

# Principal Financial Group®

## 2Q 2023 Earnings Call Transcript

July 28, 2023

9:00 a.m. CT

Nasdaq: PFG



### Call participants

#### Executives

Dan Houston: Chairman, President & CEO

Deanna Strable: Executive Vice President & CFO

Amy Friedrich: President – Benefits and Protection

Pat Halter: President - Principal Asset Management

Chris Littlefield: President - Retirement & Income Solutions

Humphrey Lee: Vice President - Investor Relations

#### Analysts

Suneet Kamath: Jefferies

Ryan Krueger: KBW

Tom Gallagher: Evercore

Erik Bass: Autonomous Research

John Barnidge: Piper Sandler

Wes Carmichael: Wells Fargo

Jimmy Bhullar: JP Morgan

Alex Scott: Goldman Sachs

Tracy Benguigui: Barclays

Mike Ward: Citigroup

## Presentation

Operator: Good morning, and welcome to the Principal Financial Group Second Quarter 2023 Financial Results Conference Call. There will be a question-and-answer session after the speakers have completed their prepared remarks. If you would like to ask a question at that time, simply press star and the number one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. 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 will now turn the conference over to Humphrey Lee, Vice President of Investor Relations.

Humphrey Lee: Thank you, and good morning. Welcome to Principal Financial Group's Second Quarter 2023 Conference Call. As always, materials related to today's call are available on our website at [investors.principal.com](https://investors.principal.com). Following a reading of the safe harbor provision, CEO, Dan Houston, and CFO, Deanna Strable, will deliver some prepared remarks. We will then open up the call for questions. Others available for Q&A include Chris Littlefield, Retirement and Income Solutions; Pat Halter, Asset Management; and Amy Friedrich, Benefits and Protection.

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, Humphrey, and welcome to everyone on the call. This morning, I will share key aspects of our second quarter financial results and some notable performance highlights. Deanna will follow with additional details and an update on our current financial and capital position. Our leading position in the U.S. small to midsize business market contributed to healthy growth across our benefits and protection and retirement businesses. Across the enterprise, we continue to balance investing for growth in our business with disciplined expense management and favorable 2023 equity market performance is starting to benefit revenue in our fee-based businesses.

Starting on slide three, we reported \$376 million of non-GAAP operating earnings, or \$1.53 per diluted share in the second quarter. Excluding significant variances, earnings per share increased 4% over the second quarter of 2022. Our second quarter results highlight our focus on our growth drivers, the power of our integrated offerings and the value of our differentiated distribution and joint venture partnerships and our deep customer relationships.

During the quarter, we delivered on our capital deployment strategy, investing for growth in our business and returning \$255 million of excess capital to shareholders through share repurchases and common stock dividends. Our businesses generated strong free capital flow in the quarter, and we are on track to deliver on our targeted 75% to 85% for the full year. We ended the quarter with nearly \$675 billion of total company managed AUM, a 2% increase from the first quarter. Improved market performance and positive impacts from foreign currency more than offset a negative \$3.9 billion of net cash flow. Across the industry, active asset managers were challenged by net outflows in the quarter.

While our real estate net cash flow was positive in the quarter and year-to-date, it was pressured relative to prior periods. Looking ahead, we are beginning to see greater opportunities to deploy new money into the real estate marketplace. We have a real estate pipeline of approximately \$7 billion of committed, yet unfunded mandates that are expected to be

invested over the next 12 to 18 months as valuations and market conditions stabilize.

The third quarter is off to a good start for global asset management, as we are seeing momentum build across high yield and core fixed income, specialty equity strategies, local solutions in our international markets and select real estate property types such as data centers. We are well positioned to capture net cash flow across our platform as investor appetite for risk assets, returns and our yield-oriented capabilities become attractive again as we approach the end of the Fed rate hike cycle.

As shown on slide four, investment performance improved significantly across our Morningstar rated funds and composites, including our fixed income, asset allocation and actively managed equity strategies. We're continuing to create new products and diversify across investment vehicles. We are bringing to market new ETFs that offer investors additional ways to access some of our most popular solutions.

In mid-July, we launched the Focused Blue-Chip ETF to offer investors another way to access our large cap strategy, which has generated strong long-term returns for our investors. We also launched a new equity strategy with our asset management joint venture, CCB Principal Asset Management. This strategy offers investors an offshore opportunity to invest in the new energy industry in China, including renewable power, electrical equipment, energy storage and electric vehicles. We are working through the final regulatory stages to make the UCITs fund available across much of Asia. With this positive momentum and recovery in our investment performance, we're optimistic for asset management net cash flow in the second half of the year.

In Principal International, total AUM increased 4% to \$174 billion during the quarter, primarily driven by favorable market performance and foreign currency translation. I've had the opportunity to engage in person with many of our long-standing global joint venture partners in the first half of the year. We have established deep relationships combining our global expertise with their market leading distribution

capabilities. I have great confidence in the differentiated value of these relationships to continue to enable preferred access to global high growth markets.

Across U.S. Retirement and Benefits and Protection, revenue is benefiting from a strong employment market, especially within the small to mid-sized business segment, though we are seeing moderation in employment growth from record highs, wage growth has accelerated. These employment trends, coupled with strong sales retention are contributing to our continued above market premium and fee growth in Specialty Benefits, which increased 8% over the second quarter of 2022.

Capitalizing on opportunities, we launched a hospital indemnity insurance product in the second quarter. This product complements our existing core workplace benefits, rounds out the voluntary products portfolio and will further drive supplemental health growth within Specialty Benefits. In Retirement, net cash flow was pressured in the second quarter due to an uptick in large plan lapses. Large plan sales and lapses fluctuate quarter-to-quarter and can have a significant impact on net cash flow, but they generally have a lower overall impact on revenue for our Retirement business.

