Principal Financial Group®
1Q 2024 Earnings Call Transcript

April 26, 2024
9:00 a.m. CT
Nasdaq: PFG

Call participants

Executives

Dan Houston: Chairman, President & CEO

Deanna Strable: Executive Vice President & CFO

Kamal Bhatia: President - Principal Asset Management

Amy Friedrich: President – Benefits and Protection

Chris Littlefield: President - Retirement & Income Solutions

Humphrey Lee: Vice President - Investor Relations

Analysts

Ryan Krueger - Keefe, Bruyette & Woods

Suneet Kamath - Jefferies LLC

Wes Carmichael - Autonomous Research

Joel Hurwitz - Dowling & Partners

John Barnidge - Piper Sandler

Wilma Burdis - Raymond James

Tom Gallager - Evercore ISI

Jimmy Bhullar - J.P. Morgan Securities, Inc.

Michael Ward - Citigroup

Presentation

Operator: Good morning, and welcome to the Principal Financial Group First Quarter 2024 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 "*" and the number "1" 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 yourself to one question 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 2024 Earnings Conference Call.

As always, materials related to today's call are available on our website at 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. Other members of senior management will also be available for Q&A.

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. Reconciliation of the non-GAAP financial measures to the most directly comparable U.S. GAAP financial measures may be found in our earnings release, financial supplements and slide presentation. We are planning to host our 2024 Investor Day on Monday, November 18th, in New York, and look forward to seeing many of you over the coming months. Dan.

Dan Houston: Thanks, Humphrey. And welcome to everyone on the call. This morning, I will discuss key milestones and highlights from the first quarter, as we continue to execute our strategy with discipline and focus and deliver strong results for our customers and shareholders. Deanna will follow with additional details on our results and our capital position.

The first quarter of 2024 was a good start to the year for Principal. We reported $394 million of non-GAAP operating earnings, or $1.65 per diluted share, an 11% increase in EPS over first quarter of 2023.

Across the enterprise, we continue to focus on growth, while balancing disciplined expense management, investing for growth and innovation in our businesses, and returning excess capital to shareholders. We remain well-positioned to deliver on our outlook for 2024, as well as our long-term financial targets.

We returned more than $360 million of capital to shareholders in the first quarter, including $200 million of share repurchases. We raised our common stock dividend for the fourth consecutive quarter, aligned with our targeted 40% dividend payout ratio.

Strong sales and favorable market performance contributed to total company managed AUM of $709 billion, at the end of the quarter. We generated nearly $1.5 billion of positive total company AUM net cash flow, after adjusting for the redemption in PGI that we discussed on recent calls.

In Principal Asset Management, PGI generated positive institutional net cash flow, as private real estate continued to attract investors and we saw renewed demand for specialty fixed income investments. In addition, general account flows were also strong in the quarter.

PGI sales were strong in the first quarter, including a rebound in US mutual fund sales. It was the best quarter for mutual fund sales in two years, driven by wins across equities and preferred securities.

Principal International net cash flow was positive $1 billion, our strongest quarter since 2021, driven by robust sales in Brazil. Principal International ended the quarter with $179 billion of total reported AUM. Favorable market performance and strong net cash flow were more than offset by foreign currency headwinds, primarily in Chile.

While persistently high inflation and low unemployment could keep the Fed from cutting rates in the near term, we remain optimistic that investors will continue to move money into longer duration and higher yielding assets, based on our engagements and conversations with customers and distribution partners.

Turning to US retirement, RIS generated strong revenue and earnings growth in the first quarter. Margins remained stable and at the high end of our guidance as we continue to focus on revenue generation, while investing for future growth.

Importantly, the fundamentals of our retirement business remain healthy with strong contract retention, as well as increases in recurring deposits, participant deferrals, and employer matches.

Total retirement sales grew 6% over the year-ago quarter, and the pipeline remains strong. This included more than $750 million of pension risk transfer sales in the first quarter, building on a $2.9 billion of PRT sales in 2023, across 73 contracts.

2023 LIMRA rankings for PRT were recently released, and Principal ranked number four in industry based on premium and number three for number of contracts. We are the only PRT provider in the top five for both metrics, solidifying our leadership position in this attractive market and supported by our market-leading defined benefit business.

We continue to leverage our favorable market position in the retirement industry with a full suite of solutions, and we are optimistic on the momentum we're seeing, across our retirement platforms.

This week, Department of Labor published its final rule defining fiduciary investment advice under ERISA and revised related regulatory exemptions. Principal has a history of effectively adapting and responding to regulatory change, while continuing to meet customer needs, and we'll do the same with this latest rule.

We are analyzing the final rule and what it means for our intermediaries we work with, along with our plan sponsors and participants. We are encouraged that the DOL confirmed and protected the importance of financial education within the workplace retirement plans with language affirming that educational support to retirement savers enforces positive savings behaviors.

