PROGRESSIVE CORP/OH/
Form 10-Q
November 01, 2007

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

(Mark One)

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended September 30, 2007

or

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from __________ to __________

Commission File Number: 1-9518

THE PROGRESSIVE CORPORATION

(Exact name of registrant as specified in its charter)

Ohio	34-0963169
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
6300 Wilson Mills Road, Mayfield Village, Ohio	44143
(Address of principal executive offices)	(Zip Code)

(440) 461-5000

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Common Shares, $1.00 par value: 698,099,891 outstanding at September 30, 2007

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

The Progressive Corporation and Subsidiaries

Consolidated Statements of Income

(unaudited)

	Three Months			Nine Months		
Periods Ended September 30, (millions - except per share amounts)	2007	2006	% Change	2007	2006	% Change
Revenues:						
Net premiums earned	$ 3,461.8	$ 3,544.3	(2)	$ 10,464.8	$ 10,609.2	(1)
Investment income	183.9	169.8	8	514.8	484.0	6
Net realized gains (losses) on securities	58.5	2.4	2338	75.2	(24.2)	NM
Service revenues	5.4	7.3	(26)	17.5	23.6	(26)
Total revenues	3,709.6	3,723.8		11,072.3	11,092.6	
Expenses:						
Losses and loss adjustment expenses	2,509.1	2,367.7	6	7,398.0	7,034.7	5
Policy acquisition costs	347.7	359.7	(3)	1,058.1	1,086.7	(3)
Other underwriting expenses	387.2	365.7	6	1,154.3	1,042.2	11
Investment expenses	2.9	2.9		10.3	8.8	17
Service expenses	5.4	6.2	(13)	15.3	19.3	(21)
Interest expense	34.7	18.5	88	74.1	58.4	27
Total expenses	3,287.0	3,120.7	5	9,710.1	9,250.1	5
Income before income taxes	422.6	603.1	(30)	1,362.2	1,842.5	(26)
Provision for income taxes	123.4	193.5	(36)	415.8	595.9	(30)
Net income	$ 299.2	$ 409.6	(27)	$ 946.4	$ 1,246.6	(24)
COMPUTATION OF EARNINGS PER SHARE						
Basic:						
Average shares outstanding	702.6	763.2	(8)	720.6	779.7	(8)
Per share	$ .43	$ .54	(21)	$ 1.31	$ 1.60	(18)
Diluted:						
Average shares outstanding	702.6	763.2	(8)	720.6	779.7	(8)
Net effect of dilutive stock-based compensation	8.2	9.0	(9)	8.3	9.8	(15)

Total equivalent shares		710.8		772.2	(8)		728.9		789.5	(8)
Per share	$	.42	$	.53	(21)	$	1.30	$	1.58	(18)
Dividends declared per share[1]	$		$	.00875	NM	$	2.00	$	.02375	NM

NM = Not Meaningful

[1] See *Note 8 Dividends* for further discussion.

See notes to consolidated financial statements.

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The Progressive Corporation and Subsidiaries
Consolidated Balance Sheets
(unaudited)

(millions)	September 30, 2007	September 30, 2006	December 31, 2006
Assets			
Investments Available-for-sale, at fair value:			
Fixed maturities (amortized cost: $9,664.2, $10,017.7 and $9,959.6)	$ 9,677.1	$ 10,044.3	$ 9,958.9
Equity securities:			
Preferred stocks[1] (cost: $2,358.7, $1,523.0 and $1,761.4)	2,312.9	1,535.4	1,781.0
Common equities (cost: $1,388.5, $1,454.9 and $1,469.0)	2,453.1	2,215.9	2,368.1
Short-term investments (amortized cost: $374.1, $1,057.3 and $581.0)	374.1	1,057.9	581.2
Total investments	14,817.2	14,853.5	14,689.2
Cash	7.7	14.5	5.6
Accrued investment income	140.8	155.5	134.4
Premiums receivable, net of allowance for doubtful accounts of $116.0, $116.7 and $122.0	2,614.0	2,698.6	2,498.2
Reinsurance recoverables, including $45.5, $58.1 and $72.4 on paid losses	355.3	387.0	433.8
Prepaid reinsurance premiums	78.1	98.1	89.5
Deferred acquisition costs	461.1	477.3	441.0
Income taxes		36.1	16.8
Property and equipment, net of accumulated depreciation of $592.2, $585.5 and $557.0	990.1	941.6	973.4
Other assets	201.2	184.0	200.2
Total assets	$ 19,665.5	$ 19,846.2	$ 19,482.1
Liabilities and Shareholders Equity			
Unearned premiums	$ 4,547.4	$ 4,658.1	$ 4,335.0
Loss and loss adjustment expense reserves	5,920.8	5,724.3	5,725.0
Accounts payable, accrued expenses and other liabilities	1,629.0	1,564.3	1,390.0
Income taxes	50.9		
Debt[2]	2,173.5	1,185.4	1,185.5
Total liabilities	14,321.6	13,132.1	12,635.5
Shareholders equity:			
Common Shares, $1.00 par value (authorized 900.0; issued 798.2, 798.7 and 798.7, including treasury shares of 100.1, 37.0 and 50.7)	698.1	761.7	748.0
Paid-in capital	834.2	837.2	847.4
Accumulated other comprehensive income:			

