

# Principal Financial Group®

## 2Q 2021 Earnings Call Transcript

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### Call participants

#### Executives

Dan Houston: Chairman, President & CEO

Deanna Strable: Executive VP & CFO

Amy Friedrich: President - U.S. Insurance Solutions

Renee Schaaf: President - Retirement & Income Solutions

Pat Halter: President - Global Asset Management

John Egan: VP - Investor Relations

#### Analysts

Tom Gallagher: Evercore ISI

Humphrey Lee: Dowling & Partners

Andrew Kligerman: Credit Suisse

Jimmy Bhullar: JPMorgan

Ryan Krueger: KBW

Erik Bass: Autonomous Research

John Barnidge: Piper Sandler

Tracy Benguigui: Barclays

Suneet Kamath: Citigroup

Josh Shanker: Bank of America

Mike Ward: UBS

## Presentation

Operator: Good morning and welcome to the Principal Financial Group's Second Quarter Financial Results Conference Call. There will be a question-and-answer period after the speakers have completed their prepared remarks. If you would like to ask a question at that time, simply press star and then the number one on your telephone keypad. We would ask that you be respectful of others and limit your questions to one and a follow up, so we can get to everyone in the queue. I would now like to turn the conference call over to John Egan, Vice President of Investor Relations.

John Egan: Thank you and good morning. Welcome to Principal Financial Group's second quarter 2021 conference call. As always, materials related to today's call are available on our website at [principal.com\investor](http://principal.com/investor). Following a reading of the Safe Harbor provision CEO, Dan Houston and CFO, Deanna Strable will deliver some prepared remarks. Then we will open up the call for questions. Others available for the Q&A session include Renee Schaaf, Retirement Income Solutions; Pat Halter:, Global Asset Management; and Amy Friedrich, U.S. Insurance Solutions. Some of the comments made during this conference call may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act.

The company does not revise or update them to reflect new information, subsequent events, or changes in strategy. Risks and uncertainties that could cause actual results to differ materially from those expressed or implied are discussed in the company's most recent Annual Report on Form 10-K filed by the company with the U.S. Securities and Exchange Commission. Additionally, some of the comments made during this conference call may refer to non-GAAP financial measures. Reconciliations of the non-GAAP financial measures to the most directly comparable U.S. GAAP financial measures may be found in our earnings release, financial supplement, and slide presentation. Dan?

Dan Houston: Thanks John and welcome to everyone on the call. This morning, I will discuss takeaways from our 2021 Investor Day, key performance highlights for the second quarter, and how our growth drivers continue to deliver results and fuel momentum across our integrated and focused portfolio. Deanna will follow with additional details on our second quarter results, our progress against financial targets and our current financial position. Starting on slide five, our recent Investor Day, we announced the results of our strategic review, including the areas of our business that we will continue to invest in and expand on as well as select markets and products we will exit and we shared how these priorities enable us to reach our financial targets and deliver against our strengthened capital management approach.

Our resulting go-forward strategy is focused on our growth drivers of retirement in the U.S. and emerging markets, global asset management, and U.S. benefits and protection. These businesses offer the greatest opportunity for growth, leverage our differentiators and integrated business model, and meet our financial objectives of being more capital-efficient with higher returns. We're exiting U.S. retail fixed annuities as well as the retail segment of U.S. individual life and we are seeking transactions for the related in-force blocks, allowing us to free up capital and de-risk our portfolio.

We are focused on executing on the transactions and expect they are actionable in the near-term. These moves will better enable us to achieve our financial targets, which include: delivering 9% to 12% annual growth in earnings per diluted share from 2020 to 2023; achieving a 15% return on equity by 2023; and generating free capital conversion of 70% to 80%. And lastly, we outlined a plan to return more capital to shareholders, totaling \$3 billion between 2021 and 2022. This does not include any excess capital that may be generated from potential transactions.

Bottom-line, the changes to our business portfolio and capital management strategy will drive future growth, reduce capital intensity, improve risk profile, sharpen our strategic focus, and reinforce our commitment to returning more capital to shareholders,

all aimed at driving long-term shareholder value. We are in a strong position to continue to create long-term shareholder value and to grow meaningful ways for our customers and shareholders as evidenced by our second quarter results. As shown on slide six, we reported \$467 million of non-GAAP operating earnings in the second quarter. Excluding significant variances, earnings increased 21% over the second quarter of 2020, driven by continued execution of our long-term strategy and improvement in macroeconomic conditions in many of our markets.

We closed the second quarter with total company AUM of \$990 billion, including record PGI-managed AUM and more than \$130 billion of institutional retirement and trust retirement assets that migrated over the last nine months. Total company net cash flow was a positive \$2.1 billion in the second quarter, including \$1.6 billion of PGI-managed net cash flow. Our growth drivers continue to deliver performance for the enterprise, generating strong earnings growth and creating long-term value for shareholders. In our U.S. retirement business, the underlying fundamentals remain strong and are fueling growth in the business. Recurring deposits increased 33% over the second quarter of 2020 with more than half of the growth coming from our legacy block and the remainder from the IRT migration.

Participant withdrawals were 2.4% of average account values in the second quarter, in line with our historical average and lower than the 2.8% we experienced a year ago during the pandemic. However, as a result of strong equity markets, participant withdrawals increased \$3 billion over the second quarter 2020. This is consistent with prior periods of strong equity performance and the opposite is true when equity markets decline. These withdrawals led to negative net cash flow in RIS-Fee of \$400 million in the second quarter as the strong growth in sales and reoccurring deposits as well as the low contract lapses were offset by higher dollars of participant withdrawals. We completed the migration of the IRT retirement business during the second quarter. As we discussed at the Investor Day, the migration of the trust and custody business will be completed in the first quarter of 2022.

Over the last nine months, through the IRT migration, we've added 2.4 million retirement participants and \$140 billion of account value to our platform, increasing scale, driving growth and positioning Principal as a top three retirement provider. The strategic benefits of the acquisition continue to emerge, including revenue and expense synergies. We're beginning to see lower TSA expenses, increased proprietary investment management opportunities and greater IRA rollovers and expanding retirement plan and total retirement solution opportunities. Our sales pipeline has nearly doubled over the last year with the strongest growth in the large plan market, which we expect to largely benefit sales in 2022.

