

Progressive Corp.

Jan '23 Earnings: Unfavorable PYD

While unfavorable PYD in January is seasonal to some degree, the level taken is higher than typical. Sequential PIF growth feels less sustainable given capital constraints.

Unfavorable PYD: It appears every January PGR takes a reserve charge since any changes in prior month re-estimates is accounted for in prior AYs rather than the CY given it is the first month of the year. Even so, the company's 6.5 pts of unfavorable PYD is higher than the 2.6 pt average run rate (from Jan '22-Jan '18). The majority (75%) of the \$330mn of unfavorable PYD related to an uptick in December case reserves for personal auto property damage, collision, and comprehensive coverages given higher settlements and changes to re-estimates including inflationary factors. The balance of adverse PYD came from commercial auto (20%) and property.

We note, PGR's reported combined ratio in January was exactly at its 96% target, a factor that may have played into PGR's thinking on the ultimate amount of adverse PYD it was willing to take in the month.

The cost & sustainability of growth: Personal auto PIF grew +2.4% sequentially (Jan '23 vs. Dec '22), up from +0.4% sequentially (Dec. vs. Nov.). On an annualized basis, that would imply PIF growth of 29% vs. 5% (keeping monthly growth constant over 12 months), though there are seasonality adjustments needed. We question the sustainability of growth, as PGR's premiums to surplus is near 3x. On a y/y basis, PGR recognized positive personal auto PIF growth over the last four months (+5.4% in Jan, +2.6% in Dec, +1.7% in Nov and +0.5% in Oct '22). PGR's pricing may appear more competitive as the insurer believes taking rates is behind it, a sentiment that we think is premature. PGR may be leaving rate on the table.

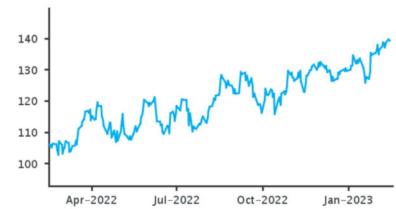
Favorable seasonality in January contributed to PGR's improved underlying loss ratio of 68.5% in Jan from 75.4% in Dec and 75.7% in Nov. PGR's expense ratio rose to a much more normal 20.2% in Jan from 17.3% in Dec and 18.0% in Nov. To recap, PGR's pre-pandemic expense ratio ran just north of 20%. We previously mentioned that an expense ratio well below 20% was not sustainable. However, a higher expense ratio in Jan is not coming from a higher policy acquisition ratio that is remaining steady, rather from higher other underwriting expenses. PGR's underlying loss ratio three-month simple average of 73.2% 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.

PGR's commercial premiums growth reached a high water mark in 2Q21. Looking back at Jan '22, PGR benefited from higher TNC premium audit for higher estimated miles driven. Reported

| CORE

PGR	UNDERWEIGHT
	Unchanged
U.S. Insurance/Non-Life	POSITIVE
	Unchanged
Price Target	USD 123.00
	raised 2% from USD 121.00
Price (14-Feb-23)	USD 139.27
Potential Upside/Downside	-11.7%
Market Cap (USD mn)	81459
Shares Outstanding (mn)	584.90
Free Float (%)	99.70
52 Wk Avg Daily Volume (mn)	2.6
Dividend Yield (%)	0.29
Return on Equity TTM (%)	4.13
Current BVPS (USD)	27.17
Source: Bloomberg	

Price Performance **Exchange-NYSE**
 52 Week range **USD 141.21-100.81**



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

U.S. Insurance/Non-Life

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commercial premium growth was down (5.8)% in Jan '23, on an adjusted basis down (1%). We estimated a (3)% reduction in Commercial NPW.

PGR continues to see more NII gains, as the duration of its assets is shorter, leading to a quicker turnover rate, and its total investments to shareholder equity is high at 3.3x. On a capital adequacy standpoint, while auto is a less capital-intensive business than other lines, we think PGR's high asset leverage may pressure an already constrained capital position. PGR's premium growth levels (+16% NPW y/y) consume capital and it is generating lower organic capital through earnings than its historical trend. PGR's pre-tax net investment income (ex expenses) this month was \$131mn vs. our \$128mn estimate. Higher equity market returns (6.4% common stock yield) boosted NII in the quarter.

