

# Principal Financial Group®

## 1Q 2023 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

Pat Halter: President - Global Asset Management

Chris Littlefield: President - Retirement & Income Solutions

Humphrey Lee: VP - Investor Relations

#### Analysts

John Barnidge: Piper Sandler

Jimmy Bhullar: JP Morgan

Suneet Kamath: Jefferies

Tracy Benguigui: Barclays

Erik Bass: Autonomous Research

Alex Scott: Goldman Sachs

Ryan Krueger: KBW

Josh Shanker: Bank of America

Wesley Carmichael: Wells Fargo

Michael Ward: Citigroup

Tom Gallagher: Evercore

Josh Shanker: Bank of America

## Presentation

Operator: Good morning and welcome to the Principal Financial Group first quarter 2023 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 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 would now like to turn the conference call over to Humphrey Lee, Vice President of Investor Relations.

Humphrey Lee: Thank you, and good morning. Welcome to Principal Financial Group's First Quarter 2023 Conference Call. As always, material related to today's call are available on our website at [investors.principal.com](https://investors.principal.com). In addition to our earnings call materials, we included additional details of our commercial real estate exposure in our slide presentation. As a reminder, financial results are now reported under the long-duration targeted improvements accounting guidance, or LDTI. Historical results have been recast and are also available on our website.

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 highlights of our financial results and key performance highlights for the quarter. Deanna will follow with additional details on our first quarter results, our current financial and capital position, as well as some details on our investment portfolio. Our integrated business model remains resilient during periods of macroeconomic volatility, as shown on our strong first quarter results. While we are not immune to credit and market pressures, we are well positioned for a variety of economic conditions.

Starting on Slide 3, we reported \$367 million of non-GAAP operating earnings, or \$1.48 per diluted share in the first quarter. We returned more than \$300 million of capital to shareholders during the quarter through share repurchase and common stock dividends. We are delivering on our capital deployment strategy by investing for growth in our business and returning excess capital to shareholders.

We ended the quarter with \$660 billion of total company managed AUM, an increase of 4 percent from year-end 2022, reflecting favorable equity and fixed income markets, positive net cash flow, as well as positive impacts from foreign currency. We generated \$600 million of positive total company net cash flow, a strong result during a period of outflows across much of the industry. This highlights one of the benefits of having a diversified and integrated business model across asset management, retirement, and benefits and protection.

Turning to investment performance on Slide 4, market volatility is underscoring the value of our diversified offering. Our fixed income strategies are delivering strong results, managing through a challenging credit environment. While our asset allocation and U.S. equity strategies have been impacted in their short-term performance, our international equity strategies are delivering strong alpha so far this year, boosting one-year performance. Our approach to invest in high-quality, high-growth companies continues to resonate with our clients, winning additional mandates. We have also received gold and silver ratings from Morningstar for several of our key equity funds.

Turning to Slide 5, I'd like to spend a moment on our investment portfolio as there has recently been increased market focus on credit and commercial real estate exposures. We're confident in our high-quality, diversified investment portfolio, which is well aligned with our liability profile. We actively manage our investment risk and have been intentional about further improving credit quality of our portfolio since the global financial crisis. The reinsurance transaction we completed in 2022 decreased our general account by 25 percent. This reduced our credit exposure and lowered our investment asset leverage well below the industry average.

We are a global real estate leader with more than seven decades of experience, managing nearly \$100 billion of assets, including more than \$70 billion for third parties. Today, we have over 300 real estate investment professionals, 55 of which have more than three decades of real estate experience through many different market cycles. Over the last decade, we have reduced office exposure in our commercial mortgage portfolio as we saw signs of stress coming in the segment, a move which has proven to be appropriate as the recent stress on the banking sector has raised financing concern for office properties in particular.

We've also enhanced our underwriting standards since the global financial crisis, producing a high-quality portfolio with substantial cushion to withstand severe downturns. Our investment and risk management teams have been diligent in transforming the portfolio, delivering a track record of strong financial performance and positioning us to weather a variety of economic conditions and market cycles.

Turning to our growth drivers and some additional highlights for the quarter, we continue to benefit from strong employment and wage growth in the U.S., particularly in the small to midsize segment with our Retirement Benefits and Protection business. In Retirement, we generated strong sales across all segments, growth and net participant activity, and positive net cash flow with recurring deposits up 11 percent on a trailing 12-month basis.

While large market sales and lapses can fluctuate quarter to quarter, we have good momentum, and our pipeline is strong for the rest of the year. Our SMB segment is holding up very well with strong reoccurring deposit growth and low contract lapses, contributing to a 33 percent increase in net cash flow compared to the first quarter of 2022. And in Benefits and

Protection, our focus on the durable small to midsize business market continues to drive growth.

Over the last 12 months, the small to midsize employer market has experienced record sales, strong retention, and demonstrated continued strong employment growth, all of which are contributing to our above-industry growth in premium and fees for Specialty Benefits. In Asset Management, our broad distribution and geographic footprint continues to produce benefits. PGI-managed net cash flow was a positive \$400 million in the first quarter.

While flows for many active managers were negative in the quarter, we continue to benefit from our integrated business model and differentiated investment capabilities, including hybrid target date, stable value, and guaranteed income products. We are winning business from both new and existing retirement customers while generating flows from our general account. As we look forward, we continue to see active engagement with global institutional clients involving investment strategies in private debt and credit, specialized investment income capabilities, and opportunistic investing in real estate.