In the RIS-Spread business, we had approximately \$750 million of MTN issuances in the second quarter and \$500 million of pension risk transfer sales. The PRT business continues to be a core offering of our total retirement solutions, and we remain disciplined in pricing to ensure opportunities meet our return thresholds.

Looking forward, our U.S. retirement business has four key growth engines, which we referenced at Investor Day; momentum from the IRT acquisition; differentiation from an unmatched set of Total Retirement Solutions; and engaging participant experience evolving with more digital enhancements; and PGI's world-class investment management solution. These four powerful engines will drive future growth for our retirement business as well as the rest of the enterprise.

Outside the U.S., our emerging market retirement and long-term savings business is facing near-term challenges from macroeconomic conditions and the pandemic. In Chile, second quarter AUM was negatively impacted by \$1.6 billion of COVID-related AFP hardship withdrawals as the country approved a third wave of withdrawals during the quarter. As a reminder, this does not impact our revenue in Chile as fees are collected on salary, not AUM. Principal International reported a flat net cash flow and \$167 billion of AUM in the second quarter, a 7% increase on a constant currency basis compared to a

year ago. China AUM, which is not included in reported AUM, was \$143 billion in the second quarter and was pressured by negative net cash flow from institutional money market funds.

Despite these challenges, we have the competitive advantage needed to drive growth over the long term within our chosen markets. We have strong local and global investment management capabilities, the right joint venture partners with meaningful reach, distribution, and brand recognition locally and a digital strategy that allows us to access and service customers where they are.

We continue to diversify our offerings in Principal International. For example, in Brazil, our multi-mercado funds, balanced funds and investments in equities or fixed income have become more attractive due to the decline in interest rates. At the end of the second quarter, these funds accounted for over 20% of AUM in Brazil Prev. With BRL28 billion of net cash flow year-to-date, we've captured 54% of the market share and 55% of second quarter sales were in these funds.

Emerging markets are long-term investments. We're well-positioned to navigate the inherent volatility that comes with doing business in emerging markets. We will continue to capitalize on our competitive advantages by offering higher value-added products and differentiated solutions to our customers as well as leveraging our global asset management capabilities to drive future growth in Principal International.

Our global asset management business is driving growth and demonstrating the strength of our integrated operating model. In the second quarter, PGI delivered \$1.8 billion of sourced net cash flows, a 45% margin, strong pretax operating earnings as well as record PGI-managed AUM of \$532 billion and PGI-sourced AUM of \$263 billion. And we continue to deliver strong long-term investment performance as 70% of Principal mutual funds, ETFs, separate accounts and collective investment trust were above median performance for the three-year period, 74% for the five-year and 88% for the 10-year. This

performance positions us well to attract and retain assets going forward and is contributing to positive net cash flow.

We're continuing to see strong interest in our flagship real estate products and continued demand for our yield-oriented products, including preferred securities, high yield, and our scaling emerging market debt strategy. Together, our strength in high-growth investment capabilities, our ability to leverage Principal's global multichannel distribution to develop and deepen customer relationships, our highly efficient globally integrated operating model, and our ability to attract and retain top talent will continue to drive growth in our global asset management business.

In U.S. benefits and protection, our small to medium-sized business customers continue to show signs of resiliency and are returning to normal sales levels, expected retention levels and positive in-group growth. In group benefits, trailing 12 months' in-group growth turned positive for the first time since the pandemic, increasing nearly 0.5% for the total block with the strongest growth in businesses with under 200 employees, our focused customer segment. In Individual Life, premium and fee growth increased, reflecting very strong non-qualified corporate-owned life insurance sales, which are critical to our business market strategy and our total retirement solutions offering.

Our latest well-being index reiterates the strength of this market. 57% of small to medium-sized businesses that responded to our survey said they are optimistic about the overall economic outlook for the next 12 months. This is a higher level than before the pandemic began. ESG continues to be a priority for Principal as highlighted on slide seven. Our ESG approach is aligned to the United Nations' Sustainable Development Goals. It is woven into our investment philosophies, our approach to diversity and inclusion, and is embedded in our philanthropic strategies.

We've recently published specific ESG commitments and will provide continuous updates to our sustainability website on [principal.com](https://www.principal.com) and our annual corporate social responsibility report. We're very

optimistic about the opportunities that lie ahead as momentum has returned in many of our businesses and we've evolved our portfolio to bring greater focus to our growth drivers. Deanna?

Deanna Strable: Thanks Dan. Good morning to everyone on the call. This morning, I'll share the key contributors to our financial performance for the quarter, our current financial and capital position, and additional details on how the outcomes of the strategic review will drive improved financial results.

Net income attributable to Principal was \$362 million in the second quarter, including \$106 million of net realized capital losses with \$5 million of credit losses. We reported \$467 million of non-GAAP operating earnings in the second quarter or \$1.70 per diluted share. Excluding significant variances, non-GAAP operating earnings of \$453 million or \$1.65 per diluted share increased 21% compared to a pressured second quarter of 2020. This is also a 14% increase compared to the pre-pandemic second quarter of 2019.

As shown on slide eight, we had a number of significant variances during the second quarter. These had a net positive impact to reported non-GAAP operating earnings of \$10 million pretax, \$14 million after tax and \$0.05 per diluted share. Pretax impacts included: a \$61 million benefit from higher-than-expected variable investment income; a \$15 million benefit from lower DAC amortization in RIS-Fee and model refinements in Individual Life; a net negative \$11 million impact from COVID-related claims; a negative \$21 million impact from IRT integration costs; and a negative \$33 million impact in Principal International, including a negative \$24 million impact of inflation in Brazil, and \$9 million of lower-than-expected encaje performance in Latin America. Additional details of the Brazil inflation impact are available on slide 20.