Net unrealized gains on securities	672.6	520.4	596.8
Net unrealized gains on forecasted transactions	28.5	7.8	7.5
Retained earnings	3,110.5	4,587.0	4,646.9
Total shareholders equity	5,343.9	6,714.1	6,846.6
Total liabilities and shareholders equity	$ 19,665.5	$ 19,846.2	$ 19,482.1

1 Includes certain hybrid securities reported at fair value. See *Note 2 Investments* for further discussion.

2 Consists of long-term debt. See *Note 5 Debt* for further discussion.

See notes to consolidated financial statements.

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The Progressive Corporation and Subsidiaries

Consolidated Statements of Cash Flows

(unaudited)

Nine Months Ended September 30, (millions)	2007	2006
Cash Flows From Operating Activities		
Net income	$ 946.4	$ 1,246.6
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	80.1	76.0
Amortization of fixed maturities	208.5	162.9
Amortization of stock-based compensation	20.8	18.7
Net realized (gains) losses on securities	(75.2)	24.2
Loss (gain) on disposition of property and equipment	.3	(5.8)
Changes in:		
Premiums receivable	(115.8)	(197.9)
Reinsurance recoverables	78.5	18.7
Prepaid reinsurance premiums	11.4	5.6
Deferred acquisition costs	(20.1)	(32.5)
Income taxes	14.9	32.0
Unearned premiums	212.4	323.0
Loss and loss adjustment expense reserves	195.8	64.0
Accounts payable, accrued expenses and other liabilities	126.1	136.5
Other, net	(6.9)	(68.8)
Net cash provided by operating activities	1,677.2	1,803.2
Cash Flows From Investing Activities		
Purchases:		
Fixed maturities	(7,391.4)	(5,203.6)
Equity securities	(1,076.5)	(720.4)
Short-term investments auction rate securities	(7,156.6)	(1,339.5)
Sales:		
Fixed maturities	7,106.0	4,707.3
Equity securities	553.8	221.5
Short-term investments auction rate securities	7,325.4	1,351.6
Maturities, paydowns, calls and other:		
Fixed maturities	466.6	546.3
Equity securities	5.1	165.9
Net (purchases) sales of short-term investments other	38.3	(294.5)
Net unsettled security transactions	94.6	(70.5)
Purchases of property and equipment	(98.8)	(267.3)
Sale of property and equipment	1.7	14.0
Net cash used in investing activities	(131.8)	(889.2)
Cash Flows From Financing Activities		
Proceeds from exercise of stock options	16.7	31.5
Tax benefit from exercise/vesting of stock-based compensation	9.9	27.4
Proceeds from debt[1]	1,021.7	

Payment of debt		(100.0)
Dividends paid to shareholders	(1,406.5)	(18.5)
Acquisition of treasury shares	(1,185.1)	(845.5)
Net cash used in financing activities	(1,543.3)	(905.1)
Increase in cash	2.1	8.9
Cash, January 1	5.6	5.6
Cash, September 30	$ 7.7	$ 14.5

[1] Includes a $34.4 million pretax gain received upon closing a forecasted debt issuance hedge. See *Note 5 Debt* for further discussion.

See notes to consolidated financial statements.

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The Progressive Corporation and Subsidiaries
Notes to Consolidated Financial Statements
(unaudited)

Note 1 ***Basis of Presentation*** These financial statements and the notes thereto should be read in conjunction with The Progressive Corporation and subsidiaries audited financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2006.

The consolidated financial statements reflect all normal recurring adjustments which, in the opinion of management, were necessary for a fair statement of the results for the interim periods presented. The results of operations for the periods ended September 30, 2007, are not necessarily indicative of the results expected for the full year.