Looking at the SMB segment within Retirement, net cash flow was a positive \$265 million, driven by a 16% increase in transfer deposits and a 9% increase in reoccurring deposits, stronger results than the overall block compared to the year ago quarter. We expect Retirement sales to pick up in the second half of the year, with strong full year growth across the SMB and large plan segments. We remain focused on driving profitable growth in RIS, leveraging our leading market position and full suite of retirement solutions. We continue to expect to be within our net revenue growth and margin guidance for the full year.

Bottom line, we are excited about the growth opportunities across the enterprise. I'm confident that our focus on the high growth markets, combined with our differentiated product suite and distinct set of distribution partnerships, will continue to drive value for our customers and our shareholders.

Deanna?

Deanna Strable: Thanks, Dan. Good morning to everyone on the call. This morning, I will share the key contributors to financial performance for the quarter, details of our current financial and capital position and an update on our commercial mortgage loan portfolio. Our second quarter results demonstrate the strength and resiliency of our diversified business model. Despite real estate-related market pressures on a number of key metrics, including total company variable investment income, as well as PGI net cash flow and revenue, we're starting to see signs of recovery and positive momentum in real estate and the broader investor market.

Reported net income was \$389 million in the second quarter. Excluding income from exited businesses, net income was \$325 million with manageable credit losses of \$37 million. Credit drift was a positive \$5 million in the quarter. On a year-to-date basis, credit drift has been a slight benefit to capital. We still feel good about our full year expectations for credit drift and losses despite the banking sector challenges earlier this year.

Excluding significant variances, second quarter non-GAAP operating earnings were \$415 million or \$1.69 per diluted share. As detailed on slide 12, significant variances had a net negative impact on our second quarter non-GAAP operating earnings of \$53 million pretax, \$39 million after tax and \$0.16 per diluted share. The significant variances included lower than expected variable investment income in RIS, Principal International, and Benefits and Protection as well as unfavorable impacts in Principal International from inflation and noneconomic LDTI discount rate impacts.

Variable investment income was positive in total for the quarter and at a similar level as the first quarter. Prepayment fees and real estate sales were immaterial, causing VII in total to be lower than our run rate expectation.

Macroeconomics were generally favorable in the second quarter as the S&P 500 daily average increased 5% from the first quarter and 2% from

the second quarter of 2022. The benefit to our fee-based businesses from this positive performance was partially offset by a decline in daily averages for small cap, mid-cap and international equities as well as fixed income.

Foreign exchange rates were a modest tailwind on a quarterly basis relative to the first quarter and the second quarter of 2022 but remain a meaningful headwind of \$12 million pretax on a trailing 12-month basis.

We continue to focus on managing expenses with pressured fee revenue across the enterprise. Through these efforts, compensation and other expenses have decreased at the enterprise level compared to a year ago despite inflationary pressures on salary levels and other expenses.

As a reminder, comparisons to a year ago are impacted by the reinsurance transactions that closed in the second quarter of 2022. Excluding significant variances, revenue growth and margins across the businesses were in line with our second quarter expectations and within our guidance ranges with the exception of PGI revenue growth.

Compared to a year ago, PGI performance fees and transaction and borrower fees were down approximately \$50 million on a gross basis, pressuring revenue, margin and pretax operating earnings. This decrease was anticipated in our full year guidance ranges. PGI's quarterly margin of 35% was within our 34% to 37% guided range and improved from the seasonally low first quarter.

Specialty Benefits pretax operating earnings, excluding significant variances, increased 29% over the year ago quarter, fueled by growth in the business, including an 8% increase in premium and fees and improved loss ratios driven by strong underwriting in disability and group life.

Turning to capital and liquidity, we remain in a strong financial position. We ended the second quarter with \$1.2 billion of excess and available capital, including approximately \$800 million at the holding company, which is at our targeted level, \$340 million in our subsidiaries and \$100

million in excess of our targeted 400% risk-based capital ratio. We returned \$255 million to shareholders in the second quarter, including \$100 million of share repurchases and \$155 million of common stock dividends, and we retired \$700 million of long-term debt during the quarter using the proceeds from issuances in the first quarter. As expected, we generated strong free capital flow in the second quarter and remain focused on 75% to 85% free capital flow conversion for the full year.

Last night, we announced a \$0.65 common stock dividend payable in the third quarter. This is a \$0.01 increase and is in line with our targeted 40% dividend payout ratio. We remain focused on maintaining our capital and liquidity targets at both the life company and the holding company, and we'll continue pursuing a balanced and disciplined approach to capital deployment.

As shown on slide five, our investment portfolio remains high-quality, aligned with our liability profile and well positioned for a variety of economic conditions. Specific to our real estate portfolio, it is high quality and positioned well to withstand potential economic stress. We revalued the portfolio again in the second quarter, reflecting the most recent cash flows and other underlying data. The commercial mortgage loan portfolio remains healthy. The current average loan to value is low at 47% and debt service coverage ratio is strong at 2.5 times. This is relatively unchanged from the first quarter and significantly improved from 2008 levels.

Turning to our office exposure within the CML portfolio, it is geographically diverse and high quality. 100% of the year-to-date 2023 maturities have been paid off and we are confident in the outcome of the remaining four office loans maturing in 2023. Throughout 2023, we are actively revaluing the entire office portfolio each quarter. As of the second quarter, we have cumulatively reduced the portfolio valuation by 25% from the peak. Our current valuation is approximately 23% below the implied index value, highlighting our conservative approach relative to the broader market. The current loan to value on our office portfolio



increased slightly to 57% as we further reduce valuations, while the debt service coverage ratio improved to 2.6 times.

We have the experience and a long established track record of navigating real estate cycles. We are confident in the quality of our real estate portfolio and remain diligent in monitoring it and proactive in servicing it. It is high quality, well diversified and a good fit for our liability profile.

We continue to be focused on maximizing our growth drivers of Retirement, Global Asset Management and Benefits and Protection, which will continue to deliver long-term growth for the enterprise and long term shareholder value. This concludes our prepared remarks.

Operator, please open the call for questions.

Operator: Thank you. At this time, I would like to remind everyone that, 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.