The second quarter financial impacts from COVID were limited to mortality and morbidity in RIS-Spread and U.S. Insurance Solutions. With just over 50,000 U.S. COVID-related deaths in the second quarter, the net \$8 million after-tax impact was higher than our rule



of thumb, primarily due to a large claim in Individual Life. This is a significant decline from prior quarters, and we expect the impact will be relatively immaterial to results the remainder of the year.

Looking at macroeconomic factors in the second quarter, both the S&P 500 Index and daily average increased 8% compared to the first quarter and the daily average increased 43% from the year-ago quarter, benefiting revenue, AUM, and account value growth in RIS-Fee and PGI. Foreign exchange rates continued to improve in the second quarter but remained a headwind on a trailing 12-month basis. Impacts to reported pretax operating earnings included an immaterial impact compared to first quarter 2021; a positive \$13 million compared to second quarter 2020; and a negative \$14 million on a trailing 12-month basis.

Turning to the business units, my following comments exclude the impacts of significant variances. As Dan mentioned, we completed the migration of the IRT retirement business in the second quarter, and we are seeing the benefits begin to play out. In RIS-Fee, we continue to expect \$55 million to \$65 million of IRT integration expenses for the full year as we continue to work to integrate the trust and custody business.

PGI benefited from strong management fees, performance fees, and disciplined expense management in the second quarter, boosting growth in revenue and earnings and expanding the margin to 45%. Pretax operating earnings benefited \$11 million from performance fees.

Specialty Benefits pretax operating earnings declined from the year-ago quarter due to higher dental and group life loss ratios driven by severity.

Corporate pretax operating losses were in line with expectations as higher one-time expenses were offset by higher variable investment income.

Turning to capital and liquidity on slide nine, we remain in a strong financial position with \$2.5 billion of excess and available capital, including: \$1.7 billion at the holding company, more than double our target of \$800 million to cover the next 12 months of obligations; \$325 million in excess of our targeted 400% risk-based capital ratio estimated to be 421%; and \$460 million of available cash in our subsidiaries.

As shown on slide 10, we deployed \$431 million of capital during the second quarter, including \$266 million of share repurchases and \$165 million to common stock dividends. Through the first half of the year, we've returned more than \$680 million of capital to shareholders.

Last night, we announced a \$0.63 common stock dividend payable in the third quarter, a \$0.02 or 3% increase from the second quarter. Our dividend yield is approximately 4%. And we continue to target a 40% dividend payout ratio for the full year.

Through the first half of the year, the impact from credit drift and credit losses has been relatively immaterial and we expect it to remain immaterial for the full year. This has improved from the \$100 million estimate at the end of the first quarter.

As we discussed at Investor Day, the strategic review validated that our capital and leverage targets are appropriate. We plan to return to our targeted levels by the end of 2022, including a 400% RBC ratio by year-end 2021 and \$800 million of excess capital at the holding company by the end of 2022. We will continue to maintain a 20% to 25% leverage ratio and expect to pay down \$300 million of long-term debt when it matures in late 2022. Between 2021 and 2022, we plan to deploy approximately \$3 billion of capital to shareholders to return to our targeted capital levels, including \$1.4 billion to \$1.8 billion of share repurchases and \$1.3 billion to \$1.4 billion of common stock dividends. This excludes any impacts of potential transactions.

Through our refined focus and strengthened capital deployment strategy, we will invest in areas where Principal has established

competitive advantages while increasing our returns to shareholders. We have a clear path to becoming a higher-growth, more capital-efficient company creating long-term value for shareholders. We are actively pursuing transactions for several in-force blocks, including fixed deferred annuities and single premium income annuities with \$18 billion of reserves and universal life secondary guarantees with \$7 billion of reserves. While we don't have details to share on transactions, we will continue to update you as we know more, including timing as well as the financial and capital impacts.

As a result of these portfolio changes, this results in approximately \$110 million of lost pretax operating earnings on an annual basis. But we expect a seven to 10 percentage point increase in free capital flow conversion and a positive impact on our return on equity.

As we look forward, we are targeting a 9% to 12% annual growth in earnings per diluted share. We have a path to a return on equity of at least 15% and we expect to generate 70% to 80% free capital conversion. These targets exclude proceeds from potential transactions but reflect the lost earnings and capital impacts from discontinued products and segments. The path forward is attractive and will benefit returns, capital, and our risk profile. This concludes our prepared remarks. Operator, please open the call for questions.

Operator: At that time, I would like to remind everyone to ask a question press star and then the number one on your telephone keypad. We'll pause for just a moment to compile the Q&A roster.

Our first question will come from the line of Tom Gallagher with Evercore.

Tom Gallagher: Good morning. Deanna, I just had a -- first question is just a follow-up to your comment about Specialty Benefits. Did you say the weakness in the quarter was related to one large claim in group life? And if so, how large was that claim? That's my first question.

Deanna Strable: Yes, Tom, I'll comment and then I'll turn it over to Amy to see if she has more to add. That comment was relative to the COVID impact in that we were slightly above our rule of thumb of \$10 million after-tax impact for every 100,000 of U.S. deaths. And that one large claim was in Individual Life, and then that took us just slightly above our rule of thumb. And so, it wasn't a comment on Specialty Benefits. It was a comment on the COVID claims within Individual Life and total company.

Dan Houston: Anything further Amy?

Amy Friedrich: No.

Tom Gallagher: Okay, great. And then my follow-up is, Dan, a competitor, Great-West, recently announced that its acquiring Pru's 401(k) business. And I guess, my question, it surprised me a little bit just because Great-West is still in the process of integrating their MassMutual block. But it obviously raises the bar in terms of scale by competitors. I guess, just in light of that transaction, just curious how you're viewing the market, your scale. Do you still feel like post the IRT deal, you have sufficient scale for the next several years? Or do you think this raises the bar for you to consider future M&A in 401(k)?

Dan Houston: Yes. Thanks, Tom for the thoughtful question. The first thing I'd say is I certainly like the valuation ascribed to the block of business. I think that speaks volumes about our platform, which I would emphasize is inclusive of more proprietary asset management. We have a lot of success in roll-ins and rollovers. We also have a lot of success around nonqualified deferred compensation and all the other drivers of our TRS business model. So, all that hangs together really well.