We also drove strong quarterly net cash flow of \$800 million in Principal International. These flows were well diversified across Southeast Asia, Brazil, Mexico, and Hong Kong as we continue to execute on our strategy, building upon our market leadership and key joint venture relationships. Specific to Brazil, we remain a market leader in pension AUM, deposits, as well as net cash flow. Bottom line, we are very excited about the growth opportunities which lie ahead. I'm confident we have the right product mix, the right market focus, and the right distribution channels 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 key contributors to financial performance for the quarter, an update on our current financial and capital position, and details of our investment portfolio. Reported net income attributable to Principal was a negative \$140 million in the first quarter. Excluding the loss from exited businesses, net income was a positive \$347 million, with \$11 million of credit losses. Credit drift was slightly positive in the quarter.

Excluding significant variances, first quarter non-GAAP operating earnings were \$395 million, or \$1.60 per diluted share, a strong result despite macroeconomic pressures on AUM levels during 2022. As Dan noted, first quarter results highlight the value of focus and the strength and resiliency of our diversified business strategy. As detailed on Slide 17, significant variances had a net negative impact on our first quarter non-GAAP operating earnings of approximately \$33 million pretax, \$29 million after tax, and \$0.12 per diluted share.

The significant variances were primarily due to lower-than-expected variable investment income in RIS and Benefits and Protection. Mortality experience true-ups in RIS were mostly offset by LDTI model refinements in Specialty Benefits. As discussed during our 2023 outlook call, we expect a variable investment income from alternative investment returns, real estate sales, and prepayment fees to be lower than 2022 levels and lower than our expected long-term run rate due to macro environment heading into the year. VII was positive in total for the quarter, but we did not have any VII from prepayment fees or real estate sales.

Macroeconomic volatility continued in the first quarter and pressured earnings in our fee-based businesses relative to a year-ago quarter. While the S&P 500 daily average increased 4 percent from the fourth quarter of 2022, it was 11 percent lower than the first quarter of 2022 and 10 percent lower on a trailing 12-month basis.

Foreign exchange rates were a tailwind compared to the fourth quarter but a headwind relative to the year-ago quarter and on a trailing 12-month basis. Impacts to reported pretax operating earnings included a positive \$7 million compared to fourth quarter of 2022, a slight negative compared to first quarter 2022, and a negative \$17 million on a trailing 12-month basis.

Turning to the business units, the following comments on our first quarter results exclude significant variances. As a reminder, comparisons to first quarter of 2022 are impacted by the reinsurance transactions that closed in the second quarter of 2022. Revenue growth and margins in Specialty Benefits and Principal International were in line with our expectations in the first quarter.

Revenue growth in RIS and PGI were pressured by the impacts of macroeconomic volatility and lower account values in AUM compared to a year ago, but both businesses are benefiting from more favorable conditions relative to the assumptions in our 2023 outlook. Despite the pressures on revenue growth, the margin in RIS was strong in the first quarter and benefited from diligent expense management, one-time items in the quarter, and timing of expenses. For the full year, we continue to expect to be within the 35 to 39 percent guided range, with the ultimate level impacted by macro conditions for the remainder of the year.



PGI's margin and pretax operating earnings were pressured by expected expense seasonality as well as expected lower transaction and borrower fees. Expenses in the first quarter were elevated by approximately \$20 million due to seasonality of payroll taxes and deferred compensation. We continue to expect PGI's margin to be within the 34 to 37 percent guided range for the full year.

Principal International had strong earnings in the first quarter, driven by growth across the business and higher AUM. Favorable impacts of inflation and higher interest rates in Brazil were offset by lower-than-expected encaje performance and VII in Chili. In Life, pretax operating earnings and margin were lower than expected, primarily due to higher claims experienced in the quarter. The decline in premium and fees was driven by the 2022 reinsurance transaction and will normalize throughout the year. We continue to expect to deliver on our 2023 guidance for the full year, both at the business unit level as well as for the total company.

Turning to capital and liquidity, we remain in a strong financial position despite the volatile environment. We ended the first quarter with \$1.8 billion of excess and available capital, including more than \$1.5 billion at the holding company. This includes our \$800 million target and \$700 million of proceeds from debt issuance in the first quarter that is earmarked for debt maturity and redemption in the second quarter, \$300 million in our subsidiaries, and \$30 million in excess of our targeted 400 percent risk-based capital ratio.

During the quarter, in addition to returning excess capital to shareholders, we accelerated our organic capital deployment as we saw attractive return opportunities in our businesses. This was a pull forward of our business plan for 2023. Looking ahead, our free capital flow

generation will increase throughout the year. We returned \$306 million to shareholders in the first quarter, including \$150 million of share repurchases and \$156 million of common stock dividends. Last night, we announced the \$0.64 common stock dividend payable in the second quarter, in line with our targeted 40 percent dividend payout ratio.

We remain focused on maintaining our capital and liquidity targets at both the life company and the holding company and will continue pursuing a balanced and disciplined approach to capital deployment. I want to end my comments by providing some additional details of our investment portfolio, including our real estate exposure. As Dan mentioned, we have intentionally improved the overall credit quality across our fixed maturity and real estate portfolios since the global financial crisis. Our investments are high quality, well aligned with our liability profile, and we are well positioned for a variety of economic conditions.

Starting on Slide 11, specific to the real estate portfolio, as of the end of the first quarter, our commercial loan portfolio has a current average loan-to-value of 46 percent and a debt service coverage of 2.5 times. This has improved from 62 percent and 1.8 times in 2008. We have minimal exposure to floating rate loans and a very manageable maturity schedule of high-quality loans with only 4 percent maturing in 2023 and another 7 percent in 2024.