Our first question comes from the line of Suneet Kamath with Jefferies. Please proceed with your question.

Suneet Kamath: Great. Thank you and good morning. I wanted to start with RIS-Fee. If my notes are right, I mean, I think this is the third quarter in a row where we've seen some large case outflows. And I get that these sometimes are low fee, but just wondering, is there something common about these outflows that we've seen over the past three quarters in terms of the type of cases or where it's going? Just some additional color on that and what the outlook is for large case flows kind of going forward?

Dan Houston: Yeah. Good morning, Suneet, really appreciate the call, or the question, and I'll have Chris get right into it.

Chris Littlefield: Great. Thanks, Suneet. Thanks for the question. Good morning. I think there's a wide range. I think as we expressed in the prior quarters, they

were limited to a couple of large ones. One was a decision that we had made with respect to whether it was a good fit for our business and the other was a choice by the plan sponsor. And so when you look at the reasons for the lapses in the large case, you just see a lot of volatility in the activity and a lot of reasons for the lapses. We see M&A activity that's impacting it. We're seeing a difference in the experience following the transition onto the platform, a reluctance to make changes to make the plan more streamlined or a change in pricing.

So there's a wide range of reasons why these lapses are occurring. And so we certainly have seen the increase in large case lapses. That has really been offset by continued strength on the SMB side. So I don't want to lose the fact that we see great resilience there with recurring deposits up 9% and transfer deposits up 16%.

I think the other thing you're seeing in the first half of the year; you're seeing a little bit of timing activity. I think as Dan pointed out, we see really good momentum heading into the second half, again, speaking to some of that volatility of large case activity. And so I think we sit really in a good position there. And while we--I mean, when we think about the pipeline, we have a healthy pipeline, increase our activity, RFP activity. We see strong sales growth for the full year across SMB and large, but there is that volatility in large plan activity and we do expect some additional pressure on that lapse activity in the second half.

It's really difficult to give you an outlook because, as you know, the second half is a very active period of time for plan change activity. And so it's really difficult and you can have things that you think are going to transition in December and move to January. So it's really hard to predict. But again, we will see strong growth for the full year across SMB and large, but we do see some additional pressure in lapses.

Dan Houston: That help, Suneet?

Suneet Kamath: That does. And then my second question is just on PGI, I guess. Would love a little bit more perspective on your confidence in terms of flows

improving in the second half. Maybe a read on what you're seeing so far early in the third quarter. And sort of relatedly, we have noted that the fee rate has been kind of coming down over time. And just curious if that trend--do you expect that trend to persist going forward or should we expect that to sort of inflect? Thanks.

Dan Houston:

One thing we know for sure, Suneet, is in that wealth management, retail space, there's a lot of money that's gone to the sidelines on money market and bank deposits. And yet, as we look through there and look at some of our asset management capabilities that we discussed in our earlier comments, prepared comments, we do feel really good about the second half of the year. But with that, I'll have Pat respond accordingly.

Pat Halter:

Suneet, thanks for the question. As Dan mentioned, we are very constructive on the second half of this year in terms of our outlook relative to net cash flow. As you can imagine, the market tone has very much improved. We're starting to see momentum in terms of capital raising and that's playing into our strong capabilities and the sort of suite of capabilities that we can offer in a marketplace that now has a little more of a flow toward risk on assets.

Let me start off with just some of our capabilities and where I see our capabilities relative to meeting those sort of growing flows. First is in real estate. As you know, we've had a very strong, I think, sort of capability in real estate, and that's really starting to see some increasing activity as the market start to get to a better place in terms of valuations. As Dan highlighted, we have a \$7 billion unfunded committed capital position in real estate now, so we're well positioned to take advantage of the markets as they develop. And you probably will see us increasing our net cash flow reporting in the second half of the year as a regard of that, and there's probably three areas you're going to see.

The first one is probably in our increased activity in terms of acquisitions. We actually are pursuing a very large portfolio as we speak in terms of an acquisition. That should create, I think, a very strong net cash flow in the second half of the year.

You're also seeing, because we are a very strong, sort of high performing manager in real estate. We're actually seeing takeover existing portfolios from poor performing managers. We think that's a new area for us in terms of potential net cash flow.

And then the third is just our normal increase in activities from funding of our institutional funds and institution investors are starting to get back engaged in the marketplace again. So very positive and constructive on that front, and not just in the U.S. but in Europe and also, in terms of some of the activity now that we have developed in terms of China with our joint venture in China with CCB, and that's in the industrial space.

On the public market, Suneet, really, the investment performance that Dan highlighted has given us greater confidence that, again, across the public asset classes, equities and fixed income, but there's favorable market sentiment that's developing. And we're always seeing this in terms of positive net cash flow in July. But we're seeing money deployed into things like Aligned, our mid-cap strategy, we're positive about that. In our income specialty capabilities like high yield, we're seeing, I think, positive activity there. So I think the results should be less muted, sort of redemptions, increase in sales, in our mutual funds and hopefully in our SMA strategy going forward. And then I think we're constructive on that also.

PI is actually off to a good start also, both in Southeast Asia and in Latin America, particularly Brazil.

So I think the second half of the year, if the markets continue to behave relatively well, we are constructive on growth, and I think we have some early indicators that we should be constructive on growth.

Relative to your second question, Suneet, in terms of base management fees, I think one of the things that we're very proud of is to manage to that 29 basis point base management fee that we've had for many years, frankly. Obviously, as you highlighted, it's dipped a little bit to 28.4 basis

points. I think that's somewhat due to the quarterly decrease in the flows we had in the second quarter, and that's driven by the mix of business as net cash flows were leaving at higher rates of return than our average block and that's why you saw that diminution in the 29 to 28.4.

But as I kind of think about the trailing 12 months and then I look forward, trailing 12 months has been strong at 28.9. And as I just highlighted in terms of constructive outlook relative to the activity for the second half of the year, back half of the year, we do think we can really improve that 28.4 back to the 29 range and that's our expectation as we look forward into the second half of the year, particularly if the equity markets continue to stay where they're at and we continue to see the mix of assets that we think we can garner in the net cash flow discussion I just provided to you, Suneet.