The other comment I'd make, Tom, is that this thesis that apparently is out there in the marketplace is the rationale behind why we bought the Wells Fargo IRT business in the first place, which was to gain scale, gain access to additional distribution capacity, certainly create new

capabilities and allow us to have a bigger footprint out there with distributors, marketers, and intermediaries.

So, frankly, we enjoy good scale today. We have good capabilities. We're constantly supplementing those and building on it from a digital perspective. But we think that we've got a really good place to fight from at this point in time. So, Renee, anything you'd like to add on top of that question, please?

Renee Schaaf: Yes, I think, Dan, you did a great job of covering exactly how we're thinking about it. It's clear that the market will continue to consolidate. And scale is important as our capabilities. We're really happy with the IRT acquisition in terms of what it did bring to us and does bring to us in terms of scale and increasing access to consultant channels that we may not have had before as well as really rounding out our set of capabilities to benefit not only the IRT customers that were acquired but our legacy customers as well. So, as we think about consolidation in the future, we're very mindful about the need to continue to watch our unit costs and scale. If acquisitions make sense in terms of scale and capabilities, we'll keep a close watch on those. But we're happy with the acquisition that we made, and we continue to watch the market very closely.

Dan Houston: Thanks, Tom for the question.

Tom Gallagher: Okay.

Operator: Our next question comes from the line of Humphrey Lee with Dowling & Partners.

Humphrey Lee: Good morning and thank you for taking my questions. My first one is on PGI. So, looking at the performance for this quarter, both fee income and margin were very strong, and you highlighted there's a component of performance fees. But even if you kind of back that out, the margin is still kind of around 44%. Just can you talk about the moving pieces for the strong margin for the quarter? And how should

we think about that in the near term, especially if the market conditions remain relatively stable?

Dan Houston: Yes. And it really was a really strong quarter across the board for PGI. I couldn't be more proud of the team. Pat, do you want to provide some additional comments and details here?

Pat Halter: Yes, Humphrey, thanks for the question. I think one of the things that I want to highlight is that we continue to see strong revenue growth because we have strong investment capabilities that are desired in the marketplace. And we're seeing the desire from retail, from retirement, and from institutional clients. So, our multichannel multi-distribution model is really playing well with capabilities that are desired in the marketplace. So, I think that's been a nice sort of revenue generator for us as an organization both in terms of sales and in terms of retention.

In terms of the margin question, Humphrey, if the macro market and markets continue to, I think, cooperate, we believe we're going to continue to generate, I think, these strong margins in the upper end of our guidance range, which is 37% to 40% and probably likely a little bit north of that 40% guidance range going forward as you kind of think about the expense control as we continue to have in place in the organization and our sort of view that our capabilities will continue to be desirable in the marketplace.

And so, I feel pretty good about the ability to continue to have some fairly strong margins in the second half of the year. I think we may have a little bit of additional sort of performance fees on the margin in the second half of the year also. But the margin outlook looks quite strong yet as I look forward into the second half of the year, Humphrey.

Humphrey Lee: Got it. Thank you for the color. My second question is related to Specialty Benefits. I think as you -- in Deanna's prepared remarks, you talked about dental, you had some severity in the quarter. I was just

wondering if Amy or Deanna can talk about like what you saw in the quarter and how has that trended kind of into July.

Dan Houston: Yes. Good question. Amy, please?

Amy Friedrich: Yes, sure. Thanks for the question. So, just to take a little bit of a step backwards, we always expect to see loss ratios in the first half of the year that are going to be greater than that second half of the year, just in terms of how these benefits get utilized. And in the first quarter, we saw the type of utilization that we expected. Second quarter, we would have assumed we drew down on that a little bit in terms of frequency and severity. And what we saw is frequency actually stayed pretty well within the ranges that we expected. It was severity that was a little bit higher. So, when we think of severity for dental, severity for dental is going to be those unit two or unit three procedures being done, so something all the way from a bridge or a crown to a filling. And so, I think what we would say there is we have really great plan design features, really great maximum features that tend to be sort of self-regulating mechanisms on those plans.

So, even if severity comes up a little bit in the second quarter, what we're going to see that second half of the year is that it's going to come back down. So, we're seeing a little bit more of those procedures. And again, I've heard lots of people speculate on what's causing that. We don't tend to speculate as much as we tend to make sure our pricing is aligned to what we're seeing in terms of the patterns. And again, we have great access to a bunch of in-network dentists who give us some good insight into this. So, what we're saying is that second half of the year, we think it's going to return to normal. Those types of things like severity don't tend to keep happening in second and third and fourth quarter because we've got plan design features that are good self-regulators.

Dan Houston: I think we've got that advantage, Humphrey, in addition to the fact that this business is annually priced. And coming out of a global

pandemic, I would expect some degree of volatility in our claims experience, so thanks for the questions.

Humphrey Lee: Thank you.

Operator: Your next question comes from the line of Andrew Kligerman with Credit Suisse.

Andrew Kligerman: Hey good morning. Just to maybe first layer on to Tom's earlier question about scale and multiples paid, we're seeing huge multiples being paid in emerging markets, specialty benefits, asset management. So, maybe just along the same lines, do you feel that you've got scale in those businesses?

And if so, when you do divest of the cited operations and you raised -- I think you had cited over \$1.5 billion or at least we think as much, would that more likely go to share repurchases as opposed to acquisitions, given the scale question?

Dan Houston: Yes, so appreciate that. One of the benefits we have just still being 30 days out of having reported on our strategic review -- and again, I won't reiterate all of what was said during the course of our Investor Day. But we literally interrogated every one of our businesses, our markets, our look-back and our look-forward. And so, we do feel as if any gaps that might exist around capabilities and scale are under our clear understanding. And frankly, we feel like we're in a very strong, competitive position across the businesses.

The ones we're exiting is where we didn't feel that the economics were in our best interest relative to a go-forward basis. And we felt there were other organizations that were better owners of these assets. We need to complete these transactions before coming to a conclusion on how we'll deploy those proceeds. But we are on the record already with investors that for the two-year period of time, we're going to deploy \$3 billion back in the form of dividends and stock buybacks. We feel we've got our arms around our capital position. We're in a very



strong position, which gives us frankly a lot of optionality. I'll ask Deanna if she has any additional comments she'd like to make here.