Our commercial office portfolio is geographically diverse and high quality. We saw signs of stress building in the sector and proactively reduced our office exposure from 37 percent of our mortgage portfolio in 2016 down to 25 percent today. We have taken a conservative approach with our office portfolio and have manageable near-term maturities.

We have already reduced valuations in our office portfolio by 22 percent from the peak, and they are 20 percent below the current implied index value. The current loan-to-value on our office portfolio is 52 percent, and debt service coverage is 2.5 times. We have looked at a number of different stress scenarios on office valuation. This includes an additional 20 percent to 40 percent decrease from our current conservative valuations and assumes an immediate default of all office loans over 100 percent LTV.

The ultimate impact to our RBC ratio is estimated to be 2 to 3 percentage points under the 20 percent additional decrease scenario and 10 to 12 percentage points under the 40 percent additional decrease scenario, both very manageable. That said, we have the experience and a long-established track record of navigating real estate cycles. It will take time for any market cycle to emerge, and the impacts would play out over a number of years.

Looking at our CMBS portfolio, relative to 2008, we have decreased the overall size of our portfolio by 22 percent and improved the quality to 98 percent with an NAIC 1 rating today. Our equity real estate portfolio is well diversified with a high concentration of property types with strong fundamentals such as industrials and life sciences. The market value of our portfolio is substantially higher than our carrying value. Overall, we are confident in the quality of our real estate portfolio, remain diligent in monitoring, and proactive in servicing it.

We have built a high-quality portfolio that is well diversified and a good fit for our liability profile.

2023 will not be without its challenges, but we are positioned to focus on maximizing our growth drivers of Retirement, Global Asset Management, and Benefits and Protection, which will drive long-term growth for the enterprise and long-term shareholder value. We have the financial flexibility, discipline, and a track record of managing through times of macro volatility and uncertainty.

This concluded our prepared remarks. Operator, please open the call for questions.

Operator: 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 roster.

Our first question comes from Ryan Krueger with KBW. Please proceed with your question.

Ryan Krueger: Hi. Thanks. Good morning. First question is just on the office stress scenario that you provided. Just curious, in the, I know it was a pretty severe scenario and a pretty limited RBC impact. Was that just based on the impact of downward ratings migration and some level of credit losses, or did you assume anything for the impact if you'd have to take over some of the properties, and they'd get the higher capital charge from being an owned real estate property?

Dan Houston: Yeah. Good morning, and appreciate that question, Ryan. I'll have Deanna handle that.

Deanna Strable: Yeah. It was us taking over those properties in a complete default. Obviously, the extreme one was very unlikely, 40 percent additional

decrease from our already reduced 22 percent value. And then, I also think it's important that that wouldn't all happen at one time and would happen over an extended period of time.

Ryan Krueger: Got it. Thanks. And then, could you talk about, I guess, the amount of committed capital you already have to deploy into real estate within PGI over time as well as your evolving thoughts on when the market may pick up for new deployment opportunities?

Dan Houston: That's a great question, really appreciate that, Ryan. Hey, Pat, can you help us out on that one?

Pat Halter: Yeah. So, thanks for the question, Ryan. I think, as you know, we have been a very strong and very active advisor to investors throughout the world in real estate. And we do have a very strong, committed but unfunded pipeline through those conversations with clients throughout the world.

As you can imagine, we have not deployed that pipeline, that sort of dry powder, into the marketplace until we believe that valuations have gotten to a point where we believe we can start to enter into the markets again. But that pipeline is over \$7 billion today in unfunded, committed capital, both in the debt and in the equity strategies. So, at the right time, at the right, appropriate time, we will deploy that.

To your second question, that timing will be, I think, dependent again, once we see valuations are at a place we think are desirable for us to engage. That probably is going to be later this year. We believe it's going to have a transmission effect over the next two quarters yet to get valuations to a place where we think we can start to enter with any sort

of strong conviction. But we will and have a desire to get back into markets when we think it's appropriate.

One other thing, just to mention, Ryan. I just was in Asia three weeks ago. And not only in terms of the additional sort of funds we have today, but the active interest from institutional investors to eventually take advantage of the opportunity in real estate, is quite pronounced. And we're having some new and active conversations with institutional investors in many parts of the world to raise money, particularly in private debt right now because I think that's the first place of entry point but also in terms of private equity as we go into 2024.

Dan Houston: Hopefully that helps Ryan.

Ryan Krueger: Great. Thanks a lot.

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

Jimmy Bhullar: Hey, good morning. So, for the first one is just on the fee retirement business. And if I look at the flows in 1Q, even if you include the spread retirement, the flows seem pretty light relative to what you had in previous 1Qs over the last several years, especially given the fact that the labor market is as strong as it is. So, if you could just give some color on what drove that?

Dan Houston: Chris, please.

Chris Littlefield: Yeah, sure. Thanks for the question, Jimmy. Yeah, I think when we look at flows in the first quarter, I'd comment on a few different things. We

certainly are seeing lumpiness in the large market, and we had one low fee plan that lapsed in the quarter that was about \$2.8 billion in assets. Despite that one lapse, we are seeing really strong pipeline in large. And a reminder that in large, you're going to see lumpiness, both on the flows in as well as flows out when that happens since they're larger plans.

When I think about transfer deposit performance, though, up 22 percent. We got really strong momentum in our business and have a really strong pipeline. The underlying fundamentals are strong as well, I think Dan mentioned in his comments, particularly in the SMB. And so, while you look at recurring deposits growing at about 4 percent versus year ago and 11 percent on a trailing 12-month basis, it's particularly strong in the SMB space.