January operating EPS of \$0.43 missed our \$0.62 estimate, reflecting adverse PYD and a higher expense ratio. We had modeled catastrophe loss of \$63mn vs. PGR's \$40.3mn.

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	1.46E	1.26E	1.71E	1.88E	1.88E	2.16E	12%	49%
Q2	1.03A	1.28E	1.31E	1.50E	1.65E	1.69E	1.76E	27%	29%
Q3	0.49A	1.43E	1.46E	1.45E	1.69E	1.71E	1.73E	198%	17%
Q4	1.47A	1.67E	1.71E	1.90E	1.86E	1.88E	2.25E	16%	10%
Year	4.12A	5.84E	5.74E	6.56E	7.09E	7.16E	7.89E	39%	25%
P/E	33.8		24.3			19.5			

Consensus numbers are from Bloomberg received on 15-Feb-2023; 13:50 GMT

Source: Barclays Research

U.S. Insurance/Non-Life						POSITIVE	
Progressive Corp. (PGR)							UNDERWEIGHT
Income statement (\$mn)	2022A	2023E	2024E	2025E	CAGR	Price (14-Feb-2023)	USD 139.27
Net premiums earned	49,241	55,706	59,435	63,478	8.8%	Price Target	USD 123.00
Net investment income (NII)	1,260	1,733	2,015	2,236	21.1%	Why UNDERWEIGHT?	
Underwriting income	1,342	1,980	2,694	3,068	31.8%	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	3,370	4,196	4,714	25.0%		
Net income	694	3,564	4,196	4,714	89.4%		
Effective tax rate (%)	21.8	20.8	21.0	21.0	-1.2%		
Combined ratio (%)	95.8	94.9	94.0	93.7	-0.8%		
Combined ratio (ex cats & py development) (%)	92.6	92.9	92.2	91.9	-0.3%		
Per share data (\$)	2022A	2023E	2024E	2025E	CAGR		
EPS (adj)	4.12	5.74	7.16	8.06	25.1%		
EPS (reported)	1.18	6.07	7.16	8.06	89.7%		
DPS	0.40	2.65	2.65	2.65	87.8%		
BVPS	26.32	30.51	34.85	35.57	10.6%		
BVPS (ex AOCI)	31.01	34.37	39.26	40.34	9.2%		
Diluted shares (mn)	587	588	587	587	0.0%		
Balance sheet and capital return (\$mn)	2022A	2023E	2024E	2025E	CAGR		
Total investments	53,548	59,094	63,322	63,787	6.0%		
Common shareholders' equity (ex AOCI)	18,140	20,103	22,913	23,526	9.1%		
Share buybacks	63	94	156	156	35.0%		
Dividends paid	234	1,550	1,547	1,544	87.6%		
Balance sheet and capital return metrics	2022A	2023E	2024E	2025E	Average		
Debt leverage (%)	25.5	23.7	21.7	21.5	23.1		
Financial leverage (%)	27.5	25.5	23.4	23.2	24.9		
Total capital return as a % of op. earnings	12.3	48.8	40.6	36.0	34.4		
Valuation metrics	2022A	2023E	2024E	2025E	Average		
P/BV (ex AOCI) (x)	4.49	4.05	3.55	3.45	3.89		
P/E (adj) (x)	33.8	24.3	19.5	17.3	23.7		
Dividend yield (%)	0.3	1.9	1.9	1.9	1.5		
ROE (%)	3.8	17.6	18.7	18.9	14.7		