Having said that, we remain concerned it will have an unintended consequence of limiting consumer access to meaningful financial tools and advice, on top of creating significant compliance costs for firms.

In Benefits and Protection, record sales, along with employment and wage growth, drove an 8% increase in premium and fees and specialty benefits over the first quarter of 2023. More than half of this growth is from net new business, demonstrating our competitive advantage by focusing on the underserved, small to mid-sized business market.

We continue to grow faster than the industry by deepening relationships with key distribution partners and with our customers.

The life insurance premium and fees for the total block increased 4% over the first quarter of 2023, including a 23% increase in the business market. Our focus on business market and SMBs are driving growth across the enterprise. More than half of our first quarter non-qualified sales were part of a total retirement solutions plan.

I'm excited about the opportunities across Principal and remain confident that our focus on higher growth markets, combined with our integrated product portfolio and important distribution partnerships, will continue to create value and drive growth.

Before turning it over to Deanna, I'd like to highlight the strong progress we've made against our sustainability goals. We've taken a measured approach to sustainability, ensuring our commitments, such as supporting the growth of diverse small businesses, accelerating the execution of our business strategy.

And in recognition of strong corporate governance, Principal is once again named one of the world's most ethical companies by Ethisphere, recognizing ethical leadership and business practices. This is our 13th time on this list, since it was launched in 2006.

Approaching our 145th anniversary, we've always recognized the importance of keeping our promises while building a track record of progress on issues that matter to our customers, employees, businesses, and communities. Building trusted, meaningful relationships across all stakeholders continues to be a bedrock for driving growth into the future.

Deanna.

Deanna Strable: Thanks, Dan. Good morning to everyone on the call. This morning, I'll share the key contributors to our financial performance for the quarter, as well as details of our capital position. First quarter reported net income was $533 million. Excluding exited business, net income was $376 million, with minimal credit losses of $19 million.

Excluding significant variances, first quarter non-GAAP operating earnings were $419 million, or $1.75 per diluted share.

EPS increased nearly 10% over the first quarter of 2023, stronger than we expected heading into the quarter. This was aided by top line growth and market outperformance, despite pressured foreign currency translation impacts. We're confident in our ability to deliver on our targeted 9% to 12% EPS growth for the full year.

As detailed on Slide 12, significant variances impacted non-GAAP operating earnings by a net negative $34 million pre-tax, $25 million after tax, and $0.10 per diluted share. Favorable Encaje performance was more than offset by impacts from variable investment income and a GAAP-only regulatory closed-block dividend adjustment in life.

Looking at macroeconomics in the first quarter, while markets were generally favorable across the board, the S&P 500 performed better than mid-cap, small-cap, and international equities, as well as fixed income and alternatives.

While the S&P 500 is a conventional gauge for market performance, it is important to note that our equity exposure is more diversified. When you break down the equity portion of PGI AUM, approximately 40% of our exposure is S&P 500, 30% small and mid-cap, 20% international, and 10% REITs.

Foreign exchange rates were a headwind, relative to both the first quarter and fourth quarter of 2023, but remained a tailwind on a trailing 12-month basis.

Turning to the business units, the following comments exclude significant variances. RIS pre-tax operating earnings increased 7% over the first quarter of 2023, driven by growth in the business, higher net investment income, and favorable market performance. Margin remains strong and at the high end of our guided range.

PGI's pre-tax operating earnings increased 4% over the first quarter of 2023, as the benefit from market performance was partially offset by the impact of recent redemptions, as well as lower transaction and borrower fees and immaterial performance fees.

The expected first quarter seasonality that we discussed on last quarter's call played out as we anticipated. PGI had approximately $25 million of higher deferred compensation and elevated payroll taxes, slightly higher than the impact in the first quarter of 2023.

In PI, strong performance in Latin America was muted by impacts of unfavorable foreign exchange, as well as macroeconomic headwinds in Asia. Specialty benefits pre-tax operating earnings increased 12% from the first quarter of 2023, driven by growth in the business and more favorable underwriting experience. The underwriting results reflect the seasonal pattern of dental claims, which tend to be higher in the first half of the year.

In life, pre-tax operating earnings were impacted by typical first quarter seasonality and some higher non-qualified surrenders, which can be volatile, quarter to quarter.

Across the businesses, we remain confident in delivering on our revenue growth and margin guidance for the full year, anchored to our long-term financial targets.

Turning to capital and liquidity, we are in a strong position with approximately $1.4 billion of excess and available capital, including approximately $1.1 billion at the holding company, which is above our $800 million targeted level and $300 million in our subsidiaries. Our risk-based capital ratio was approximately 400%, in line with our RBC target.