Those recurring deposits are up sort of 8 to 9 percent, and our net cash flow in SMB alone was nearly \$2 billion in the quarter. So, we're seeing really strong performance there. But, again, it doesn't take away from some of the lumpiness you're going to see on flows when you have one large plan, trying to pull people in.

Dan Houston: Yeah, one large plan like that can mask a really strong quarter. Do you have a follow-up, Jimmy?

Jimmy Bhullar: Yeah, just, it was on PGI margins. As we think about margins for the rest of the year, is 1Q a good number to use going forward in terms of expenses and just overall margin levels in PGI?

Dan Houston: Pat please.

Pat Halter: Yeah. So, thanks, for the question, Jimmy. As you note, the margin for the first quarter was a little over 30 percent. That should not be a good reflection of where we see the rest of the year in terms of margins. We did have, as you recall, every year we have a sort of onetime expense adjustment associated with retirement, deferred compensation, and also payroll taxes that is a onetime first quarter. That was around \$20 million. So, that's one thing just to highlight, Jimmy, in terms of that margin discussion.

The second thing is we do think, and have seen, a first quarter sort of a reset in terms of some valuations starting to increase. And that's going to allow for a little bit larger AUM base going forward along with the growth that we continue to expect in the platforms we have. And so, our guidance of 34 to 37 percent that we presented to you in the outlook call, we remain very confident that we will achieve that 34 to 37 percent by the end of the year, Jimmy.

Jimmy Bhullar: Thank you.

Dan Houston: Thanks for the question.

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

John Barnidge: Morning. Thank you very much for the opportunity. Oftentimes, you talk about employee withholding match and the trends there. How has that trended versus last year? Are you seeing employees or employers pull back at all on how much they're contributing? And how did that factor into the recurring deposit growth within RIS? Thank you.



Dan Houston: Yeah, it's a great question. The one thing that's amazing is just how competitive that SMB marketplace still is in terms of attracting and retaining talent. Those things still remain strong. But, Chris, do you want to provide some additional detail on the strength of the matching contributions?

Chris Littlefield: Yeah, sure. I would say we still see growth, although it's certainly slowing from what we saw in 2022. So, John, when I look at the number of participants deferring, the numbers receiving a match, the new participants with account value, and the overall average of deferred dollars per participant, all of those metrics were up 3 percent to 4 percent year-over-year. And, again, as I highlighted in the SMB, it's particularly strong at 8 to 9 percent on recurring deposits. So, that is all positive, albeit a bit slower than we've seen in past years.

John Barnidge: Thank you. And my follow-up question, maybe just a clarifying, on the \$1.8 billion on Slide 3 of the presentation, there's a footnote, and you talked about it in your prepared remarks, about the \$700 million in proceeds. Are we supposed to normalize to that, or is the \$1.8 billion the number we should be using? Thank you.

Dan Houston: Deanna, please.

Deanna Strable: Yeah. Thanks, John, for the question, and hope your recovery is going well after your accident. Just a couple of things there. That \$1.8 billion that you see on the slide is elevated due to a \$700 million of debt issuance that we issued in the first quarter, but we will pay off the corresponding existing debt in the second quarter. So, a pro forma would be more like the \$1.1 billion.

Your follow-up is then why did that go down from where we were at the end of the year? And so, just a couple of comments on that. Really, the two things that are going to impact that roll forward, other than that issuance of debt I just referred to, is, one, the return of capital to our shareholders and, two, any free cash flow and dividends between entities during the quarter.

So, obviously, you saw during the first quarter, we continued to return a sizeable amount to our shareholders, over \$300 million with \$150 million of share buybacks and a slightly larger amount to our common stock dividend. On free cash flow and dividend, first quarter is always seasonably light. It's really kind of two primary drivers there. We build up, and then there's just seasonality in the timing of dividends. And then, also in the first quarter, you have all the cash payments of bonuses that also pressures first quarter as well.

If you go back to 2022 and look at the roll forward from fourth quarter of 2021 to first quarter of 2022, you're going to see a very similar pattern, which pointed to minimal free cash flow in the first quarter but albeit very strong free cash flow for the full year. Beyond that, fourth quarter is always our largest quarter for free cash flow.

As you heard me mention in our prepared remarks, one thing that was a little different this quarter versus first quarter of last year is we did see a higher volume of high-return organic deployment opportunities in the quarter and accelerated a portion of our full-year sales plan. We're not changing our full-year sales expectation, so, again, it's just a shifting from future quarters into the current quarter.

And we actually then will see higher than originally anticipated free cash flow in the other quarters. The one I would point to that is most obvious

is PRT. We had nearly \$600 million of sales in the quarter, and first quarter is typically a very, very light quarter. So, I think bottom line, the seasonality we saw was not unexpected. We've seen it in prior years. We'll continue to see it in future years. And we remain confident about our free cash flow opportunities for the entire year.

Thanks, John, for the question.

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

Tracy Benguigui: Thank you. I'd like to touch upon the Specialty Group Benefit. Can you add color regarding what drove higher loss ratios across several products like dental and vision, group life, individual disability?

Dan Houston: Yeah. Amy will handle that accordingly. Amy, please.

Amy Friedrich: Yeah, sure. So, I think I would settle in on saying we were generally feeling good about the loss ratios you're seeing. They're within the ranges that we would have expected. And dental is probably the one that I would highlight there. It does have a bit of seasonality in it. As you know and as we've discussed on a lot of previous calls, the dental loss ratios really got out of track in terms of seasonality with COVID. So, with some of the closures and other things that happened, we sort of lost our ability to see that seasonality in the industry for a couple years.