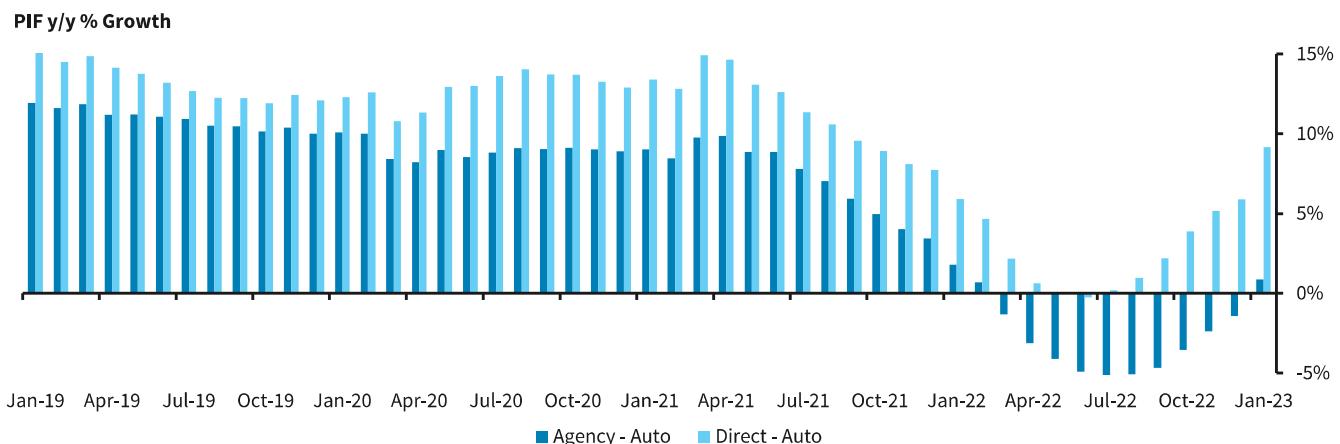
Note: FY End Dec
Source: Company data, Bloomberg, Barclays Research



PIF Growth Spotlight

PGR reported personal auto PIF y/y growth of +5.4% in January (well above our estimate of +3.2%), as auto agency PIF (+0.9% vs. our -0.6%) was augmented by growth in auto direct (+9.2% vs. our 6.3%). We note, this is the first time auto agency PIF was in positive territory since February '22.

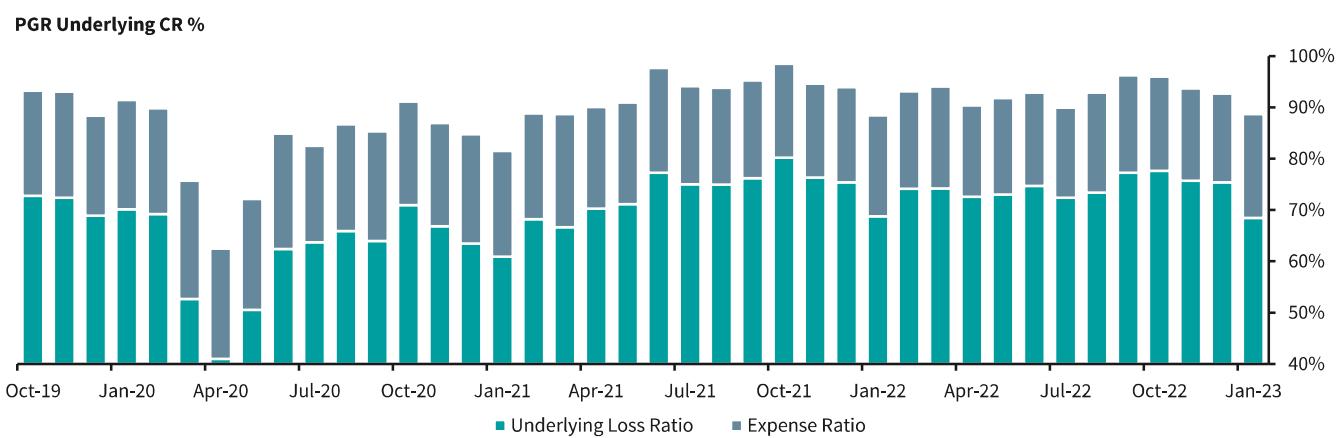
FIGURE 1. PIF growth y/y in January with agent (+0.9%) and direct (+9.2%)



Underlying loss ratio - Favorable Seasonality

Favorable seasonality in January contributed to PGR's improved underlying loss ratio of 68.5% in Jan from 75.4% in Dec and 75.7% in Nov. PGR's expense ratio rose to a much more normal 20.2% in Jan from 17.3% in Dec and 18.0% in Nov. Collectively, PGR's underlying combined ratio of 88.7% has improved from 92.7% in Dec, 93.7% in Nov, and 95.9% in Oct.