As shown on Slide 3, we returned more than $360 million to shareholders in the first quarter, including $200 million of share repurchases and $162 million of common stock dividends.
We continue to expect to deliver on our targeted 75% to 85% free capital flow for the full year.

As discussed on last quarter's call, free capital flow is always the lightest in the first quarter, due to timing of capital generation and increases throughout the year.

We are committed to returning excess capital to shareholders and continue to expect $1.5 billion to $1.8 billion of capital deployment for the full year, including $800 million to $1.1 billion of share repurchases. The pace of share repurchases will increase throughout the year, as free capital flow increases.

Last night, we announced a $0.71 common stock dividend payable in the second quarter, a $0.02 increase from the dividend paid in the first quarter and an 11% increase over the second quarter 2023 dividend. This is in line with our targeted 40% dividend payout ratio and demonstrates our confidence in continued growth and overall performance.

Our disciplined capital management strategy is aligned with our commitment to deliver long-term enterprise growth, while allowing a significant amount of capital to be returned to shareholders.

Based on net income, excluding exited business, we target 15% to 25% to organic capital to support growth in our businesses, 40% to common stock dividends, 35% to 45% to share repurchases, and up to 10% to strategic M&A to enhance our capabilities and support organic growth.

We remain focused on maintaining our capital and liquidity targets at both the life company and the holding company and will continue a balanced and disciplined approach to capital deployment.

Our investment portfolio remains high quality, aligned with our liability profile, and well positioned for a variety of economic conditions. The commercial mortgage loan portfolio remains healthy.

As discussed on our last call, we had one scheduled loan maturity in the first quarter in our office portfolio, and it was paid off in January. The remainder of the office portfolio and the underlying metrics are relatively unchanged from last quarter.

In closing, I am proud of our first quarter results, demonstrating the power of our higher growth, higher return, and more capital-efficient portfolio. We are in a strong financial position and are well-positioned to deliver on our Enterprise 2024 targets, including 9% to 12% growth in earnings per share, increasing return on equity, and 75% to 85% free capital flow conversion.

We are grounded in our growth drivers of retirement, asset management, and benefits and protection and executing on a strategy focused on continuing to drive long-term shareholder value.

This concludes 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 “*” and then the number “1” on your telephone keypad. We’ll pause for just a moment to compile the Q&A roster.

The first question comes from Ryan Krueger of KBW. Please go ahead.

Ryan Krueger: Hey, thanks. Good morning. My first question was on PGI flows and I guess, in particular, can you provide some more color on the conversations you're having and kind of the optimism you discussed in the prepared remarks for continued improvement and allocations to yield products, going forward?

Dan Houston: Yeah, and good morning Ryan, and thanks for joining the call. And Kamal Bhatia is here with us to replace Pat Halter. He's certainly getting well-grounded after having been with us now for four years and an industry vet. So with that, I'll ask Kamal to respond, directly, Ryan.

Kamal Bhatia: Sure. Good morning, Ryan, thank you for your question. Thanks Dan. Ryan, I'll just reiterate something Dan said and give you additional data points that will help you with your question regarding what we see from a sentiment perspective.

As you saw, we had a very good flow quarter, particularly on the institutional side with real estate and fixed income. And also, as Dan mentioned, we had our best quarter in mutual fund sales in two years.

So I'll give you three data points from a global perspective. The first one is retail. And as you saw, we are seeing encouraging signs of turnaround in retail. More interestingly, retail flows are difficult to predict, but we have a different momentum with our client base, right now.

We see interest expanding across sophisticated gatekeepers, particularly with our higher revenue fundamental equity strategies. And some of these mandates are significantly higher sized. But they will continue to be lumpy. That is the big change in the retail space, unlike a trickle that would come from the advisory base.

The other data I would point to you is we are seeing early signs with our real estate business. As you know, we have roughly $6 billion of unfunded capital commitments in our institutional real estate strategies, which we project to call over the next 18 to 24 months. These are predominantly in closed-end funds and separate accounts. We are seeing early signs of value emerging in that market to call capital, but we will have to do so on a selective basis, as these opportunities emerge.

One of the things I would highlight for you is sellers are finally reconciling to a higher plateau in rates, and that's creating a better environment for us as investors in that space.

And then the last thing to your question on where we see in global asset management, this was a very strong quarter for our international business, particularly in Latin America, and we anticipate positive momentum for the rest of the year, particularly with our Brazil pension business and our Mexico funds business, as well.

So overall, encouraging signs in retail. We continue to see more interest from our institutional client base, and our international segment is continuing to scale up.

Dan Houston: Ryan, does that help?