Dan Houston: Hopefully that was helpful.

Suneet Kamath: Yep, very good. Thank you.

Dan Houston: Just one comment I want to follow up on with regards to Chris's explanation when he said M&A, just for those less informed on this. In the SMB market, there's not a lot of M&A. In the large case market, there does tend to be a lot of that. A lot of times, these are publicly traded companies or large private companies. And when the much larger plan comes in and acquires that smaller organization, we could be the smaller organization, oftentimes, it goes to the acquiring company and there was a fair amount of that activity and that's probably a new narrative for us as our large plan market has grown at Principal.

Next question, please.

Operator: Thank you. Our next question comes from the line of Ryan Krueger with KBW. Please proceed with your question.

Ryan Krueger: Hey. Thanks. Good morning. I had a follow-up on real estate. Just, I guess, level set. Can you give us some perspective on what your real estate

flows were in the first half of the year? I think they're included in the alternatives line that you provide, but I'm not sure if there's other impacts in there as well.

Dan Houston: Yeah. That's exactly right.

Pat Halter: Yeah. So Ryan, in terms of the flows in the first half of the year, they were muted relative to our historical sort of flow analysis. And I would suggest to you, that will change in the second half of the year, as I highlighted in my comments. Those flows were in the \$450 million range, relative to the net cash flows. If you look historically over the last five, six years, we've averaged about \$3 billion a year in net cash flow. And I'm anticipating that we could be looking at something along what we typically have had, as I think about the full year in 2023, and I hope that gives you a little bit of indication of our constructive view of our second half of the year.

Ryan Krueger: That's great. Thank you. And then on buybacks, they came down a little bit in the quarter, and I recognize there was a lot of market volatility probably earlier in the quarter, so just hoping to get a little more perspective on if you may ramp up buy back a little bit more versus the second quarter level in the second half of the year? Thanks.

Pat Halter: And we have full intentions on delivering on our full year outlook, but I'll have Deanna provide some additional context on the quarter.

Deanna Strable: Yeah. Thanks, Ryan. Where you ended there is exactly right. Obviously, early in the quarter, we were all seeing heightened credit and macro concerns driven by the banking and the real estate cycles. And obviously, even though we felt confident on our full year free cash flow, we wanted to be prudent as we saw those concerns play out. I think if you look at our excess capital roll forward, that does point to strong free cash flow. It also points to the fact that we do still have that.

And so again, it's much more of a timing issue than it is any issue with our capital levels or free capital flow outlook for the rest of the year. So I'd

heighten back to what I talked about last year. I think we still feel that approximately \$600 million of buybacks for the full year is a good range. And if you then take into account what we've done, that does point to slightly higher buybacks in the back half of the year.

Dan Houston: Thanks, Deanna.

Ryan Krueger: Thank you.

Operator: Thank you. Our next question comes from the line of Tom Gallagher with Evercore ISI. Please proceed with your question.

Tom Gallagher: Good morning. A question on variable investment income. Pat, just listening to what you're saying about real estate pipeline and how you expect more of those flows to be coming through, I'm curious if we should also take that to mean transaction activity on your own owned real estate might start picking back up again and could drive better variable investment income returns? Curious what you're thinking there for the back half of the year. Would you still expect VII to be below plan or do you think the clouds might be lifting here a bit?

Dan Houston: Yeah. Good morning, Tom. I'll tell you what, I think I'll have Deanna respond accordingly on that one.

Deanna Strable: Yeah, just a couple of comments there, and then I'll have Pat add some color. I actually think we'll see inflows into real estate before we see transaction volume in real estate. So I think our outlook would probably still see some muted results in variable investment income due to real estate sales in the second half of the year. What we've seen thus far in VII, very similar results in the first quarter and second quarter, virtually no prepays, virtually no real estate sales, but actually pretty strong and in line returns from our alt portfolio.

And I think what you would say is it is hard to forecast. Maybe towards the end of the year, we might see some transactions, but again, that might also roll into early '24 as well. So probably our best guess right

now is that third and fourth quarter VII would be similar to what we saw in the first half of the year. But Pat, any thoughts on transactions?

Pat Halter: Yeah. I just mentioned, Tom, that I think, as you know, we had a pipeline of opportunities in terms of investments that we're developing. And those usually are sort of the merchant build program that allows for variable investment income to be generated in the future. And my anticipation, you'll start to see more of that in 2024 than in 2023, but there is a pipeline out there and we're obviously harvesting that pipeline for the right time to optimize that. But my guess, Tom, would be more 2024 than the next two quarters.

Tom Gallagher: Okay. Thanks for that. And then my follow-up is, I guess, for Chris or Dan, just curious about bigger picture competitive landscape within 401(k) and large case. When you're losing these cases, is it mainly going to large asset managers, is it insurance companies? And I heard you mention that's partly just driven by M&A. But just curious what's happening on pricing. Are you noticing any more aggressive pricing? Is it the same? Just any color on what you're seeing competitively would be helpful. Thanks.

Dan Houston: Yeah. Tom, as you very well know, this has been and continues to be a competitive marketplace. We actually differentiate ourselves in leveraging our TRS capabilities, and you see that through the nonqualified deferred compensation growth. You see that through ESOP and our ability to attract these large DB plans as well. As Chris framed earlier, it is M&A. Whether it's a good fit or not, there's still a little bit of a shakeout relative to the IRT transfer block of business and whether that's a perfect alignment with our service model. But Chris is closer to it, I'll ask that he add some additional color.

Chris Littlefield: Yeah. I mean, I think it's a very competitive market. And I think as we've expressed in the past, our focus is really managing our profitable growth and maintaining our pricing discipline and driving additional revenue and managing our expense discipline really well, and so that's where our focus is. I mean, not all flows are created equal, and they come with different revenue and profit profiles, and we're really focused on how do



we maximize revenue generation and profitability rather than how do we maximize flows.