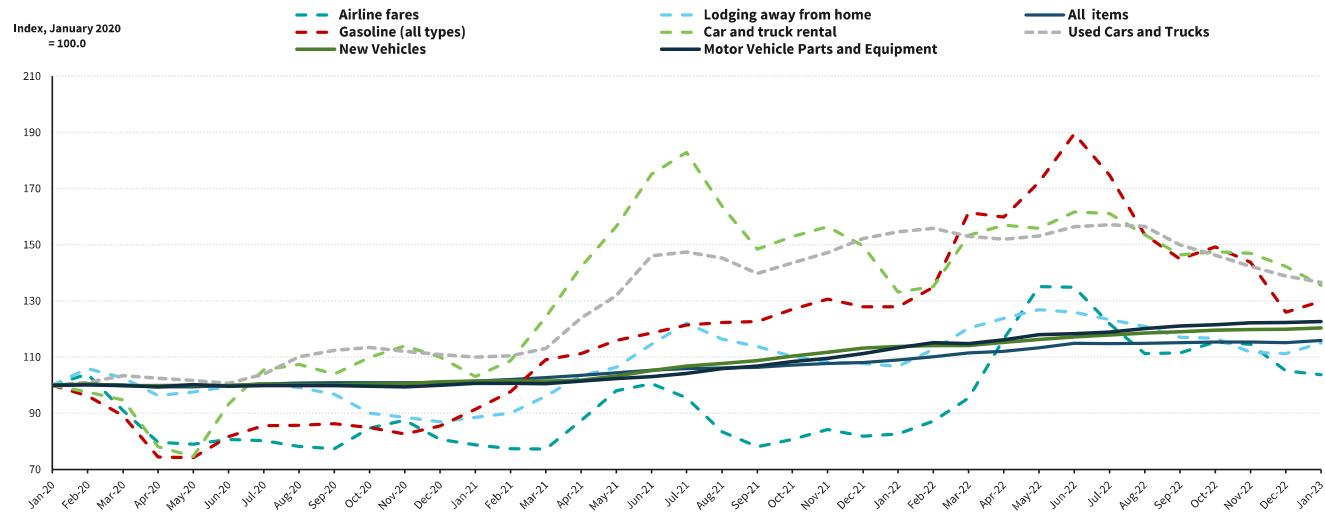
FIGURE 2. January '23 underlying loss ratio of 68.5% (vs. 74.1% Barclays) and expense ratio of 20.2% (vs. 17.5% Barclays)



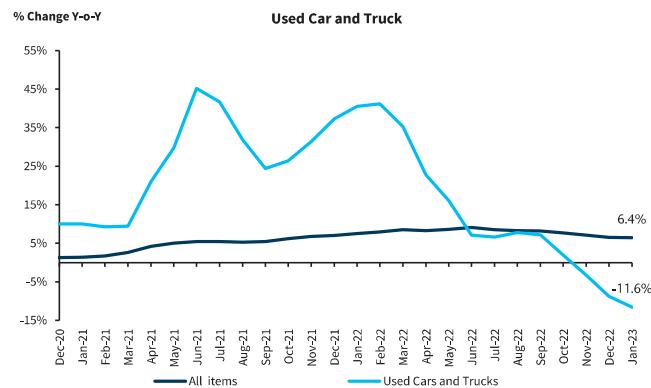
Inflation: Focus on Absolute Levels

Our focus is on an absolute basis, where used car pricing remains significantly elevated (see Figure 3). Likewise, if we compare used car & truck pricing to Jan '19 levels, it is up 34.7% vs. all items at 18.9%. We pay lesser attention to the Consumer Price Index (CPI) for All Urban Consumers, which rose 6.4% over the 12 months from Jan 2022 to Jan 2023. Used car and truck CPI trails all items at -11.6% in Jan vs. -8.8% in Dec.