Ryan Krueger: Yeah, that was great. Thanks. And then just the follow-up was on the fee rate. Down some year-over-year, 28 basis points in the quarter. What are your expectations on the fee rate in PGI, going forward**?**

Dan Houston: Yeah, 28 basis points to 29 basis points is where we said it would be and it falls within that range. And maybe, Kamal, any additional comments you'd like to make there**?**

Kamal Bhatia: Sure. I'll give you a couple of data points on that, Ryan, as well, maybe three data points. As Dan said, we remain comfortable in managing to our 28 data points to 29 data points. So just with respect to 1Q, market conditions did shift the product mix, which impacted our revenue. As you heard in our comments earlier, if you exclude the previously communicated large outflow at the beginning of 1Q, our flows were positive.

The other change in the revenue rate for 1Q was based on annual price reviews on our US mutual funds and some of the real estate valuations late in fourth quarter, which also had some additional effect.

I would point to the--moving forward, when I look at the revenue rate, I think the strong institutional real estate flows and fixed income flows, our fixed income sales are continuing to happen in the high yield credit space, which is a strength of ours but also an area where, generally, it's good for management fee rate. And we also are continuing to see retail flows improved, which traditionally go to higher revenue and higher margin products, such as equity mutual funds.

I would also reiterate for you because clients, obviously, pay keen attention to performance, and that drives flows and growth in management fee rate. We had a very, very strong investment performance track record, this last quarter. In particular, I would highlight for you the substantial improvement in our multi-asset strategies that drives our future retirement flows.

So the shift towards private assets, which we see improving over as the year goes by, should help with the performance rate, as well.

Dan Houston: Thanks for the questions, Ryan.

Ryan Krueger: Thank you.

Operator: Our next question is coming from Suneet Kamath of Jefferies. Please go ahead.

Suneet Kamath: Thanks, good morning. Just a question on RIS fee. I guess we're all sort of going on the assumption that we're going to be in a high for longer rate environment. So just curious if that's having any impact on the participant level withdrawals one way or the other. And maybe if you can talk a little bit about what you're seeing at the participant level, maybe currently versus prior years.

Dan Houston: Chris, please.

Chris Littlefield: Yeah, thanks for the question, Suneet. On a participant basis, we are seeing a little bit of an uptick in the participant retirement withdrawals. So, again, that's going to really be impacted both by the strong equity markets, which actually increases account values. And then when they take the withdrawals, that has a bit of an impact. So we are seeing some elevated activity in participant withdrawals in the first quarter, and we'll be monitoring those elevated withdrawals, through the balance of the year.

Suneet Kamath: Got it.

Dan Houston: I was just going to have Chris make any comments with regards to the higher interest rate environment and how we might see that play its way through in terms of asset capture, perhaps, at benefit event.

Chris Littlefield: Well, we definitely are seeing the benefit from higher interest rates in RIS. And certainly, we're getting some benefit as we capture participant accounts on rollover. To the extent that we capture those accounts either in IRA rollover or safe hold, we definitely are seeing some benefit in bank in terms of those higher interest rates, as well. So, we do see retirement withdrawals. We capture some of those withdrawals on rollover. And to the extent they end up within our bank product, we do see some benefits from that, as well.

Dan Houston: Sorry to interrupt Suneet go ahead.

Suneet Kamath: That's actually where I was going to go next. I think, Dan, in the past, you actually used to give us a stat on that, like, when you have a benefit event, what percentage of the assets you guys retain. So I was just curious if there is a stat that you can give us there, and I don't know if you have any sense on how that would compare to sort of the overall industry.

Chris Littlefield: I think competitors generally don't disclose that, and so we don't disclose that, at this point.

Dan Houston: We used to share that number, years ago. At benefit event, there's job changers, there's retirees. It's really trying to identify the best prospects for Principal and whether that's retained through partnering with our brokers that brought the business to us or to do it on a direct basis, but again, it is a significant part of our value creation for our participants to be able to give them that choice of benefit event for either purchasing a Principal product or, in many cases, leaving the money in the plan, and that's another area that's sort of hard to measure because we don't know how long that money will stay within the plans. But anyway, there's a real mix of measurements out there in the industry. Hopefully, that helps.

Suneet Kamath: Yeah, it does. Thanks

Dan Houston: Thank you.

Operator: Thank you. The next question is coming from Wes Carmichael of Autonomous Research. Please go ahead.

Wes Carmichael: Hey, good morning, and thank you for taking my question. I wanted to stick with RIS maybe for a moment. But you mentioned the pipeline remains strong and you called out PRT as one of those areas. Can you maybe just help us with what the size of that pipeline looks like and how much you might be targeting in terms of sales or capital you want to deploy there for the year?

Dan Houston: Hey, Wes. Congratulations on joining Autonomous. Appreciate you being on the call. One other thing I'm just going to add before Chris jumps into those specifics. We just actually were on the West Coast together, Chris and I and his team, with our institutional client council and our institutional client advisory group, and the feedback was really positive. We really are seeing a strong momentum with our customers in terms of them embracing, helping their participants be better educated, very open to providing additional services to those plan sponsors and, frankly, the IRT integration is well behind us at this point in time, and the sentiment was quite positive.