Deanna Strable: Yes, I think one of the things we did lay out at Investor Day is the fact that one of the reasons why we have a low leverage ratio, it does allow us to fund any potential inorganic acquisitions through the issuance of more debt as well as our strong free capital flow position allows us to use some of the near-term free capital flow to also help aid in that. So, obviously, we're going to be looking to see if there are organic or inorganic opportunities. I think what Dan said is we feel good about the scale and the capabilities of our go-forward growth strategy. But we'll continue to be good stewards of capital. Our plan is to return that capital release from transactions unless there is a clear value-accretive opportunity to deploy it in another way. So, hopefully, that helps.

Dan Houston: Thanks Andrew. Do you have a follow-up?

Andrew Kligerman: Yes, a follow-up -- very helpful answer. I'm just curious now in RIS-Fee, now that you've brought the IRT onboard, sales were \$3.3 billion, up from \$2.8 billion year-over-year. Just kind of curious now that it's all onboard, what kind of sales trends you will likely see as you're now expanding your reach into larger markets? So, could we see a big uptick in sales?

Dan Houston: Yes, I think one way to look at that is we'll help frame that as we get fully integrated, as we sort of set our targets here in 2022, they might be premature. Your observation is a good one with regards to increase in sales from \$2.8 billion to \$3.3 billion. I'd also remind you that embedded within those PGI numbers in terms of strong results, we had another \$3.8 billion of DCIO sales. And so, these strategies are working very well.

And maybe with that, I'll ask Renee to talk a little bit about the markets that we have historically have not played in that will be additive to our existing distribution strategy. Renee?

Renee Schaaf: Yes, Andrew, thank you for that question because I think there's a lot to be said in terms of the organic growth that we're seeing within RIS-Fee. So, maybe starting with first quarter, you'll recall that in first quarter 2021, we had about \$8 billion of sales, which was an exceptionally strong result and included a couple of very large plan sales in there as well as strength in the small to medium-sized market. So, that indicates that we are, we can and we will play in the large plan market, we are successful and we're winning. Then we turn our attention to the second quarter. And what we see is a very strong \$3.3 billion, which is up 17% from a quarter -- a year-ago quarter.

The second quarter sales were really dominated by small and medium-sized plans, which again speaks to the fact that we have strength in small-, medium- and large-sized plans. We communicated at Investor Day and in last quarter's call that we are seeing a really nice increase in our institutional or our large plan pipeline. And we're very pleased with that. And it reflects the fact that we're making good inroads and relationships with top-tier consultants. The large plan market, however, has a longer sales cycle. So, we would anticipate that those sales will hit in 2022. So, all said, very pleased with the momentum that we see in organic growth. It's strong across small, medium and large plan markets and the -- we continue to be very optimistic about our capabilities and our ability to compete in this marketplace.

Dan Houston: Thanks, Andrew for the question.

Andrew Kligerman: Thank you.

Operator: Your next question will come from the line of Jimmy Bhullar with JPMorgan.

Jimmy Bhullar: Hi, good morning. So first, just had a question on investment performance. And if you look at the data that you disclosed on your funds, it seems like the one-year performance is worse than three-year, that's worse than five-year and that's down from the 10-year.

So, just wondering if this is because of a few funds or more broad-based. And then what the implications of this are in your ability to attract flows?

Dan Houston: Very good. Pat, please?

Pat Halter: Yes, thanks for the question. I think in terms of our performance, we still feel very positive about our long-term performance. Our one-year has dropped off a little bit. And specifically, it dropped off in our U.S. and non-U.S. equity performance. As you know, the U.S. equity markets in the first half of the year, because of just a strong stimulus, fiscal and monetary, optimistic growth, the environment was really one of owning risk in that marketplace and you're rewarded for that. Our sort of overall fund sort of approach is more -- it's not universal, but it's probably biased more toward higher quality and lower -- higher quality than lower quality sort of the companies. And that's probably held back a little bit of our performance.

Our investment approach process, we have a lot of conviction that will come back again. We've had periods in the past where we had sort of this risk-on approach and our high quality, low vol sort of style has been made out of favor. As we talk to our clients, they know our process. They know what they're investing in, in terms of our processes. They feel very confident and comfortable with what we're doing. So, we have not seen any drop-off at all in terms of either retention or sales because of that. So, that's probably the most important part of the sort of, if you want to say, less drop-off or a little bit of a drop-off in performance.

Dan Houston: Jimmy, do you have any follow-up?

Jimmy Bhullar: Yes. And then on the international business, your flows seem weak across a number of regions, so if you could just talk about that. And then also on the Chilean pension market, given how the election has

gone thus far, how do you feel about the sort of any potential pension reform there?

Dan Houston: Yes, all good questions. So, the first place I'd start is in relative to PI net cash flow. I think it was a challenging quarter. But frankly, on a trailing 12-month basis, you've got \$4.4 billion of positive net cash flow. That's three percentage points at the beginning of year account balances. It's up 10% compared to the trailing 12 months' second quarter 2020. And that's up 25% on a constant currency basis. I could get into the details.

But examples might be, for example, last quarter, we saw \$900 million positive in Southeast Asia. In Malaysia, negative \$300 million this quarter entirely attributable to an institutional money market fund moving in and moving out. So, again, when we look at our long-term equity strategies across the board, they're actually holding up really well in these markets. And where there is downward pressure, some of that, of course, is coming from -- they are frankly still struggling from an economic recovery perspective, in large part due to COVID and some of what's happening here in the U.S.

So, at the end of the day, we still feel we've got a really strong position. As you could see, when you adjust OE for encaje inflation in the Chile variable investment income, it's a good result for PI and still retaining 32% margins.