The competitive environment is competitive but we're maintaining pricing discipline. I think it really shows up in the fact that we are very confident that we're going to land within the full year guidance for net revenue and we expect to be in the upper half, the top end of our margin guidance for the year, and that's how we're managing the business.

Dan Houston: We'll also say, Tom, just to maybe clean-up just a little bit, among the top three players in this industry, we all keep getting larger. Without naming names, there is a fair amount of swapping of these plans between the relative players, we win from the large players, we lose large to players. And TRS is still a big differentiator out there as well as our customer service platform, so hopefully, that helps.

Tom Gallagher: That does. Thank you.

Operator: Thank you. Our next question comes from the line of Erik Bass with Autonomous Research. Please proceed with your question.

Erik Bass: Hi. Thank you. I was hoping you could talk a little bit about the net flow dynamics in the RIS-Spread business. You're seeing nice wins in PRT and growth in deposits, but flows have been a little bit muted there due to higher withdrawals. Is this just a function of having larger blocks and needing more sales to offset the natural runoff or are there any other dynamics to think about?

Dan Houston: I think to be the biggest dynamic there is to make sure you remain disciplined in your pricing as you attract new business, and there is a steady roll off as you would expect. Chris, you want to add some additional thoughts?

Chris Littlefield: Yeah. On our spread-based net cash flow, it was flat in the quarter. We certainly saw the strong PRT sales. I'd point out that those were really nice returns and so we continue to see compelling opportunities there,

but that was offset by some of the GA flows due to better equity markets. Certainly, when you see better equity market performance, you see a movement out of capital preservation products, and we certainly saw that in the second quarter.

The other trend I'd highlight is, as you know, we run our investment only business, our IO business opportunistically and so the maturities can be lumpy. And we certainly experienced some lumpiness in some outflows in this quarter, contributing to the flat performance on spread-based net cash flow.

Erik Bass:

Got it. Thank you. And then going back to PGI. I was hoping, Pat, you can talk a little bit more about the retail demand and flow dynamics that you're seeing. And in particular, curious as money is coming back to the market, are you seeing it go back into actively managed funds to the same degree as it was before or is passive continuing to take share?

Pat Halter:

Yeah, Erik. I think the passive sort of share of the marketplace continues to increase, and that's why the investment performance numbers that we illustrated in our prepared remarks is so important, because we have to be able to demonstrate that we are producing an active return over those indices. And so we do feel with those numbers improving on the investment side, we should start to see the trajectory, and are seeing the trajectory, frankly, in the first two weeks of July in terms of our ability to get a little more of the mind share of the law in terms of flows going into active mutual funds.

It's a tough sort of marketplace in that yet to deliver really first one-third sort of investment profile performance to get that wallet share. With some of our improving investment performance, we're seeing some of that increased activity, as I mentioned earlier in my prepared remarks on the net cash flow. SMA is a space that we continue to want to grow in. Mutual funds is clearly a place that we've been very active with in terms of over the years and really the place where I think we have an opportunity to grow again is in CITs.

There has been a little bit of a pushback on CITs in terms of net cash flow because of the flows going out of stable value back in the equity markets. We think that's sort of a temporary sort of situation, but that's sort of the landscape of what we're seeing right now relative to the retail space and retirement, individual space, Erik.

Dan Houston: Hopefully, that helps.

Erik Bass: Yes. Thank you.

Operator: Thank you. Our next question comes from the line of John Barnidge with Piper Sandler. Please proceed with your question.

John Barnidge: Good morning and thank you for the opportunity. Can you maybe talk about the sales volume in Specialty Benefits? I know there's the second straight quarter of declines. Is it that '22 had a bunch of pent-up demand that's creating tough comparables, or are you seeing other things? Thank you.

Dan Houston: Yeah. I appreciate that, John, and good morning. And no doubt, we had a very strong '22 and ['23] is strong, just not equally as strong. But Amy, you want to go and add some additional color?

Amy Friedrich: Yeah. Sure, happy to add some color here. So John, I think you're hitting on one of the main points here, which is there definitely was pent-up demand, particularly in the smaller market kind of flowing through 2022 results. So when you look at the sort of fierce labor fight out there, sort of fierce fight for talent, there were smaller market players kind of making some purchases out there that really did represent that pent-up demand. So that was definitely good news in our 2022 results.

But to put it in perspective, I view our 2023, our second quarter results, as really strong. They are down, as you note, from 2022, but they are literally the second best second quarter sales we've ever recorded. So when I look at those sales, I see really good things for both the current quarter and looking ahead. So when I look ahead at that second half of

the year, as Dan mentioned in his comments, we have introduced a new hospital indemnity product. It's performing well, rounding out our supplemental health offering.

And when I look at the basics, the fundamentals of our business around staffing, process, technology, distributor relationships, those are really strong right now. So again, I would say it's more a comparability issue that we're seeing. I'm very comfortable with both our total premium and fee growth and the sales component of that.

John Barnidge: Thank you for that. And then my follow-up question, maybe on that hospital indemnity product, can you talk about how you think about the maybe TAM or total addressable market and the SMB space for that, and then the product pipeline as well for other products that you may be working on? Thank you very much.

Amy Friedrich: Sure. Dan, happy to take that if you're okay with that?

Dan Houston: Yeah, please. Yeah.

Amy Friedrich: Great. So when I think about hospital indemnity, it really is not one product that's going to sit out there and kind of do the work by itself. It really is going to sit as a supplement to the core benefits that we already have in place. So what we're seeing is that it's a nice offering to fill some gaps. So when people have a hospitalization, when people have other needs that are going to be travel related or outside of something that would get covered by the medical plan, this is going to be something that helps with that supplemental hospitalization cost and pieces, so I see it as a complement.

