Glenn M. Renwick
Non-Executive Chairman

And Alison, trends for the quarter, I'm not sure exactly what you're looking for there but I'd just give you a couple of pieces of color. I mentioned earlier that physical damage, severity trends are now a little faster than we'd seen for some time, which is okay. We priced to those. They're not sort of so ridiculous that they'll necessarily cause consumers to have major problems, but we're starting to see a little pickup in new car sales and all of that could be good from our perspective. The bodily injury -- the physical damage, as you well know, is not a big driver of reserves, so I'm not too worried about that. We just need to make sure that we get it into pricing at the right level. Bodily injury, which clearly is a big driver of reserves and pricing, seems to be manageable. The one -- and Brian hit it with almost all the states that he mentioned, one that really is always going to be something on top of mind for all carriers and auto is PIP. PIP sometimes has severities that we can sit and we can talk about, and then the real question is "Well why is this happening?" And unfortunately, that answer gets a little trickier. In Florida, there is some very real issues in terms of why that's happening right now because of some changes in quote decisions that have promoted a large number of claims that were, we believed, reconcile or sold and paid to be reconsidered, and that is something that the whole industry is facing. That's not a trend that you typically can anticipate or put into your pricing, so I hope we don't see a lot of that.

This year, gas prices might affect a little bit the monitor or the mileage driven. One of the comments that we made in our investor meeting is for us, this is actually trying to be alert to those frequency changes, possibly driven by exogenous events such as gas prices. We now have a very large sample of automobiles running around the United States that we can actually determine if, in fact, there are instantaneous changes in miles driven based on certain events. Or at least try to relate those as quickly as possible. So we feel great that we're in a position to have that early monitoring device, such as the Snapshot devices that we have out there. We still see a fair amount of advertising in the industry. I don't expect that to fall off, but it, in my belief, becomes harder and harder for those without a great deal of brand recognition to break into the significant consideration set. So we're delighted that we're there. And we're going to price as -- I threw in a chart of industry-wide premium growth and combined ratio, and you well remember when the industry was running at low 90s and hitting 80s on a regular basis. Those days have long since changed. And now that -- while I recognize everybody has their own goal, I suspect most companies are a lot closer to their acceptable level of combined ratio, and some possibly over it. The game gets a lot harder now. The tight road is really there, and a few points one way or another is not absorbed by the slack in the combined ratio, and that's likely to be overall a driver of premium growth. And most of this conversation to date has been us talking a little bit about what I think will be a meaningful offset to that overall premium growth driver for our customers, in that their ability to at least -- or our new customers to offset that with driving behavior discounts.

Matt Downing

Great. We have time for one more question.

Operator

Our final question today is from Ian Gutterman with Adage Capital.

Ian Gutterman
Adage Capital Management, L.P.

I have a number of questions, but I'll limit myself to 2 out of courtesy. First, on the reserves, while I was looking at your triangles, normally I would expect to see the majority of the reserves from the recent or 2 most recent acts in the years. It appeared this year the great majority of the releases were '07 and '08 and up till now, those acts in years have shown very little development. So I was just wondering -- those years seem a little unusual. If you can talk about what happened. Why releases for such old acts in years and why it took so long for them to develop positively?

Glenn M. Renwick
Non-Executive Chairman

Yes, fair question. That was about 50% of the release, so Brian, do you want to take that?

Brian C. Domeck
Former Vice President

The large part of that favorable development, and in fact, a large part of our overall development was settlements on larger losses. So think of it as higher-limits policies, and those actually have a tendency to take longer to settle. So it's really closures on some of those older claims at less than reserves amounts, which is why they're showing up in '08 and '09 sort of acts in years.

Ian Gutterman
Adage Capital Management, L.P.

Okay, got it, great. Was that CAT-related or is that just high-severity auto policies?

Brian C. Domeck
Former Vice President

High severity. Bodily injury claims for the most part.

Ian Gutterman

Adage Capital Management, L.P.

Understood, okay, great. And then just my other one is from what GEICO reported in the Berkshire results, it looked like they're at 100 combined this quarter, and I think they're a little bit high in the Q3 as well. I'm just wondering if you've noticed any change in their behavior. I mean, were those results a surprise to you at all? Or maybe you kind of expect it based on what you've observed from the market over the last year. Just wondering if you have any thoughts on their behavior versus yours.

Glenn M. Renwick
Non-Executive Chairman

I guess you wouldn't believe me if I said I hadn't noticed. You know what? I've -- and I mean this in -- much more serious than that comment. I think we're always better off just talking about Progressive and what we do. We know how hard it is to sort of be profitable over long, long periods of time, because it's the pricing decisions you make in very different periods. And sometimes, not GEICO-related, people can celebrate sort of volume and good profitability, but they're not really the matched pair. I'll let GEICO speak for themselves. It's a terrific company, and you look at their results over any long period of time, and I tell you, if you think about that top right-hand corner of growth and profitability, when I said I animated it to see the movement of people in and out, we would probably be the constant along with GEICO. So I have nothing but admiration for them, and that doesn't mean we're not daily competitors, but they can speak for themselves on the results.

Ian Gutterman
Adage Capital Management, L.P.

Very fair. I guess, have you seen any signs that their pricing behavior early this year is different than it would've been 6 months ago, and that maybe they are reacting to their results, I guess?

Glenn M. Renwick
Non-Executive Chairman

I will give you this. We have seen that a higher percentage of our customers coming to us now previously being GEICO customers.

Operator
Thank you. That concludes Progressive Corporation's Investor Relations Conference Call. An instant replay of the call will be available through Friday, March 16, by calling 1 (866) 407-9262, or can be accessed via the Investor Relations section of Progressive's website for the next year. Thank you for joining. You may disconnect at this time.