As it relates to the Chilean elections, that's interesting. A couple of candidates who are challengers here have what I would consider and categorize as more moderate approach to AFP reform. Obviously, we're involved and engaged and talking about those topics with regulators on the value creation to Chilean citizens and how the AFP system has actually worked quite well. It's frankly what's allowed them to use it as a funding vehicle as they've authorized these 10% withdrawals coming out of the AFP system.

So, we've got a lot of work to do to continue to inform legislators, inform the public. It's a concerted effort to do that. It has served the

people there well in the past. And we believe it still will survive going forward. As you know, we'll have the first round of elections in November, second round of elections in December. And we'll continue to be vigilant in making sure that our point is made relative to the strength of the AFP. Did that help?

Jimmy Bhullar: Yes. Thank you.

Dan Houston: You're welcome. Thanks for the question.

Operator: Your next question comes from the line of Ryan Krueger with KBW.

Ryan Krueger: Hi thanks. Good morning. I just had one quick one in terms of the guidance that you had given at the Investor Day, the 9% to 12% EPS growth. I know you included stranded overhead. Did you include anything for lost fees that you earn on the general account assets that would be reinsured within PGI?

Dan Houston: Deanna?

Deanna Strable: Yes, that was included, Ryan.

Dan Houston: So, the loss fees on GA were included in the 9% to 12%, yes.

Ryan Krueger: Okay. Thanks. That's all I had.

Dan Houston: Thanks Ryan. Appreciate it. Next question.

Operator: Our next question comes from the line of Erik Bass with Autonomous Research.

Erik Bass: Hi. Maybe just a follow-up on Ryan's question on the EPS growth guidance, I do continue to get some questions from investors. So, I just want to clarify that we're looking at it correctly. But I think you're

starting from a base of \$5.67 in 2020, then assuming 9% to 12% growth, which would imply a range of roughly \$7.35 to \$7.95 for 2023. And I believe the growth rate assumes the \$110 million pretax drag from lost earnings from the businesses you're exiting and you're not assuming any benefits from redeploying that capital. So, I guess, first, do I have that baseline correct? And then if so, should we assume that a sale of the fixed annuity and/or SGUL blocks would be accretive to your EPS growth as you redeploy the proceeds?

Dan Houston: Deanna?

Deanna Strable: Yes, you are correct. And then just following up on that last question from Ryan, it also included an estimate around stranded costs and PGI lost revenue from the general account. Obviously, those last two items are estimates, and they would be dependent on the specifics of the transaction. But you have that right.

And so again, relative to that guidance, there could be some upside relative to the deployment of the proceeds from the transaction. Obviously, the magnitude of that will depend on the process and the specifics of the deal. But again, the confusion was probably that I made a comment, slightly dilutive. Slightly dilutive was not relative to that outlook. It was relative to a BAU result that obviously would be hindered by that lost earnings that I just discussed.

Dan Houston: Erik, does that help? Are we clear on that one?

Erik Bass: Yes, thank you. That helps. And then maybe the follow-up on it, could you give a sense of what you're assuming for growth in the RIS-Spread and Individual Life businesses in your guidance? And should we assume that earnings from these businesses are flat or maybe even down over the period, given the planned product exits from the stranded costs?

Deanna Strable: Yes, what I would say there is standard costs are not just in those lines of business. They go over into PGI and they actually go across the

entire enterprise. The reason we didn't go into a walk-forward on those two lines of businesses as well as obviously, corporate is those are the ones that are going to be impacted by the transactions. And likely what we expect to see is somewhat of a reset and then a growth that would be more typical from what we have seen up to this point. And so again, I think that's one that we'll give you more insight as we transact and as we go forward. But again, the three that we didn't give you specific guidance are rolled up into that 9% to 12%. But that's how I would think of it as somewhat of a reset and then a growth from there.

Erik Bass: Perfect. That's helpful. And so just take out the \$110 million is a fair assumption?

Deanna Strable: Yes.

Erik Bass: Got it. Thank you.

Dan Houston: Thanks, Eric for the question.

Operator: Your next question comes from the line of John Barnidge with Piper Sandler.

John Barnidge: Thank you very much. Can we talk maybe a little bit about the PGI in the equity product? Because I look at the withdrawal activity experience, it looked like it was the lowest level since 2Q 2016. And clearly, the turnaround in equity flows really helped PGI there. Can you maybe talk about what you're seeing from a withdrawal activity perspective as well as your expectations going forward? Thank you.

Dan Houston: Pat, some insights?

Pat Halter: Yes. So, John, thanks for the question. I think on the institutional side, we're actually seeing a positive net cash flow on the equity side, some small-cap, international are two notable areas. We're also -- I think I

mentioned at our Investor Day, discussion that Origin, which is one of our emerging market investment boutiques, has had some very strong sales growth and they continue to attract some institutional sort of sales activity. So, the institutional side, the activity looks quite good on the equity side.

I think what you're probably referring to, John, is what you're seeing maybe within our platforms. Platforms, we are seeing some withdrawals within the mutual fund, particularly the mutual fund. We're actually seeing some, I think -- on a broader sort of commentary, we're seeing actually some positive net cash flows in our international wealth, [Dublin] platform, and our SMA sort of product line, specifically with Aligned Investors, which is a very strong sort of mid-cap, large-cap manager. So, it's going to be a mixed bag in terms of mutual funds. But I think we still believe we have a very strong lineup of equity capabilities across the different segments that we cover, John.

Dan Houston: Follow-up, John?

John Barnidge: Yes. Great. Thank you for the answer. Yes, Deanna, a follow-up maybe on the specialty benefit side and the increased loss ratios in dental and vision in the first half of the year.

Can you talk about addressing that from a pricing dynamic on renewal and how you're maybe thinking about whether this could lead to more regular frequency than pre pandemic since we all suddenly became aware dentist offices could be closed on a long-term basis?

Dan Houston: Amy, please?

Amy Friedrich: Yes. Sure. Happy to give an answer to that. So, I think Dan mentioned that at the tail end of the question that we took before, but that is that the dental business is one of our highest product lines in terms of annually renewable. So, when we look at those things that are going



to be naturally repriced every year, that's going to include dental. We do trend. We do a look on trend on a regular basis. We do a lot of regular pricing scrutiny, in fact, more than once a year, probably on more of a quarterly basis to look at our dental prices exactly what they need to be in the marketplace.