Chris, you want to go ahead and respond directly to the question?

Chris Littlefield: Sure. I think, Wes, your question was about PRT and the momentum in PRT and what we expect for the year. We certainly had a strong start to the year in the first quarter with PRT sales at close to $800 million. We certainly saw that carryover benefit from the fourth quarter. We saw good fourth quarter momentum, and that carried into the first quarter. And so, we continue to take advantage of that and, most importantly, we did that above our targeted returns, as we've talked about in the past. We really tried to get the right balance between growth in our PRT business and overall returns.

As we look toward the balance of the year, the industry is expecting another strong year in PRT at about $30 billion to $40 billion in total industry sales. We are targeting, and we've said on the first quarter--the end of the year call, we're targeting somewhere in the neighborhood of $2.5 billion to $3 billion in PRT sales for the full year, and we expect most of that to come a little bit now later in the year, as people close out their defined benefit pension liabilities and look at that as they head into ‘25. So, we do generally see a ramp up in PRT activity in the late third and fourth quarters, and we expect that sort of seasonality of the sales to continue.

Wes Carmichael: Thank you. And just on the Department of Labor, I know you're still in early innings of analyzing a very big document, but you mentioned a little bit in terms of increased compliance costs. Is there any way you can help us with sizing that and what you think the increased expense might be associated with that, based on what you know today?

Dan Houston: Yeah, my guess is that's going to be sorted out over the next six to 12 months, as we continue to digest this most recent decision on the Department of Labor. It's something I've been involved with all the way back to 2010.

One of the pieces of good news that came out of that is the regulation that provides a bit more clarity on guidance and advice and education at the work site, which we find very positive. But I don't think we've got this all sorted out except to say that it will require more licensing on the part of some of our internal personnel.

There's training that will need to take place and, of course, just the appropriate oversight and overseeing these registered reps and staying in compliance and working on matters related to transparency and disclosure.

So, we'll sort it out over the course of the next six to 12 months to keep you apprised of how that's impacting our business. Bottom line is it's something we view as manageable and quantifying the cost is not something we've put a figure on yet.

Wes Carmichael: Thank you.

Dan Houston: Thanks, Wes.

Operator: Thank you. The next question is coming from Joel Hurwitz of Dowling. Please go ahead.

Joel Hurwitz: Hey, good morning. I wanted to start on RIS fee rates. So the fee rate looked to be down around two basis points from where it ran in '23. Could you just provide some color on sort of the fee rate compression you saw in the quarter and the expectations, moving forward? And then also in terms of the fee business, how much of the business has revenue that's based off of account value versus a per participant fee?

Dan Houston: Great questions there. I'll just have Chris go and pick that one up, Joel.

Chris Littlefield: Yeah, great. Thank you, Joel, for the question. So, we think fee revenue rate performed largely in line with our expectations, this quarter. We've previously guided that we expect in the neighborhood of 2 to 3 basis points of compression in normal markets.

So, a couple of factors I'd point out. Strong equity markets impact fee revenue rate, and when you think about the proportion that's asset based versus either per member or transaction or flat fee based, about 80% of that revenue is asset based and around 20% is non-asset based. So as a result, when you see a significant equity market performance, it can impact fee revenue rate, as the denominator tends to be more sensitive to equity markets than the numerator.

In addition, there's fluctuation in fee revenue collection from period to period. And reminder that fourth quarter of last year, the revenue was quite strong due to seasonal demand for some consulting and other billable services. And as a result, because that fee revenue rate fluctuates from quarter to quarter, whether it's through the markets or seasonality of fees or expenses of fees, it's better to look at on a long-term basis. And when you look at the trailing 12-month period, the fee revenue rate held steady at about 40 bps. So that's the comment I'd give you on fee rev rate.

Dan Houston: Does that help, Joel?

Joel Hurwitz: That helps. And then switching gears to specialty benefits. So sales were very strong, particularly in group disability. Could you just provide some color on what you saw in terms of the group disability sales and in terms of group disability top line, overall? I guess I was sort of surprised, though, to see it down from where it was in Q4, given the strong sales and anything that drove the sequential decline in group disability premiums and fees.

Dan Houston: I think it's another example of where Principal focuses on that SMB marketplace, where we still see growth and strong, vibrant SMB place in which we do business. Do you want to go ahead and cover that, Amy.

Amy Friedrich: Yeah, sure. Thanks for the question. So, a couple of questions embedded in there, kind of what's going on, on that line and then let's look at it sort of sequentially. And the answer actually to both of those questions kind of comes back to the same product.