What I see in dental seasonality is it's returning back to pre-COVID levels. So, when I look at how dental utilization emerges over the year, it's typically the highest in first quarter. So, what I would say is that loss ratio that we're seeing for dental is seasonal. It's back to expected patterns,

and it's still within what we would expect to see. Our full-year ranges for some of the loss ratios that we're seeing across our group benefits and IDI block are within normal levels.

Deanna Strable: Hey, Tracy, you also mentioned Group Life. Actually, Group Life is down once you adjust first quarter of 2022 for the COVID claims. It is up from fourth quarter, but it was more because we had an abnormally low loss ratio in the fourth quarter of 2022. So, you had mentioned Group Life, so I just wanted to touch on that one, as well.

Tracy Benguigui: Thank you. Excellent. Just circling back on the comments about adjusting your available in excess cash. So, if I take out the \$700 million from your \$1.5 billion in Hold Co cash, you're exactly at the \$800 million minimum threshold. And then, when I'm thinking about it, there isn't a lot of excess capital from your subsidiaries, \$300 million or so. You do sound confident about meeting your 75 percent to 85 percent in cash flow conversion. Are you expecting greater organic surplus generation through earnings, and that's how you'll get there for the remainder of the year?

Deanna Strable: Yeah. So, as you're aware, our free cash flow is all driven by statutory results as well as, again, in non-life entities, it would be the movement of that excess cash and capital up to the holding company. We are confident on that. As mentioned, the seasonality and some of just the pressuring of dividends and the fact that we dividend a high amount in the fourth quarter, so you start the year at a smaller level in those subsidiaries.

We feel very confident relative to that, don't see any meaningful disruption to our capital plans in the current environment. And the other

thing I'd bring you back to is post the transactions last year, our risk profile of our business mix is lower. Our credit risk is lower. We've talked a lot and given you a lot of material of why we feel really good about the high quality of our investment performance, or portfolio, that will perform well. And so, again, when you bring that altogether, we will see higher dividends in 2Q, 3Q, and 4Q. And we also do see that seasonality in statutory results as we go throughout the year.

Dan Houston: Hopefully, that helps, Tracy.

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

Wes Carmichael: Hey, good morning. Thanks for taking my question. I kind of wanted to stick with free cash flow for a second, too. But, on Slide 2 of the deck, it mentions that you expect free cash flow conversion to increase throughout the year. But, my understanding is that ratio is on the net income excluding the exited business. So, if I looked at the first quarter, the \$300 million return to shareholders, I calculated a ratio of 86 percent. So, it seems like you're kind of there already in the first quarter, so I'm just trying to reconcile that with your thoughts on that, should accelerate.

Dan Houston: I'll have Deanna handle that. But, Wes, welcome, and appreciate you picking up coverage on PFG.

Deanna Strable: Hey, Wes, just so you're aware, deployment can come out of two places. It can come from excess you had coming into the quarter as well as the free cash flow generation during the quarter. And we came in at about, I think it was just shy of \$300 million of excess coming into the year in

our Hold Co and in the entities. And so, again, you need to factor that into that result as well.

Wes Carmichael: Got it. And can you maybe just talk about your outlook for 2023 for Pension Risk Transfer sales? You had \$600 million in the first quarter in RIS. But it seems like it might be a pretty good environment with higher interest rates as well as a tailwind from the equity markets bouncing back.

Dan Houston: I'll, true to that. Chris, do you want to go ahead and respond?

Chris Littlefield: Yeah. Welcome, Wes. Thanks for the question. Yeah, I mean, as Deanna mentioned, we had a very strong start to the year, which was a little bit unusual for first quarter. We do expect to grow our PRT business, call it 10 percent to 15 percent over last year. So, in that \$2.3-ish billion range is kind of what we're shooting for. The industry is expecting opportunities of the \$30 billion to \$40 billion range overall, and plans are still really well-funded, according to Mercer, at 102 percent.

So, we do see a lot of opportunities for PRT. I think the most important thing for us, though, is we deploy that capital in a disciplined way. And so, we're not going after every PRT opportunity. We're going for those where we can get a good return on the capital that we're investing in that business.

Dan Houston: It's also probably worth calling out, Wes, that about 25 percent of those PRT sales actually came from existing full-service customers. And, again, that comprehensive approach to retirement solutions is what we're about. And you can see where those intersections come together and help drive results for the organization.

Chris Littlefield: And to that point, Dan, about \$150 million of the \$600 million in this quarter were existing DB customers of ours, so you do see the power of that in our business.

Dan Houston: Thanks, Wes, for the questions.

Wes Carmichael: Thank you.

Operator: Our next comes from the line of Michael Ward with Citi. Please proceed with your question.

Michael Ward: Hi. Thanks, guys. Good morning. I really appreciate the disclosures on CRE, very helpful. I think you guys mentioned that the LTVs are revalued quarterly. So, I was just curious about the debt service coverage component and how current these metrics are. And I'm just trying to figure out mechanically, not necessarily just for Principal, but for CRE debt like this, how might this evolve over time? And how sort of current are the debt service coverage metrics that we see?

Dan Houston: Appreciate that, Michael. And, Pat, it also might be helpful just to maybe share a little bit with the group about the resources we have surrounding this in terms of valuations and feet on the streets to assess this asset class.

Pat Halter: Thanks, Michael, for the question. I think one of the sort of the benefits that we have as an organization, as Dan highlighted in his prepared remarks, in terms of size of our organization, so on the office component, which I know is very important to all on the line here, but we also do this

for the broader portfolio. But office, we're actually reevaluating, re-underwriting each one of those loans every quarter. So, we have a very deep, wide, experienced team that covers 40 of the major markets in the U.S.