So, the good news there is the brokers and employers who have those products are used to sort of that regular cadence. And so, what I would say we're seeing first half of the year, though isn't probably indicative of big pricing changes. I would say we tend to look at those over the course of the full year. Now, the pandemic has put some different dynamics at play, so we'll continue to be really agile in responding to those. But if the second half of the year emerges the way that we believe it's going to, we will not be facing a large pricing movement.

Now, what I would say is that when we look at April and May in terms of their utilization and severity, those were more notably higher than even what we're seeing in June and July. So, those getting to taper off. So, that's increasing our certainty that, that second half of the year is going to behave on a more normalized pattern. And so, I don't foresee we're going to have to make large movements.

Dan Houston: Hopefully, that helps, John.

John Barnidge: It does. Thanks for the answers and good luck.

Dan Houston: All right. Thank you so much.

Operator: Your next question comes from the line of Tracy Benguigui with Barclays.

Tracy Benguigui: Thank you. Turning to your strategic update, I know you're not saying a lot about it. But is it fair to say that an FA block sale could potentially happen sooner than ULSG since on the buyer side, there's a lot more saturation from alternative asset managers?

Dan Houston: Yes, I think the best way to think about it is we view these as potentially one transaction. And there's no shortage of interest in these blocks, whether it's the annuity or the life. As you can expect, we are pulling a lot of data together and initiating the process. But we -- our intention is to go in, is to maximize shareholder value and whatever structure that is. You're correct in making the assumption that there is sort of a better path or a more well-worn-out path relative to the annuity blocks than something like ULSG, but again, we feel like there are good buyers out there. Deanna, anything you'd like to add to that?

Deanna Strable: No, I think if we think about the outreach that we've had since the announcement and the discussions that we've had, we do think there's a path for execution on both of those. We're diligently focused on that. And we think that we'll have further announcements over the next 6 to 12 months on both transactions.

Dan Houston: On full completion. Tracy, a follow-up?

Tracy Benguigui: Yes. My follow-up is I'm wondering why you wouldn't refinance your \$300 million 2022 debt maturity, would still be in the 20% to 25% leverage range and it would leave more room to get to a capital return at the higher end of your range?

Deanna Strable: We are planning to refinance that. So, is your question why we would do that?

Tracy Benguigui: Okay. Yes, it wasn't clear to me in your comments. I thought you just mentioned you'll pay that down, which felt to me that there was no refinancing, but you're—

Deanna Strable: No, we are planning -- we are not refinancing. Our plan is to pay that off when it comes due in the third quarter of 2022. If you remember back, we, during the pandemic, took the opportunity to issue \$600 million of extra debt due to uncertainty in the marketplace at very, very attractive rates. Fast forward today, we found that we do not

need that for that volatility or any credit pressure from the pandemic. And so, we felt it was prudent to again take down the debt and retire that \$300 million that comes due in third quarter of 2022.

Tracy Benguigui: Okay. So, I should think about that as prefunding and more likely you would want to operate at the lower end of that range?

Dan Houston: That's correct. That's exactly right.

Deanna Strable: Correct.

Tracy Benguigui: Okay. Thank you.

Dan Houston: Thanks Tracy.

Operator: Your next question comes from the line of Suneet Kamath with Citi.

Suneet Kamath: Thanks. Good morning. I wanted to come back to the scale issue in RIS-Fee and maybe just ask for your thoughts on something. So, last week, Empower said on the call that they viewed scale in kind of a DC business as 6 million plan participants, which was up from 2 million five years ago.

And I guess, what surprised me was just the rate at which that changed, like a threefold increase in plan participants to get to scale. And I guess, I'm wondering if you had any thoughts on that change, like that pace of change or if there's something different about your business mix or your target market that maybe would be inconsistent with that commentary.

Dan Houston: Yes. Everyone's entitled their own views and opinions on what is the right scale. And those people with a lot of scale like Principal would argue that having more is better and it helps drive down your unit cost.

So, I would agree with the overall arching view that more is going to be better. And then you have to start focusing on the things that really

matter, which is what is the quality of the customer service that you're able to deliver, what are your capabilities? And that gets around the Total Retirement Suite in DB and nonqualified. And clearly, the importance of defined contribution, 401(k) and, of course, what is that customer experience.

So, the scale is one key component. It's an important component. We're there, and we're going to continue to enhance and deploy technology to help us be more efficient. Renee, I don't know if you have any additional thoughts on this topic?

Renee Schaaf: Yes, thanks. And Dan really, you've nailed the really critical pieces of this. I think the thing to remember, when we talk about our value proposition and how we compete in the marketplace, we differentiate on several things.

First off is Total Retirement Suite and our ability to take our capabilities far beyond defined contribution. Defined contribution, there's no doubt, that is a highly competitive marketplace. And record-keeping fees are being driven down not only by competition but also just automation and digitization of the business.

But when we look at our ability to pull together multiple retirement plan types and serve that up to the plan sponsor and the participant in a fully integrated basis using proprietary capabilities and technology, it sets us apart. And the same thing is true with the participant and the plan sponsor experience that we deliver, again fully integrated across multiple plan types.

And last of all, our ability to work closely with a global asset manager that truly is expert in retirement. And so, all of those things create a differentiation that allows us to successfully compete against other competitors that might be more solely or primarily focused on the defined contribution market.

Dan Houston: Does that help, Suneet?

Suneet Kamath: Yes. No, that makes a lot of sense. Thanks for that. And then I guess my follow-up for Deanna, on the \$110 million of pretax earnings from the blocks that you plan to divest, our assumption is that the vast majority of that is from the fixed annuity block and there's not much of an earnings contribution from the SGUL block.

Is that a fair characterization? And can you give any help in terms of that \$1.5 billion of capital that's in those businesses, what the split is between the two blocks? Thanks.