So, one of the newer products in that group--and keep in mind, when we look at group disability, we're going to have long-term disability, short-term disability, and then paid family medical leave is going to be on that line.

One of the things we've seen happen is that markets, state by state, have kind of been opening up with paid family and medical leave products. So, we participate in that marketplace.

There's markets that we participate in, Massachusetts, Connecticut, Oregon, Colorado. And one of the things you're seeing flowing through those sales results is when you open up a state and when basically you say we have put a product in front of the state, they've qualified that product, say it's an approved private plan carrier, and helps meet the state-driven mandate for meeting that coverage, when you're part of that grouping, then those new products all kind of come in at the same time. So those have been a little bit lumpier.

What you're seeing in fourth quarter last year for PFML was one of the states that opened up that came in that quarter, and then you're seeing that again in first quarter. Actually, the one that came in fourth quarter last year on that line item was even a little bit larger than what we saw in first quarter. But it's a good explainer for why that's moving up.

When I look at short-term disability and long-term disability, those are growing in ways we expected them to grow. So we're seeing more like that 3% to 5%, 3% to 7% growth in some of those products in terms of new sales. Does that help give some color to that?

Joel Hurwitz: That does. Very helpful. Thank you.

Operator: Thank you. The next question is coming from John Barnidge of Piper Sandler. Please go ahead.

John Barnidge: Good morning. Thank you for the opportunity. Maybe if we could stick with that strong specialty benefit sales in the quarter, can you maybe talk about growth from pricing versus employee count? It seems like there's pretty strong growth outside of just the paid family leave expansion.

Amy Friedrich: Yeah, I'm happy to talk about that. One of the things that we always keep track of because we want to make sure that what's happening with our growth--and again, we're really pleased with the growth we're seeing. We like the growth rates we're seeing, across our specialty benefits lines.

But one of the things we look at, consistently, is what's coming from what we would consider net new business versus what's coming from that employment or wage growth and then what's coming from rate action. When we divide that up in this quarter, we're getting about 55% of our premium growth from that net new business. So by far, the biggest number in there is that net new business. So that's going to be new business we brought on minus any of the lapses that happened.

Forty percent is going to be from a combination of employment growth and wage growth. The bigger driver there is still employment growth. And then 15% is going to be from rate actions. Within that employment growth picture, we are still seeing the smaller market be the driver of that employment growth.

So, if you're an employer that has under 200 folks, that's been the strongest employment growth that's still happening. What we would consider mid-market, 200 to 500, has seen good growth, as well. Our block, over 500 lives, is the place where that growth, in terms of employment growth, is really moderating.

Dan Houston: Hopefully that helps, John.

John Barnidge: That’s very helpful. Yeah, it does. Thank you, that’s very helpful. My follow-up question, you have a term capital allocation to strategic M&A in the presentation. With the change in non-compete laws, how does that impact maybe how you approach recruitment in asset management?

Dan Houston: Yeah, great question. And frankly, we don't use a lot of employment agreements, here at Principal. I'd like to think that the culture that we've built allows us to attract, retain talent for the organization. Within asset management, we're paying competitive fees, we have a lot of flexibility and we've had, frankly, not a lot of turnover. So in the grand scheme of things, I don't really anticipate that that's going to alter Principal's ability to attract and retain talent.

As it relates to our clients in terms of opportunity, we know from the studies that go out there that employee benefits matter, strong retirement plans, health care, specialty benefits. So we actually think it plays to the strength of making sure that the employment environment is healthy and people want to be part of that.

The other thing, as you very well know, is we're a big player in the non-qualified deferred compensation space, which is another one of those areas where you think about locking in talent and having the proper plan design. We do a lot of work with employers in designing ways to retain talent.

Having said all of that, I'll see if Kamal has anything as it relates to anything within asset management.

Kamal Bhatia: John, just to add on. Dan has covered it very well. I think you'll remember that we are one of those firms that continues to get, year over year, the reward for being best places to work in money management. And one of the reasons for that is the culture we've created in our investment management or asset management division.

And two of those reasons are, obviously, the investment culture that really encourages independent thinking and independent growth, which is what the top-tier investment talent always looks for. We don't have a top-down view. And our view is you can create an environment where the best investors can do their best work, without having a big legal structure around it. And so, I would just point to that as the additional data point.

Dan Houston: Hope that helps, John

John Barnidge: Thank you very much.

Operator: Thank you. The next question is coming from Wilma Burdis of Raymond James. Please go ahead.

Wilma Burdis: Hey, good morning, everyone. Just talking about the specialty benefits loss ratio, it appeared to be a little bit favorable, despite the seasonal impacts. Could you talk about some of the repricing and should we expect it to continue, throughout 2024? Thanks.

Dan Houston: Amy.