Note 2 ***Investments*** The composition of the investment portfolio at September 30 was:

(millions)	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value[2]	% of Total Portfolio
2007					
Fixed maturities[1]	$ 9,664.2	$ 80.0	$ (67.1)	$ 9,677.1	65.3%
Equity securities:					
Preferred stocks	2,358.7	12.4	(55.2)	2,312.9	15.6
Common equities	1,388.5	1,068.1	(3.5)	2,453.1	16.6
Short-term investments:					
Auction rate municipal obligations					
Auction rate preferred stocks					
Other short-term investments	374.1			374.1	2.5
Total short-term investments	374.1			374.1	2.5
Total portfolio[3]	$ 13,785.5	$ 1,160.5	$ (125.8)	$ 14,817.2	100.0%
2006					
Fixed maturities	$ 10,017.7	$ 100.7	$ (74.1)	$ 10,044.3	67.7%
Equity securities:					
Preferred stocks	1,523.0	27.8	(15.4)	1,535.4	10.3
Common equities	1,454.9	767.4	(6.4)	2,215.9	14.9
Short-term investments:					
Auction rate municipal obligations	199.4			199.4	1.3
Auction rate preferred stocks	173.3	.6		173.9	1.2
Other short-term investments	684.6			684.6	4.6
Total short-term investments	1,057.3	.6		1,057.9	7.1
Total portfolio[3]	$ 14,052.9	$ 896.5	$ (95.9)	$ 14,853.5	100.0%

[1] Includes $19.3 million of gains on open derivative positions as well

as $20.2 million of collateral in the form of Treasury Notes, delivered to a counterparty on an open derivative position.

[2] At September 30, 2007, preferred stocks included a $3.0 million change in fair value on certain hybrid securities (described below) recognized as a realized loss on securities.

[3] Includes net unsettled security acquisitions of $136.5 million and $88.0 million at September 30, 2007 and 2006, respectively.

Our fixed maturity securities include debt securities and mandatory redeemable preferred stocks. The preferred stock portfolio includes nonredeemable preferred stocks, which contain certain securities that have call features with fixed-rate coupons (i.e., hybrid securities), whereby the change in value of the call features is a component of the overall change in value of the preferred stocks. Other short-term investments include Eurodollar deposits, commercial paper and other investments which are expected to mature within one year. Common equities include common stock and other risk investments.

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Our securities are reported at fair value, with the changes in fair value of these securities (other than hybrid securities) reported as a component of accumulated other comprehensive income, net of deferred income taxes. The change in fair value of the hybrid securities discussed above is recorded as a component of net realized gains (losses) on securities, as prescribed by current accounting guidance.

Note 3 ***Supplemental Cash Flow Information*** We paid income taxes of $391.0 million and $534.0 million during the nine months ended September 30, 2007 and 2006, respectively. Total interest paid was $59.9 million and $63.6 million for the nine months ended September 30, 2007 and 2006, respectively. Non-cash activity includes changes in net unrealized gains (losses) on investment securities and dividends accrued for restricted stock awards granted after February 2007, under which dividends are deferred until the underlying stock vests.

Note 4 ***Income Taxes*** In July 2006, FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, was issued, which provides guidance for recognizing and measuring the financial statement impact of tax positions taken or expected to be taken in a tax return. This interpretation was effective beginning January 1, 2007. As of January 1, 2007, we had no unrecognized tax benefits. We analyzed our tax positions in accordance with this interpretation and determined that it did not result in any changes to our reserve for uncertain tax positions. As a result, no adjustment to January 1, 2007 retained earnings was required.

We recognize interest and penalties, if any, related to unrecognized tax benefits as a component of income tax expense. As of January 1, 2007, we had not accrued any interest or penalties related to unrecognized tax benefits.

The statute of limitations remains open with respect to our federal income tax returns for tax years 2004 and later. The 2004 through 2006 returns are currently under examination. We have entered into the Compliance Assurance Program (CAP) for the 2007 tax year. Under the CAP program, the Internal Revenue Service begins its examination process for the tax year before the tax return is filed, by examining significant transactions and events as they occur. The goal of the CAP program is to expedite the exam process and to reduce the level of uncertainty regarding a taxpayer s tax filing positions.

There have been no changes to our liability for unrecognized tax benefits, interest and penalties during both the third quarter and year-to-date period ended September 30, 2007.