Deanna Strable: Yes, I think that's a fair assumption on the earnings. I don't think we feel it's prudent to split those numbers into the underlying pieces, given the fact that we are planning to market the divested business as a single transaction and we're already providing incremental disclosure to interested parties. We'll take the opportunity when we announce the transactions to determine whether disclosing more details on the specific blocks that we transact is warranted. But at this point, I think your assumption on the earnings split is directional.

Dan Houston: Hopefully, you can appreciate the rationale behind the discussion, Suneet.

Suneet Kamath: Yes, understood. Thank you.

Dan Houston: Okay. Thank you.

Operator: Your next question comes from the line of Josh Shanker with Bank of America.

Josh Shanker: Yes, sorry about that. Thank you. I just had a question about calculating this inflation issue in Brazil. Is that a year-over-year change or is that a quarter-over-quarter? And if the if the quarter were to end today, how could we sort of translate that into an outcome for the quarter?

Dan Houston: Deanna, do you want to shed some light on that?

Deanna Strable: So, a couple of things I'll talk about there. And again, that is a quarter impact. And so, this is all coming about. And if you actually go back to the -- it's actually a true-up is basically what it is, right? And so, we have to calculate based on this closed block of business that we have not sold since 2001.

Dan Houston: There's a little bit of feedback coming in on the line. You might want to go on mute.

Josh Shanker: I'm going to mute while you're talking.

Dan Houston: Okay. Thank you.

Deanna Strable: Yes. So, the liability and the underlying contract provision links the inflation to an index, the IGPM. Due to unavailability of those assets, only about 50% of the assets backing that liabilities we're able to exactly match to that indices. The other remainder, we track to a retail inflation index, the IPCA. Over a long period of time, this has actually been very benign. Back to 2011, it's actually been a cumulative benefit. But it has been a hit over the last 12 months.

There's a portion of that in the given quarter that is a lag. But the majority of that impact is the fact that there's a mismatch between what we're earning on the assets versus what we're crediting on the liability. We can take it offline with IR and get into some more details of how you could potentially track this a little bit more closely. But we do believe that over the long term, this will come back into more congruence between the two indexes. But we have a little bit of a mismatch, just given the economic and financial volatility that's occurring in the Brazilian market.

Dan Houston: It's also probably worth noting Josh that this is a –

Josh Shanker: Yes, go ahead.

Dan Houston: This is an active conversation with the regulators and the appropriate authorities. They're aware of it. There's a lot of domestic players that are obviously impacted, including our joint venture partner. So, this is getting a lot of airtime and a lot of debate and discussion on what is an appropriate solution. I cut you off, go ahead, your question?

Josh Shanker: I'll take the month-to-date conversation offline with you guys and figure out what I can do there. I just wanted to change to PGI for a second. The results were very good in the quarter. I'm wondering if there is a strategy shift going on, where you're able to push more money into the higher fee-generating strategies. And is there -- can we talk about really what led to the really strong results in the quarter?

Dan Houston: I don't think we want to ever push. I think the idea is that we're going to have very attractive products for our customers. And right now, the performance and the asset classes line up well with what customers are asking for. But Pat, some additional color?

Pat Halter: Yes, Josh, I think it really is that we have an incredibly very vibrant marketplace right now, both in terms of market conditions and in terms of the flow of capital. And some of our flagship capabilities, like real estate, which are absolutely higher fee generation capabilities, are in vogue right now. So, I think that's one area just to highlight. We're very sort of alpha-producing active specialist capabilities, where we're really providing that sort of upper first and second quartile performance. We're getting a lot of strong support with that.

And I think our multichannel distribution model, our distribution teams led by Tim Hill and Kirk West, both on the platform side, the U.S. side and on the international side, are really performing very well right now. So, we seem to be doing really well, both in terms of the capabilities that we can offer to the marketplace and getting those capabilities to the broad reach of the retail retirement and the

institutional marketplace. So, it just seems to be coming together quite nicely right now.

Dan Houston: Thanks Pat.

Josh Shanker: Thank you for the answers.

Operator: Our final question will come from the line of Mike Ward with UBS.

Mike Ward: Thanks for fitting me in. Good morning. I was just wondering if you could maybe frame the strategic review results, you recognizing you still have to get through the business exits and de-risking that you've identified, which is no easy feat, I'm sure. But I'm just wondering if we should think about the review as being largely complete or is it sort of ongoing? Was this kind of the first step? Could there be more incremental de-risking or divestment in other lines over time?

Dan Houston: Yes, I really appreciate the question, Mike. And what I would first say is our Board and our Board Finance Committee just did an incredible job under Clare Richer's leadership and Scott Mills, our Lead Director. As I said earlier in my comments, it was an incredibly thorough process. We've put in some additional internal mechanisms to monitor performance and to ensure that the go-forward strategy lives up to our investors' expectations and our expectations. And so, I don't think it's ever complete. I think the reality is you're constantly looking at your portfolio for those businesses and those markets that can drive growth to reward investors. And so, I'd say Phase 1 is certainly in play as we speak. And I would look for us to continue to look very closely at these businesses in these markets to make sure that they're meeting our appropriate thresholds and we'll continue to update investors as we go along. Did you have a follow-up?

Mike Ward: No, that was it. Thanks very much guys.

Dan Houston: Appreciate the question.



Operator: We have reached the end of our Q&A. Mr. Houston, your closing comments, please?

Dan Houston: Yes. Thank you. And again, if I were to summarize, I think it was a very strong quarter, both measured by financial and customer metrics, strong return of capital and advancing our strategy. My closing comment really before, and those were the same comments I made when we closed out our Investor Day, which was we're going to stay focused on our long-term growth strategy. We are committed to creating long-term shareholder value. We're confident in our ability to execute and we've demonstrated it historically and again, this quarter was no exception. And we've got 38 million customers around the world to help achieve financial security. And that's job one for us. So, appreciate your time today and look forward to follow-up conversations with all of you. Thank you.

Operator: Thank you for participating in today's conference call. This call will be available for replay beginning at approximately 1 o'clock P.M. Eastern Time until end of day, August 3rd, 2021. 7696420 is the access code for the replay. The number to dial for the replay is 855-859-2056 for U.S. and Canadian callers or 404-537-3406 for international callers. You may now disconnect.

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