The real power in having this is that it rounds out the rest of our worksite portfolio. So we've historically seen much of our organic growth relying on that basic kind of product sets that are going to be dental and disability and life. And I love having those product sets in place, but where we haven't put our competition out there as much has been in the worksite space. So as we bundle up accident and critical illness and

hospital indemnity, it's going to give us the ability to compete on some of those additional worksite sales that we simply haven't been as competitive in the past.

So I like what that says in terms of market applicability. I like what that says in terms of how it can help us grow our total wallet share that we have across our extensive small and midsize business customers.

Dan Houston: And we're doing survey work with employers, small, medium and large. The one thing we consistently hear is healthcare is probably one of the most important. Second is around retirement, but supplemental benefits like this are a strong number three. And so we see this as a real growth driver for our small to medium sized segment. So appreciate it, John.

John Barnidge: Thank you.

Operator: Thank you. Our next question comes from the line of Wes Carmichael with Wells Fargo. Please proceed with your question.

Wes Carmichael: Hey. Good morning. I just wanted to follow up on the performance fees in PGI. I know in the supplement, you provide that, and it's down quite a bit year-over-year. I know, Deanna, you addressed that. But just curious for your outlook for the remainder of the year, how you think that should trend? And I guess I'm trying to, does that kind of tie to your comments on VII where you need to see the inflows first? I think some of the fees in PGI are related to real estate transaction activity.

Dan Houston: Yeah. Pat can clarify that for us.

Pat Halter: Yeah, Wes. So those are the two different sort of discussions between VII and then the performance fees that would come to PGI and be part of the operating earnings profile of PGI. But we do, as I mentioned, because of the activity increases we see in real estate, Wes, we would expect sort of the muted performance fees that we saw in the first half of the year to start to change. And second half of the year, you should see some

more sort of robust performance fees coming into the second half of the year.

Wes Carmichael: Got it. Thanks. And then on capital in the holding company, sitting at the \$800 million level of liquidity, just curious if you're kind of expecting to run that near the target there or if you expect to leave some excess there over time? And also, just on the leverage ratio. It's down now when you took out \$700 million of debt, just curious if that's going to migrate back towards 25% over time or if you want to be a little bit lower towards that target?

Dan Houston: Go ahead, Deanna.

Deanna Strable: Yeah. I'll answer your second question first. So on a leverage ratio perspective, it was really just an anomaly given the fact that we issued \$700 million of debt in the first quarter, and we paid off the \$700 million of debt in the second quarter. And so if you would have adjusted for that, we would have been consistent at that 22% level. I think, again, our target is 20% to 25% but I think that 22% is a really good place to be, gives you some dry powder if there is opportunities, and I think that's what you'll see us consistently show there.

Regarding your other question around the Hold Co., we actually spent an extensive amount of time with our Board Finance Committee. On a quarterly basis, we look at our capital at risk. And given the change in our business mix and some of the transactions that we conducted in 2022, the need to hold a lot of cushion relative to that is not as needed as it has been in the past. And so I think you'll see that around a pretty tight range, around that \$100 million. Obviously, if we're seeing big pressures in the market, it might flex a little bit up. But I think given our business mix, as well as the high level of free cash flow that we generate, I don't think you'll see that move significantly one way or the other.

I hope that helps, Wes.

Wes Carmichael: Yeah. Very helpful. Thank you.

Dan Houston: Appreciate it.

Operator: Thank you. Our next question comes from the line of Jimmy Bhullar with JPMorgan. Please proceed with your question.

Jimmy Bhullar: Hey. I had a question first on just PGI flows. And I think, Pat, in your comments, you mentioned sort of a little bit of an improvement in the overall environment, but wanted to see how much of your optimism on flows improving in the second half is because of actual commitments you received from clients versus maybe the improved performance or just an expectation that activity will get better?

Dan Houston: I think it's two things, and I'll throw it to Pat quickly. Number one, the investment performance helps out immensely. And then secondly, we already feel good about here in the first month of the third quarter and what we're seeing with solid flows. But Pat, please.

Pat Halter: Yeah. Jimmy, thanks for the question. Just to highlight Dan's last comment there, Principal International was off to a very strong start in July, so that's very encouraging in terms of its flows. And then as we discussed, we have seen a turnaround in terms of some of the retail flows and it's looking much more constructive, again, because of investment performance. Obviously one month doesn't make a trend for the rest of the year, but based on the market sentiment, based on the conversations we're having with clients and with the markets themselves, there is definitely flows and the increasing flows are out there and so we're encouraged by that anticipated pipeline of activity.

On the real estate side, just to be clear, those discussions I highlighted in terms of acquisition portfolios, taking over existing portfolios, funding in terms of new funds, that's real capital commitment. That's actually money that's been committed. So we're very encouraged by the opportunities to change that into a strong net cash flow.

Jimmy Bhullar: Okay. And then you discussed performance fees, but if we look at asset management fees in the PGI business or just a normal management fee

revenues, those are down as well. So are they down more because of just the rates and the impact of that on assets or are there other factors going on that might be more sort of sustainable in nature?

Dan Houston: Go ahead, Pat.

Pat Halter: Yeah. So we discussed earlier, base asset management fees and that they keep going down from 29 to 28.4. We did see a little bit of lower transaction fees in the first half of the year, Jimmy. So maybe that's what you're also highlighting, but that was fairly limited. Our mortgage activity, our mortgage origination activity actually has started to increase in June. That's increasing again in July. So we're actually expecting transaction fees to probably get back to more of a historical level of what you've seen in the past.

And then as I mentioned, performance fees, very light in terms of performance fees in the first half of the year, but we do expect performance fees to probably get more back to the normal level of what you've seen in the past relative to PGI.

Jimmy Bhullar: Okay. And then any comments on just competition and fee pressure in asset management? Is that same as before or have there been any changes?

Pat Halter: Yeah, Jimmy. Yeah, there's always intense competition in the asset management business. That's why we have to continue to deliver on strong alpha performance. That's why you have to continue to make sure we have relevant capabilities globally. The fee pressure is absolutely there in the marketplace, so we have to continue to make sure we are delivering on value to our clients, in the eyes of the clients in terms of the capabilities we offer and then the level of performance that those capabilities are generating.