Amy Friedrich: Yeah, so it is looking favorable. What I would say is we continue to reiterate that that long-term range that we have is--we're going to be probably towards the lower end of that range. We have definitely seen the market, as well as our portfolio do a little bit of repricing.

What I would say is, though, that's not been in one consistent direction. So, some of the things we've had to do with our pricing to realign the experience we're seeing emerging in dental means we did a little bit of that rate increase action. Some of the things we were seeing in some of our disability block has meant that we've taken that down. So in sum total, what we see is that we think the rate actions that we're taking, the rate environment, the competitive environment that we're seeing is going to mean we're still going to sit towards that lower end of the range.

Wilma Burdis: Okay, thank you. And then, can you guys talk about some of the competitors at the small end of the PRT market and just talk about the sourcing of those small PRT deals as well, please? Thanks.

Dan Houston: Chris.

Chris Littlefield: Yeah, thanks, Wilma, for the question. So we certainly, over the last couple years, have seen a lot of new entrants into the PRT market. I think what distinguishes us and gives us competitive advantage is the fact that we know the defined benefit business, extremely well. We've been involved in it. We know it. We provide consulting services on it. And as a result, when our customers look for solutions to defuse that liability, they talk to us, and we're able to provide them a solution that allows them to secure a good outcome for them.

So if we think about our overall business and the type of business we get, we get about 20% in the first quarter, about 20% of the business came from existing customers, existing customers of Principal. And so, we just play in a different part of the market.

We also, as we talked about in the fourth quarter, have very strong onboarding capabilities that lets us take advantage of times when the PRT market is very favorable because onboarding tends to be a little bit of the pipeline--the thing that can close the pipeline for others. So we're used to doing lots of different contracts, which also gives us a diversity of the risks and then able to source a lot of them from existing customers of Principal which, again, really believe gives us a competitive advantage in the PRT space.

Dan Houston: Thanks, Wilma.

Wilma Burdis: Thank you.

Operator: Thank you. The next question is coming from Tom Gallagher of Evercore ISI. Please go ahead.

Tom Gallagher: Good morning. On another earnings call, this morning, they mentioned that group life pricing is the widest I think they've ever seen it, which sounded a bit extreme. And they were suggesting that they're seeing some aggressive price competition and they lost some business. Just curious what you're seeing specifically in group life. I know your results were pretty good this quarter there from an underwriting perspective. But would you share that view? And if so, how are you responding to it?

Dan Houston: Yeah, good to hear from you, Tom. Amy.

Amy Friedrich: So, yeah, I'll give you my perspective on that. Keep in mind that our portfolio is going to be squarely in that small to midsize marketplace.

So when we work with smaller or midsize employers, the things that we typically have to do in terms of the maximums we put in, the types of coverage they want maybe on some of their executive populations, the types of standards and what we will do in terms of what is underwritten as a group, we tend to stay closer to sort of a fundamental smaller box.

So we tend to have amounts that are more standard, coverages that are a bit more standard. And we don't have to do as many things as we look at getting coverage out there for either some of those kind of executive type populations.

And so, what I would say is, yes, I understand the comment in terms of the competitiveness, but given Principal's nearly sole focus in the small to midsize marketplace, we don't have to compete on that. We don't have to offer three and four and five year rate guarantees. We offer single, sometimes two year rate guarantees. We don't tend to have to compete on some of the maximums. And we don't have to tend to extend beyond our underwriting parameters, consistently.

So, I feel really good about the marketplace we're in. We are seeing rational competition for group life in the marketplace we're in. We rarely write group life, alone. We tend to write it with a bundle, meeting the needs of the full employer, so we don't have to get into that competition just based on a single product. It's a bundle. We're in a small market, and it's pretty rational in that space.

Tom Gallagher: Yeah, that’s great color. So, it sounds like that's really in the larger end of the market, then it's not filtering down to small to mid. Is that fair?

Amy Friedrich: I have not seen it filter down. Correct.

Tom Gallagher: Dan, for my follow-up, just I guess Joel asked a question earlier on the fee proportion that's non-asset based. And Chris, I think you said it was 20%. Just curious, for that per participant price business, what has the growth rate actually been? Is this a fee pool that's growing or shrinking and by how much?

Chris Littlefield: Yeah, Tom, I would say that it stayed relatively stable in that, call it, anywhere between 17% to 20%. So we're not seeing a big increase. The big increase happened when we integrated the IRT block, which tended to be larger customer, but we were a little bit more steady state now that we're five years beyond that acquisition. So I would say it's staying relatively constant.

Tom Gallagher: And relatively constant, but is it actually growing? Like, is that having-- does that look different or very similar to the overall blocks from a net growth or shrinkage perspective, organically?

Chris Littlefield: I think it looks pretty similar to the overall block.