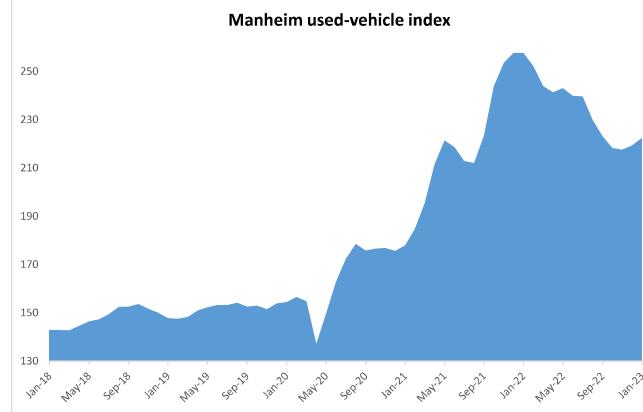
Manheim pricing was +1.5% m/m. We put less weight on Manheim pricing -13.7% y/y basis. More importantly, if we compare Jan '22 to Jan '20, Manheim pricing is still up 44%. Compounded auto pricing during that period has not caught up – not anywhere close. There is still significant rate catch-up needed 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 -11.6% in Jan '23)

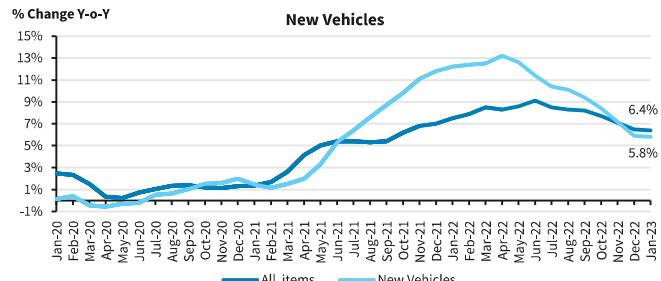
Source: Barclays Research, U.S. Bureau of Labor Statistics

FIGURE 5. Manheim used car prices (y/y -13.7% in Jan '23)

Source: Barclays Research, Bloomberg, Manheim

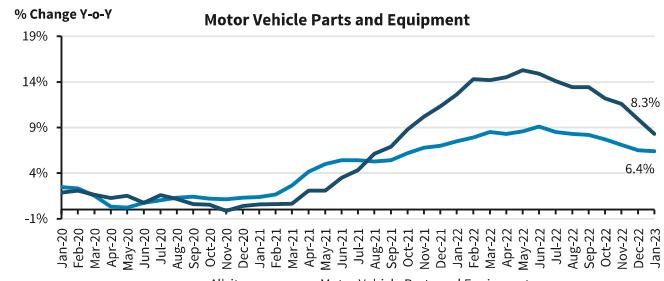
The new vehicle CPI index rose 5.8% y/y (vs. 5.9% in Dec) and Motor Vehicle Parts and Equipment CPI index rose 8.3% y/y (vs. 9.9% in Dec). However, comparing Jan '23 vs. Jan '19, new vehicles and car parts rose 20.5% and 24.9%, respectively.

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

Valuation

Our PT of \$123 (up from \$121) is based on 16.5x our new '24E EPS and 3.2x '24E BVPS (ex AOCI). Multiples are unchanged.

Model Updates:

We typically base our loss ratio expectations on a rolling 3-month average. We are also reducing growth within commercial auto in our forecast period. Lastly, we are adding 3.5 pts of unfavorable PYD in Jan '24 and Jan '25.

Updated EPS: We revise '23E from \$5.84 to \$5.74 and '24E from \$7.09 to \$7.16.