Dan Houston: Jimmy, as you very well know, it isn't just active to active like the good old days, with passive taking more of the share. If you don't have value added capabilities, you're not winning. And the good news at Principal,



whether it's in the high yield space, preferred space, real estate, direct lending, these are areas where we can differentiate, and it is our intentions to continue to build out those unique capabilities to compete in the marketplace. Hopefully, that helps.

Jimmy Bhullar: It does. Thank you.

Dan Houston: All right.

Operator: Thank you. Our next question comes from the line of Alex Scott with Goldman Sachs. Please proceed with your question.

Alex Scott: Hi. First one I have for you all is just maybe a high level question on inflation and how it's affecting your expenses. I mean, certainly, there's some help up to the top line from what's been going on in the markets. But how do we think through inflation as a potential offset to some of the help that you're getting just in terms of top line and the economy, or the market potentially continuing to recover a bit, versus the inflationary pressures that could offset some of that?

Dan Houston: Yeah. I'll make some initial comments and then ask Deanna. But we've talked about this in here before. As a matter of fact, when inflation started to tick up in particular as it relates to wage inflation, which most employers are happy to deal with as it relates to maintaining an attractive and recruiting talent, and we see that manifest itself in higher dollar amounts of wages, often translates into higher dollar amounts of life insurance coverage, higher premiums for disability. All of those, again, are tied back to wages. Individuals, as they see salary increases, mostly of those are set in automatic nature and so 401(k) salary deferrals rise accordingly.

And on a net-net basis, Principal has always been the benefactor, as you pointed out, that top line revenue growth. Principal has its own internal challenges related to inflation as we retain and attract talent. And again, that's part of our overall expense management responsibility within the business units and something that Deanna works with the CFOs around

here every day on. But maybe I'll have Deanna add some additional thoughts here.

Deanna Strable: Yeah, Alex. Thanks for the question. I think Dan really talked about well that we are uniquely positioned that when inflation plays through, especially when it plays through on salary levels, we do get benefit in both RIS and Benefits and Protection and obviously, that plays through from a revenue perspective. We definitely have a proven track record of aligning expenses with revenue. When revenue goes down very fast or goes up very fast, there's always a natural lag.

But one thing I'm really proud of is if you look at our comp and other, whether it be relative to a year ago quarter, relative to last quarter or relative on a trailing 12-month basis, they're down on all of those comparisons. Probably most valid is on the trailing 12 month basis. We're seeing about a 3% to 4% decrease in adjusted comp and other, and that's despite the fact that, as you mentioned, we have had to increase salaries because of that inflationary pressure and war on talent. We've had other expenses that have been negatively impacted from inflation.

And also, we have to make sure that we continue to invest in our businesses to make sure that we can continue to deliver on our promises and drive growth in the future. And so I think that's the proof of the fact that we do have that track record, and you'll continue to see that play out as we go forward.

Alex Scott: Got it. That's helpful. A follow-up question I have is on dental. Just noticing the loss ratio is up a little bit. Are you guys seeing anything around utilization, maybe elective procedures, that kind of thing? I guess I've heard some of the managed care providers talk about this. And I don't think it was still focused on dental in some of the comments, but I think one of them mentioned dental. So I was just interested if that's something you're seeing.

Dan Houston: Yeah. I'll have Amy take that. Before I do that, just a reminder, when you compare Principal to other competitors in our set, we're not a pure play

asset manager, so we do have operations and more customer service expense. And so on pure play asset managers, when you have more variable expense because it's incentive compensation and so on and so forth, you see expense reductions perhaps a little bit easier than you do in an organization like Principal when we're providing a lot of value added services across these fee spread and risk businesses. But I think it's always important to put that in the proper context when you're doing your comparable.

So with that, Amy, Dental?

Amy Friedrich:

Yeah. So just a few comments about dental. Definitely feel good about our overall loss ratio and margins. So when we talk about the full suite of products, I feel really good about how they're operating together. When we dig in just on dental, we are seeing some things happen there that are a little bit, I would call them sort of out of seasonal patterns. And so I think we are still seeing the first half of the year is some definite keeping up on utilization and frequency. People are going to the dentist back to pre-pandemic levels, but we're probably still seeing a little more severity flow through our results, so think of that as the higher dollar procedures.

The open question out there in the industry is, will that be continuing on? Is that setting a new level, or is that something that's still sort of the last remnants of the pandemic? So my particular belief and the belief on our block of business is that we'll see that experience moderate through the second half of the year. I think we will continue to see that come down. We might see some elevation still in severity, but the great news about our block is that our block is about 90% of it is going to have an annual ability to get rerated and renewable.

So dental is a very responsive product if we need it to be on things that are happening within how it's being utilized and changed. So great news is that's a short blip if that does happen, but my perspective is I do think we'll see that moderate a bit and I think we're seeing some of the last remnants from the pandemic coverage being disrupted, but more to come.

Dan Houston: (Inaudible)

Alex Scott: Got it. Thank you.

Dan Houston: Next question, please.

Operator: Thank you. Our next question comes from the line of Tracy Benguigui with Barclays. Please proceed with your question.

Tracy Benguigui: Thank you. Listening to your comments, it sounds like we're reaching an inflection point on real estate where you saw some pressure this quarter on some of your key metrics. But then you said you're seeing signs of recovery and positive momentum in real estate, like in PGI, your mortgage origination activity is up. What is going on in real estate fundamentals that's driving that or is it more technical?

Dan Houston: Pat?

Pat Halter: Yeah. So I think what's driving the sort of activity is there's places where we're starting to see the entry points in terms of where the risk/return trade-off looks reasonable again. So there's a sort of an opportunity there, both in terms of core real estate but also manufacturing real estate in terms of turnaround and in development. We also, I think, are very, I think, mindful that the debt markets have to stabilize. And with the Fed now starting to become, I think, maybe at a place where they may take a pause, I think people are having a little more confidence in terms of being able to understand where the path will be going forward in terms of valuations and debt availability and capital availability.