Note 5 ***Debt*** Debt at September 30 consisted of:

(millions)	2007		2006	
	Carrying Value	Fair Value	Carrying Value	Fair Value
6.375% Senior Notes due 2012	$ 348.5	$ 363.7	$ 348.2	$ 366.8
7% Notes due 2013	149.2	161.1	149.1	164.0
6 5/8% Senior Notes due 2029	294.4	310.1	294.3	323.5
6.25% Senior Notes due 2032	393.9	396.9	393.8	408.2
6.70% Fixed-to-Floating Rate Junior Subordinated Debentures due 2067	987.5	985.4		
	$ 2,173.5	$ 2,217.2	$ 1,185.4	$ 1,262.5

On June 18, 2007, we issued $1 billion of 6.70% Fixed-to-Floating Rate Junior Subordinated Debentures due 2067 (the Debentures). The Debentures will become due on June 15, 2037, the scheduled maturity date, but only to the extent that we have received sufficient net proceeds from the sale of certain qualifying capital securities. Progressive must use its commercially reasonable efforts, subject to certain market disruption events, to sell enough qualifying capital securities to permit repayment of the Debentures in full on the scheduled maturity date or, if sufficient proceeds are not realized from the sale of such qualifying capital securities by such date, on each interest payment date thereafter. Any remaining outstanding principal will be due on June 15, 2067, the final maturity date. The Debentures will bear interest at a fixed annual rate of 6.70% through, but excluding, June 15, 2017, payable semiannually. Thereafter, the Debentures will bear interest at a rate equal to the three-month LIBOR plus 2.0175%, payable quarterly. Subject to certain conditions, Progressive has the right to defer the payment of interest on the Debentures for one or more periods not exceeding ten consecutive years each. During any such deferral period, among other conditions, interest would continue to accrue, including interest on the deferred interest, and we generally would not be able to declare or pay any dividends on or purchase any of our Common Shares.

Subject to the replacement capital covenant discussed below, the Debentures may be redeemed, in whole or in part, at any time: (a) prior to June 15, 2017, at a redemption price equal to the greater of (i) 100% of the principal amount of the Debentures being redeemed, or (ii) a make-whole amount, in each case plus any accrued and unpaid interest; or (b) on or after June 15, 2017, at a redemption price equal to 100% of the principal amount of the Debentures being redeemed, plus any accrued and unpaid interest. In connection with the issuance of the Debentures, Progressive entered into a replacement capital covenant in which we agreed, for the benefit of the holders of a senior debt security, that we will not repay, redeem, defease or purchase all or part of the Debentures before June 15, 2047, unless, subject to certain limitations, we have received proceeds from the sale of certain replacement capital securities, as defined in the replacement capital covenant.

Prior to the issuance of the Debentures, we entered into a forecasted debt issuance hedge against a possible rise in interest rates. Upon issuance of the Debentures, the hedge was closed and we recognized, as part of accumulated other comprehensive income, an unrealized pretax gain of $34.4 million. This gain is deferred and is being recognized as an adjustment to interest expense over the 10-year fixed interest rate term of the Debentures.

Note 6 ***Segment Information*** Our Personal Lines segment writes insurance for private passenger automobiles and recreational vehicles. Our Commercial Auto segment writes primary liability and physical damage insurance for automobiles and trucks owned by small businesses in the specialty truck and light and local commercial auto markets. Our other indemnity businesses primarily include writing professional liability insurance for community banks and managing our run-off businesses. Our service businesses include providing insurance-related services, primarily providing policy issuance and claims adjusting services for Commercial Auto Insurance Procedures/Plans (CAIP), which are state-supervised plans serving the involuntary market. All revenues are generated from external customers. Following are the operating results for the periods ended September 30:

(millions)	Three Months				Nine Months			
	2007		2006		2007		2006	
	Revenues	Pretax Profit (Loss)	Revenues	Pretax Profit (Loss)	Revenues	Pretax Profit (Loss)	Revenues	Pretax Profit (Loss)
Personal Lines								
Agency	$ 1,900.5	$ 110.8	$ 1,973.0	$ 223.7	$ 5,772.3	$ 406.6	$ 5,956.9	$ 723.1
Direct	1,091.6	67.9	1,091.2	142.6	3,285.3	284.4	3,250.4	439.2
Total Personal Lines[1]	2,992.1	178.7	3,064.2	366.3	9,057.6	691.0	9,207.3	1,162.3
Commercial Auto	464.3	38.1	473.8	85.8				