Variance Tables – Jan '23

FIGURE 8. Variance Analysis - Jan '23

Summary Details		M/M		Y/Y		Barclays Est.	
(in \$mn, except per share)	Jan '23A	Dec '22	% Change	Jan '22	% Change	Jan '23	% Var.
Net premiums written	\$5,332	\$3,574	49%	\$4,585	16%	\$5,178	3%
Net investment income	\$131	\$151	-13%	\$70	86%	\$128	2%
Combined Ratio	96.0%	93.3%	270 bps	93.0%	300 bps	92.9%	313 bps
Combined Ratio ex cats and PYD	88.7%	92.7%	(400 bps)	88.4%	25 bps	91.6%	(295 bps)
Operating EPS	\$0.43	\$0.53	-19%	\$0.51	-15%	\$0.62	-31%
Book value per share (ex. AOCI)	\$31.7	\$31.01	2.2%	\$30.3	4%	\$31.6	0%

NPW by Segment		M/M		Y/Y		Barclays Est.	
(in \$mn, except per share)	Jan '23A	Dec '22	% Change	Jan '22	% Change	Jan '23	% Var.
Personal lines-agent	\$1,918	\$1,348	42%	\$1,631	18%	\$1,880	2.0%
Personal lines-direct	\$2,411	\$1,522	58%	\$1,922	25%	\$2,284	5.6%
Total Personal Lines	\$4,329	\$2,870	51%	\$3,553	21.9%	\$4,164	4.0%
Commercial Business & Other	\$826	\$498	66%	\$877	-6%	\$851	-3%
Property	\$176	\$206	-15%	\$156	13%	\$163	8%
Total Written Premiums	\$5,332	\$3,574	49%	\$4,585	16%	\$5,178	3%

CR by Segment		M/M		Y/Y		Barclays Est.	
(in \$mn, except per share)	Jan '23A	Dec '22	% Change	Jan '22	% Change	Jan '23	% Var.
Total Personal Lines	96.5%	91.8%	470 bps	95.0%	150 bps	91.8%	470 bps
Personal lines-agent	93.6%	92.5%	110 bps	91.5%	210 bps	91.8%	180 bps
Personal lines-direct	99.1%	91.1%	800 bps	98.2%	90 bps	90.5%	860 bps
Commercial Business & Other	94.9%	96.8%	(190 bps)	87.6%	730 bps	93.9%	105 bps
Property	88.7%	104.8%	(1610 bps)	77.0%	1170 bps	109.0%	(2030 bps)

Source: Barclays Research estimates, Company Data.

Model Summary

FIGURE 9. 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	56,937	60,685	64,791
Revenues:							
Net premiums earned	36,192	39,262	44,369	49,241	55,706	59,435	63,478
Investment income	1,042	937	861	1,260	1,733	2,015	2,236
Total net realized gains (losses) on securities	1,029	1,630	1,509	(1,912)	246	-	-
Fees and other revenues	564	604	692	722	834	892	952
Service revenues	195	226	271	299	326	357	381
Total revenues	39,022	42,658	47,702	49,611	58,845	62,698	67,048
Expenses:							
Losses and loss adjustment expenses	25,471	25,122	33,628	38,123	41,848	43,670	46,443
Total underwriting expenses	7,998	8,843	9,368	9,777	11,878	13,071	13,967
Policyholder credit expense	-	1,077	-	-	-	-	-
Investment expenses	25	20	26	24	31	34	36
Service expenses	179	206	253	297	304	327	349
Interest expense	190	217	219	244	252	251	251
Total expenses	33,862	35,485	43,492	48,689	54,312	57,353	61,047
Underwriting Income	2,724	5,297	1,374	1,342	1,980	2,694	3,068
Income before income taxes	5,160	7,173	4,210	922	4,533	5,345	6,001
Provision for income taxes	1,180	1,469	859	201	942	1,122	1,260
Other comp (income) loss att. to NCI	(10)	-	-	-	-	-	-
Net income	3,970	5,705	3,351	721	3,591	4,223	4,741
Less: Preferred stock dividends	27	27	27	27	27	26	26
Net income to common shareholders	3,943	5,678	3,324	694	3,564	4,196	4,714
ATX total net realized gains (losses) on sec	813	1,288	1,192	(1,496)	194	-	-
Other	-	-	-	(225)	-	-	-
Operating income to common shareholders	3,130	4,390	2,132	2,415	3,370	4,196	4,714
Operating EPS	\$5.33	\$7.47	\$3.63	\$4.12	\$5.74	\$7.16	\$8.06
Net EPS	\$6.72	\$9.66	\$5.66	\$1.18	\$6.07	\$7.16	\$8.06
Net Written Premiums (y/y %)	15.2%	8.0%	14.4%	10.1%	11.5%	6.6%	6.8%
Net Earned Premiums (y/y %)	17.0%	8.5%	13.0%	11.0%	13.1%	6.7%	6.8%

Source: Barclays Research estimates, Company Data.