So there is a sort of emerging market developing in terms of this transaction activity in general, picking up. It's still early yet, but being early sometimes is where you actually can really add value to your clients. And so there is an opportunity, as I mentioned, through the three areas that we have been very active in, which is acquiring a portfolio or taking over other managers' assets or being able to find funding for new creative things to invest in, for instance, like data centers. So there's a lot

of interesting opportunities. I know office has the headline and we're not in the office. We're not investing in new office, but we are investing in other asset classes, whether it's industrial, whether it's data centers, whether it's residential. So that's really the important thing to mention as to where we're at, what we're doing as we talk about this increased activity.

Dan Houston: Tracy, do you have a follow up?

Tracy Benguigui: Great. Yeah, a quick follow-up. I just want to touch on the credit cycle. You mentioned credit drift was slight benefit of capital, so you feel good about your full year expectations where you were building in some credit drift. What do you think is going on? This is probably the longest debate of whether we're going to enter recession or not, maybe as far back in 2019 when we saw the credit cycle reach maturation. So what do you think is driving that positive drift? And is this a timing difference where we could see credit drift materializing, but it just may come later?

Dan Houston: Deanna, some thoughts?

Deanna Strable: Yeah, just a few comments there. Let me just frame kind of where we are kind of year-to-date from a drift perspective and ultimately, kind of tie it back to your questions there. Both first quarter and second quarter, we actually saw positive capital impacts from drift, modest, about \$5 million a quarter. And I think that really comes back to our high-quality diversified portfolio. And so even though we are seeing some downgrades across the portfolio, they're more than being compensated by some upgrades. And again, that could be within the real estate portfolio on some of the asset classes that Pat mentioned or it's in other parts of our balance sheet as well.

And so again, we do think there will be some drift as we go through the rest of the year, but I'd say there's a couple of things, right? I think the recession is not thought to be as deep as maybe what it was anticipated coming into the year. And then you come back to the quality and the

diversification of our balance sheet, and I think, again, we continue to see good results there. But I'll see if Pat has anything to add.

Pat Halter: No, I think Deanna has done a nice job of summing that up really well.

Dan Houston: Very good. Okay?

Tracy Benguigui: Thank you.

Operator: Thank you. Our final question this morning comes from the line of Mike Ward with Citi. Please proceed with your question.

Mike Ward: Thanks, guys. Good morning. Thanks for squeezing me in. Just on PRT, we've been hearing pretty bullish commentary from some of the insurance brokers out there, it seems like more than usual. So just wondering if anything is changing in terms of the returns or there's got to be more competition, but any way to sort of size the opportunity from here?

Dan Houston: Chris, please.

Chris Littlefield: Yeah. No, I think we see a very strong PRT marketplace right now. I think industry sales are expected to be in that \$30 billion to \$40 billion range for the year. Again, as we think about this business, we really focused on the returns we're getting on the capital we're investing in that business and so we remain disciplined, and so we're very comfortable. We feel very good about our performance for the first half, and we're on track for our plan for the year, and we're doing so at very nice returns.

The other thing I'd say is we do benefit from having our WSRS business. A lot of the activity that we're seeing, we're able to take our existing clients' plans given that client are fully funded. I think Mercer is calling it 105% funding at the end of June, and we're able to talk to them about planned terminations and the opportunity to write PRT business with them. And then we just look at that overlap between those businesses,

about 15% of our premium and about 42% of the cases in our PRT business year-to-date has come from existing clients.

So we do see a robust environment there. We're picking our spots where we can maximize the return on capital, and we have some built-in advantages from having an existing client base.

Dan Houston: Do you have a final question, Mike?

Mike Ward: Yeah. Maybe just on Specialty Benefits. Just wondering what you guys are sort of hearing and feeling from the employers out there, how they feel about the labor market and wages and if their attitude is changing in terms of their approach to benefits?

Dan Houston: Amy, please.

Amy Friedrich: Yeah. So I think the good news there is that the small to mid-sized marketplace is still really vibrant. They understand that they need to keep talent. They understand that a great benefits and savings and retirement package offering for their employees is critical to making that happen for them, and they're displaying that through their purchasing behavior and their funding and persistence on those plans. And so I think the most interesting piece is that when you look at employment growth and we look at wage growth, wage growth is across all of the segments that we're seeing and equally present in the small market but employment growth, at least in our block of business and I think this is across over into the retirement business as well, has stayed really strong. So our employment growth numbers are twice as strong, three times as strong in the smaller market, so those employers are continuing to hire and they're continuing to indicate that they need great employees to fuel the growth.

So we continue to hear sentiment that there's caution. They're very confident about their businesses, they're also very confident about their kind of region or community. They get a little less confident in their sentiment when they head over into total U.S. or total global economy.

So that's where their sentiment begins to start to fall apart, but their actions are usually based on their local or their business sentiment and it remains very positive.

Dan Houston: Thanks, Amy.

Mike Ward: Got it. Thank you so much, guys - really interesting.

Dan Houston: We really appreciate the questions, Mike.

Operator: Thank you. Ladies and gentlemen, that concludes our time allowed for questions. I'll turn the floor back to Mr. Houston for any final comments.

Dan Houston: Yeah. Thanks again for joining us today. And as I reflect on the quarter, the earnings and the margins aligned with guidance, there's a path on the free cash flow of 75% to 80%. Net cash flow, we all know on a macro level, it was a very challenging environment. We're making changes in the business in order to improve the results. We're continuing to focus on aligning expenses with revenues and it continues to be a priority while still investing for growth and innovation and the digitizing of our business and making sure that we don't miss that opportunity, and we continue to execute on profitable growth for our long-term shareholders.

So thank you for your time and attention today. We'll see you out on the road.

Operator: Thank you. This concludes today's conference call. You may disconnect your lines at this time. Thank you for your participation.



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