And we have underwriters who are steeped in knowledge, steeped in those markets, to do basically quarterly reevaluations, reconstructing the cash flows associated with the rental streams, and lease structure of those transactions in real time, along with getting market data on where cap rates may be, where they may be heading, what's going on in terms of market rents relative to the contract rents in our sort of property, tenancy changes, and really updating on a cash flow basis each one of those assets from a property income expense perspective.

So, we are actually doing a deep cash flow analysis, which allows us to have a lot of confidence in those debt service coverage ratios as a result of that in terms of analysis, Michael. And then, in terms of valuations, obviously, we also have a very deep, experienced equity real estate group, which is developing, managing real estate throughout the country.

So, they're getting real-time broker opinions as to the trends that are going on in terms of cap rates, trends that are going on in terms of investor sentiment. And so, it's a very robust process that we're engineering every quarter now for our office portfolio. And then, on the residential and industrial portfolios also, we're going through that same process over a sequence of quarters.

Dan Houston: Does that help, Michael? Thank you Pat.



Michael Ward: Yeah, that's very helpful, guys. Thank you. So, maybe on commercial mortgage loans versus CMBS, just wondering if you could comment. I think you guys are mainly or almost all conduit. And I believe about 30 percent of that is office, so hoping you could comment on that and whether or not that's included in the RBC stress test.

Dan Houston: Pat please.

Pat Halter: Yeah, so we do have an analysis that goes on relative to our CMBS portfolio also. And interesting to note that our sort of office exposure in the private space in terms of that percentage is somewhat similar to what we have in our CMBS portfolio holdings; 25 percent, 30 percent is in office. We are actually evaluating those assets also from the point of view of both maturity and in our sort of CMBS portfolio. Those office loans in terms of maturity are quite limited in terms of 2023 and 2024.

But, we're also, because of the subordination levels, we're doing a sort of a bottom-up analysis as to, how are those subordination levels protecting us from then the expectations of performance in those underlying loans as we stress test them? And we're stress testing those loans clearly from the point of view of the appraisal analysis, the valuation analysis I just highlighted, Michael, and the cash flow analysis I just highlighted.

And we're then applying that to the actual structure of those CMBS structures in terms of subordination levels. And what we're finding is very positive thus far, and that is when we stress test those portfolios, we still have subordination levels that would allow us to have a great deal of comfort because those subordination levels would still be in a stress test environment of 21 percent or better. And that is an A quality

approach and level of rating if we looked at that from a, sort of a comparable, sort of a rating agency perspective.

Deanna Strable: Hey, Mike. That was not included in the stress test that we included. But, if you actually look at Page 14, and given that 98.5 percent of those CMBSs are NAIC 1, I think any impact in a stress scenario, and, again, in addition to the commentary that, Pat, would be very, very minor relative to that risk.

Michael Ward: Thanks very much, guys, extremely helpful.

Dan Houston: Thanks for the question Michael.

Operator: Our next question comes from the line of Suneet Kamath with Jefferies. Please proceed with your question.

Suneet Kamath: Thanks. Good morning. Appreciate all the color on how you go about valuing the office CRE. It does sound like you have a lot of resources. But just curious, is there part of the process where you go through getting a sort of a third party to kind of validate the analysis just to kind of give you one more check?

Dan Houston: Pat?

Pat Halter: Yeah. So, typically, you'd get an appraisal. The challenge today, as you can imagine, Suneet, is the appraisals are probably not as current, not as, I think, active in understanding in real time what's going on within the reconstruction of those cash flows, the buildings, and how, the tenancy and the market rents relative to the contract rents in those buildings are

evaluating and changing. So, we do not sort of, in that sort of analysis, go out and get a third-party valuation opinion. We think that our expertise, our deep analysis, is probably superior, frankly, to that.

Dan Houston: We meet once a week, Suneet, with the real estate team and assess these investment options in our investment community. These professionals are in there. They're talking about this. They have deep relationships with brokers in each one of these subcategories. And so, I think there is a really honest assessment in valuation associated with how we keep these on the books. And, again, it's a rigorous process that is staffed incredibly well.

Pat Halter: And, Suneet, just to add to that. We have over 550 institutional investors in over 34 countries. And they also feel very comfortable with the process we deploy here.

Suneet Kamath: Got it. Makes sense. And then, I guess a quick one for Deanna. Just in terms of the outlook for buybacks, I guess you did \$150 million here in the first quarter. Is that about the pace that we should expect going forward? Or just any color in terms of expectations on that. Thanks

Deanna Strable: Yeah. I think there will be volatility quarter-to-quarter, but I think if you annualize that amount, that's in the ballpark. And I think if you kind of looked at kind of our free cash flow estimates relative to kind of what you'd be expecting, you'd get to that same level. Obviously, we want to recognize the current environment. We need, there is some lumpiness quarter-to-quarter we need to take into account. But, yeah, I think that's a good indication of what could occur through the rest of the year.

Suneet Kamath: Okay. Thanks.

Dan Houston: Thank you.

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

Erik Bass: Hi. Thank you. In the RIS business, net investment income increased pretty materially from the fourth quarter, even adjusting for variable investment income. So, I was just hoping you could talk about what's driving this and the outlook going forward and then how we should think about how much of that benefit drops to the bottom line?

Dan Houston: Chris, please.

Chris Littlefield: Yeah, sure. Thanks for the question, Erik. I mean, I think we definitely are seeing three primary drivers in what's happening in the investment income. Certainly, we've seen a benefit to the increase in short-term interest rates, and that's certainly had a positive effect. We've seen some additional timing difference between when the rates were increasing and when rates are credited back to the customer, so the lag. That's been a second driver. And then, third, we've seen overall growth in the block of our business. So, those are the key drivers in NII.