FIGURE 10. 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%	75.1%	73.5%	73.2%
Expense ratio	20.5%	21.0%	19.6%	18.4%	19.8%	20.5%	20.5%
Combined ratio	90.9%	85.0%	95.3%	95.8%	94.9%	94.0%	93.7%
Catastrophes pretax	552	880	1,310	1,667	796	862	933
Cat pts	1.5%	2.2%	3.0%	3.4%	1.4%	1.5%	1.5%
PYD pretax (negative is unfavorable PYD)	(232)	(195)	5	86	(330)	(178)	(190)
PYD pts	-0.6%	-0.5%	0.0%	0.2%	-0.6%	-0.3%	-0.3%
Underlying loss ratio	68.2%	61.2%	72.8%	74.2%	73.1%	71.7%	71.4%
Underlying combined ratio	88.8%	82.2%	92.4%	92.6%	92.9%	92.2%	91.9%
<u>Share information</u>							
Shares beginning period	583.2	584.6	585.2	584.4	584.9	584.8	583.6
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	584.8	583.6	583.2
Weighted average shares - basic	583.8	584.9	584.7	584.6	585.0	584.1	583.9
Dilution	3.1	2.5	2.3	2.3	2.7	2.7	2.7
Weighted average shares - diluted	586.9	587.4	587.0	586.9	587.7	586.8	586.6
<u>Shareholders' equity and returns</u>							
Common shareholders' equity ex AOCI	12,612	15,613	17,697	18,140	20,103	22,913	23,526
Average common shareholders' equity ex AOCI	11,423	14,113	16,655	17,918	19,121	21,508	23,220
Book Value Per Share to common ex AOCI	\$21.57	\$26.68	\$30.28	\$31.01	\$34.37	\$39.26	\$40.34
Operating return on avg. common SHE ex AOCI	27.4%	31.1%	12.8%	13.5%	17.6%	19.5%	20.3%
Trailling twelve month average ROCE (as reported)	31.3%	35.6%	18.5%	3.8%	17.6%	18.7%	18.9%

Source: Barclays Research estimates, Company Data.

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Progressive Corp. (PGR, 14-Feb-2023, USD 139.27), Underweight/Positive, CD/CE/J/K/M

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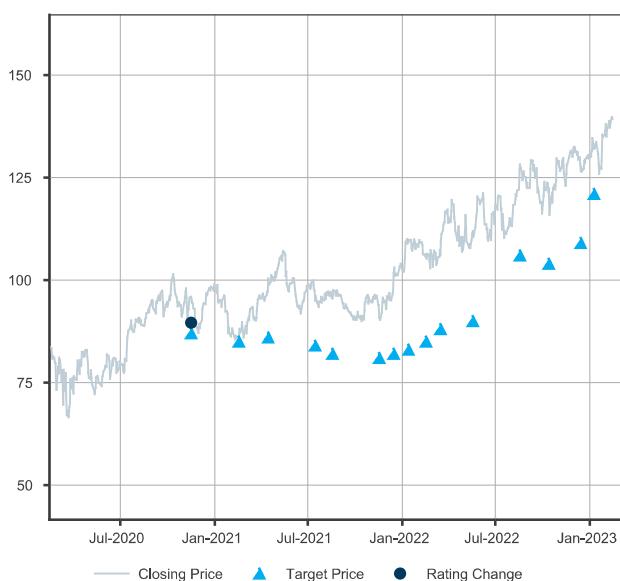
Stock Rating: **UNDERWEIGHT**

Industry View: **POSITIVE**

USD 139.27 (14-Feb-2023)

Rating and Price Target Chart - USD (as of 14-Feb-2023)

Currency=USD



Source: IDC, Barclays Research

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

Publication Date	Closing Price*	Rating	Adjusted Price Target
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

*This is the closing price referenced in the publication, which may not be the last available closing price at the time of publication.

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