I think when you look at the supplement, you look just at NII, it can, it's not necessarily the best picture because you also have to take into account the interest that's being credited in the BCSD line. And so, there is certainly a benefit that we're seeing, but it's not as large as you would see just by looking solely at the NII line, so definitely a benefit.

We expect to see some additional benefits if interest rates continue to rise, although I think we're kind of nearing the end of the larger increases that we saw over the course of 2022. And we expect to have some benefit. What we've also said through 2022 and what I'll reiterate again today, that will normalize over time in net interest margin. There are competitive pressures and others, and that will tend to normalize over the long term, but we will, we expect to see some benefit.

Dan Houston: Do you have a follow-up, Erik?

Erik Bass: Thanks, yes, a follow-up for Pat. And just curious what you're seeing in terms of client demand for fixed income. And has interest started to pick up now that rates have stabilized a bit? And, if so, are you seeing new money going into traditional active products, or is more being allocated to passive?

Pat Halter: Yeah, great, thanks, Erik. Thanks for that question. It's been interesting. We actually were, in our fixed income sort of portfolio, we had a couple things that were kind of interesting in the first quarter. One was, as you know, we're very active in preferreds. And given the banking prices, we did have a little bit of outflow from preferreds. Interesting to note, though, as we sort of communicated to investors, and we've gone sort of maybe on the other side of the banking prices, investors are now starting to look at preferreds again.

And I mention that because I think our Specialty Income sort of capabilities continue to be relevant in the marketplace, even with investors moving to money market and to CDs. We do think there's been a little bit of a pause because of that, but there is a lot of active discussions underway about high yield. There's a lot of active

discussions, as I mentioned, about preferreds and, relatively speaking, things that we think we're very good at, like the emerging market debt, REITs.

That activity is also increasing in terms of income-producing investments. So, we think that fixed income, once interest rates stabilize and the Fed starts to maybe get in a place of not raising rates, there will be maybe more of an interest, a bigger amount of active investing in fixed income, and we're expecting that.

Erik Bass: Thank you.

Dan Houston: Thanks for the questions.

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

Tom Gallagher: Good morning. My first one, Deanna, I just wanted to ask about some of the details about cash flow generation in the quarter, recognizing your seasonal comments. I can appreciate that. But, if I sell for, forgetting about seasonality for a minute. If I sell for normal capital generation in the quarter versus how much you produced, I end up with about a \$350 million to \$400 million shortfall versus normal.

Now, I'm assuming PRT consumed around \$50 million. The seasonal cash payments that you highlighted, maybe that's another \$50 million to \$100 million. That would leave me with about a \$200 million shortfall. Tell me if that math sort of adds up. And, if so, what else would fill in the gaps here? Thanks

Deanna Strable: Yeah. Thanks, Tom, for the question. I think the seasonality is greater than what you're giving credit to, if you went back to the roll forward from fourth quarter to first quarter last year, there we deployed approximately \$900 million in the quarter, and our capital was reduced by just shy of \$900 million and so, again, very modest free cash flow. So, you're understating the amount of seasonality. I think maybe the organic opportunities is probably in the ballpark. But, really, that seasonality is much greater than what you were anticipating in your roll forward.

There were some modest one-timers in the quarter. I'd say either they were anticipated in our capital plan, but we knew they would be pressuring first quarter, or they will reverse in future quarters. But, it's really that seasonality that you're understating, and I'd take you back to a year ago to kind of do a comparison.

Tom Gallagher: That's helpful. Thank you. And then, my follow-up was for Pat. The part, it's a question on your updated investment disclosure. The \$2.9 billion off-balance sheet gain on your equity real estate, if I just look at the carrying value versus the current estimate of market value, that's a very big, we'll call it off-balance sheet gain.

How should we think about what we should do with that number? Should we just assume slow, steady monetization of the difference is going to help you produce your alternative return goals? Or would you ever look to do a big acceleration, a bigger portfolio sale, to create a lot more excess capital?

Dan Houston: Yeah. Let me have Deanna go ahead and respond to that, again, her responsibility over cap marks.

Deanna Strable: Yeah. I think there's a couple things there, Tom. I think, yeah, we obviously haven't disclosed this over a period of time, but this would be something that we've had in our portfolio. Obviously, we're going to do what's right for our investors and our customers over the long term. Sometimes, we'll see that offset some credit pressures, other parts of our, in our portfolio. Sometimes, we'll actually roll it into new equity real estate investments, so it doesn't drop to the bottom line.

But, again, I think your bottom-line observation relative to that is right. But, again, it's not something that we would pull just to return to our shareholders because, again, we want to do what's right over the long term relative to this portfolio. It's a very high-quality portfolio. It's a very diversified portfolio. And it is something that has served our customers well over many decades. And, again, we're very active at looking at those opportunities and pulling triggers and pulling the levers when it makes sense for our customers and our shareholders.

But, Pat, anything to add there?

Pat Halter: No, I think that's really well said. Just to add a little bit, Tom, to the dimensionality of it. It is, does have a big concentration in industrial, and it has a big concentration in residential, so that's really good. I think we've identified in the office in the past what carrying value is, a little over 500. We have over \$1.5 billion versus the cost basis of \$500 million. So, but it's a very diversified portfolio. I think we have a lot of flexibility to use the portfolio as Deanna highlighted, and it's well-positioned for that.

Dan Houston: Thanks for the questions, Tom.



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

Alex Scott: Hi. Good morning. The first one I had is on the RIS expense timing. Compensation and other came down a pretty good amount year-over-year. And I know you called out expense timing. So, I just wanted to see if you could unpack that a little bit for us. I mean, I'm cognizant of the fact that you guys have been very good at managing expenses over time. So, I want to understand how much of it like more pure expense timing versus good old-fashioned expense management the way you guys have been doing the last couple quarters?

Dan Houston: We're trying to have good, old expense management around here all the time across all the businesses. And I think what makes RIS a little bit unique is the post transaction with the Wells Fargo IRT business. But, Chris, do you want to provide some additional detail?

Chris Littlefield: Yeah. Thanks for that, Alex. I mean, what I would say is we continue to exercise good discipline expense management. And I think, as I said last quarter, we're committed to maintaining our margins. And so, we're going to take the actions that we need to align revenue and expenses.

We definitely did see some one-time benefits from some prior period accruals that were no longer needed. We had some timing, which we think will catch up in the quarter over the course of the year. We're delivering on the expenditure synergies from IRT, and we're investing for growth. So, when I put all of that together, we, by the end of, through 2023, we expect comp and other to essentially be flat year-over-year.

We'll get some good savings, but we're also investing in for future growth, as well. So, hopefully, that answers the question.

The only other thing I'd point out that we haven't highlighted is when we're taking these disciplined expense management, we had about \$3 million of severance expense in the first quarter that we didn't call out specially. We had about 7 in the fourth quarter last year, and we had 11 for full year last year. So, we're still showing good expense management despite some of those additional severance costs.

Deanna Strable: Now, just one thing to point. I don't know what you were comparing to. But, if you were comparing back to first quarter of 2022, that would have included expenses relative to the retail fixed annuity business. Again, that will normalize. And we still had PSA expense and some other items in there as well.

Alex Scott: Yeah, understood. And maybe just high level on PGI. Could you talk us through the outlook for flows and any nuances in your portfolio that kind of push it one way or the other, or should we just think about some of the overall industry pressures, and any color you can provide to help us out there?

Dan Houston: Pat, please.

Pat Halter: Yeah. So, thanks for the question, Alex. Clearly, I think on the retail side, the platform side, there still continues to be a lot of investor uncertainty relative to market conditions, the economy, inflation, the path of interest rates. And, as I mentioned in my response to Erik, there is a lot of money that continues to flow into money market accounts, CDs. And that is, I

think, something that will continue to probably be an active area for investors.

That being said, I think, as I mentioned earlier, we do like our relative position to Specialized Investment Income products, as I mentioned in my previous response. And I think we will continue to see, as I highlighted also, more active interest in private credit, private debt, some of the real estate sort of offerings that we believe are viable in this marketplace as we look forward to the next year or two.

And so, I think that's an area of potential growth on the institutional side. The equity space, we have some strong equity sort of capabilities. We had a couple nice wins. I think we highlighted that in the material in the first quarter. So, I think there's still uncertainty, there's still a lot of sort of thought capital we need to provide investors, where to position themselves in this uncertain marketplace. But our broad base of investment capabilities, I think, offer a lot of choice to them.

Dan Houston: Thanks, Pat.

Alex Scott: Thank you.

Operator: Our final question comes from the line of Josh Shanker with Bank of America. Please proceed with your question.

Josh Shanker: Yeah, thank you. Just an easy one. I want to follow up on a few things that Tom was asking. In the prepared remarks, you talked about the pull forward on your business plan. What's the normal seasonality of deploying capital into the business plan? Is it usually equal in every quarter? And how big is the variance?

Dan Houston: Deanna.

Deanna Strable: Yeah. I don't think that's an easy answer because every product is different. Again, the one we highlighted was PRT because that was different than what was kind of a normal seasonality where PRT tends to be in a normal year, very back-end loaded. And we saw it, again, great opportunity, great returns, and wanted to take advantage of that. And so, again, seasonality, as I said, first quarter free cash flow very pressured, fourth quarter free cash flow very strong. But, again, product by product, that seasonality is very, very different.

Josh Shanker: Okay. I'll let it go there. Thank you.

Dan Houston: Thank you. Appreciate the question, Josh.

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

Dan Houston: Yeah, appreciate that, Christine. A couple of quick comments, the first of which is we appreciate your insights and your questions. Secondly, a large portion of the management team that's here today was here during the '08, '09 period. We've been through this cycle before, and we'll find an appropriate path through this cycle. Maybe, third, just recognizing that we're trying to be very proactive with investors on the disclosures, in particular around commercial real estate and office, because we think it's the right thing to do to provide that level of transparency.

Also, I think it's helpful to understand the clarity and the emergence of our free cash flow, again reaffirming where we had set out from the beginning of the year, again, the first quarter has had this historically, and then also to recognize the fundamentals of the markets which we serve. And, by the way, the international markets as well, which we didn't get into a lot of conversation today, has really held up well, so seeing very positive cash flows in both Asia and Latin America.

So, in spite of some very challenging and what I'd call volatile macroeconomic environments, the markets in which we serve have held up very well. And it's certainly our intention to deliver on the promises we made during our outlook call. So, thank you, and look forward to seeing you on the road. Have a great day.

Operator: Thank you for participating in today's conference call. This call will be available for replay beginning at approximately 12 p.m. Eastern Time until end of day May 1, 2023. 13735216 is the access code for the replay. The number to dial for the replay is 877-660-6853 for U.S. and Canadian callers or 201-612-7415 for international callers. You may disconnect your lines at this time,

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<sup>1</sup> As of December 31, 2022

<sup>2</sup> Ethisphere, 2023

<sup>3</sup> Pensions & Investments, 2022