Tom Gallagher: Okay, great, thanks.

Dan Houston: Thanks, Tom.

Operator: Thank you. The next question is coming from Jimmy Bhullar of J.P. Morgan. Please go ahead.

Jimmy Bhullar: Hey, good morning. So, most of my questions were answered, but maybe on individual life. To what extent were the weak margins this quarter an aberration or seasonality driven versus indicative of the earning power of that business?

Dan Houston: Hey, good morning, Jimmy. Amy.

Amy Friedrich: Yeah, I'm happy to answer that. I see it more as a one-off, more as an aberration, as you're saying, than indicative. We continue to see some seasonality with the business. We build a bit of that seasonality expectation in, especially for kind of that first quarter claim.

What I would say is we do expect 2024 earnings to be higher than 2023, and we think the margin results, as we communicated, and outlook expectations are going to be just below that lower end of that long-term guidance range. So, we're seeing more of an adjusted margin expectation to be in that 13% to 15% range for the bulk of the year for life.

Jimmy Bhullar: Okay, and then, Dan, on the DOL rules, it seems like there was a possibility that it could have been negative for you guys, but the carve out for employers not being considered fiduciaries seemed like somewhat of a positive. I don't know if you agree with that or not, but then any other things within the rule that are, potentially, positive or negative for Principal, based on your initial assessment?

Dan Houston: Yeah, Jimmy, appreciate the question. So, you're exactly right. One of our primary concerns was our ability to, in the normal course of working with plan participants, providing them with education and guidance, and then it wouldn't fall underneath the definition of the fiduciary rule.

Because if you think about it, so many of those plan participants, in particular the lower income, smaller account balances, they don't have a financial advisor. They are looking for us to help them and guide them in the right direction. And a lot of these products that are available were chosen from the employer and so, defaulting to a target date option, effectively, can really help out a great deal.

Before, we were even having some limitations on being able to provide guidance on whether or not to take out, or providing insights on loans and hardship withdrawal. So without question, the ability for us to continue in the normal course of business, of providing that participant insights is now affirmed, it seems, from the initial read on the red.

Likewise, for those individuals who are asking for advice, Principal has had a 25-year history of having that capability inside Principal to help provide the guidance and the advice necessary to have the right products to do so. And as I said earlier on that call, there are instances where we're handing that call back off to the original plan, the advisor who sold the plan, originally.

At the end of the day, this is going to be around making sure that we have all the proper rules in place, all of the scripts were necessary, and then of course, maintaining compliance. So I think the bottom line is we'll manage our way through this, as we have all the other times that we've had these sort of regulatory opportunities and manage it, accordingly. Hopefully that helps.

Jimmy Bhullar: Thank you.

Operator: Thank you. The next question is coming from Michael Ward of Citi. Please go ahead.

Michael Ward: Thanks, good morning. Maybe for Kamal, and I'm just a little bit curious about private credit. It seems like a pretty solid growth area across the industry; has been. Just wondering if you could remind us how you are participating in that, and if that could maybe bolster flows, over the near term.

Kamal Bhatia: Sure. Mike, great question. Thank you for asking. I think we started, organically, a private credit business inside Principal. We are quite proud of the investment results we have generated with that business over the past three years. And as you highlighted, it's one of the high growth areas in asset management.

I'll give you a couple of observations on the marketplace, today. One of the things we purposefully designed our expertise around was to be to the smaller and middle end of the direct lending space, which gives us an edge, both in terms of generating long-term performance but, also, it was less covered by the larger private credit players.

As you've observed, the industry has grown bigger and bigger, and many of the large private credit operations are only operating at the large end of the marketplace, where I would observe there has been some reduction in pricing in terms of management fees, but also the quality of underwriting has become slightly less stringent.

And so, we remain focused on the smaller end where we find more alpha, but I'll also observe that from our seat, we have become more risk aware also, in that space. We are passing on more deals than we have, historically, because we want to make sure the deals we get into will generate the IRRs we expect.

And this comes a little bit from our culture as Principal. Our legacy around high-yield credit has been to be much more smarter about risk management through a full market cycle, and that's our approach to private credit.

Hope that answers the question, Mike.

Michael Ward: Yea--no, that’s helpful. Thanks, Kamal. Maybe for Deanna, I was just wondering on the Bermuda entity. I think that freed up like $200 million in the fourth quarter, last quarter. Assuming you've kind of used that for PRT a little bit, maybe some life in one key, I'm just curious if there's any change. Should we think about that as maybe bolstering free cash generation, or is it just kind of supporting the profile, as it stands?

Dan Houston: Mike, I'm glad you asked the question because you're on the verge of breaking a record of never having a question for the CFO. So I think Deanna is very enthusiastic about this response.

Deanna Strable: Yeah, thanks a lot, Mike, for the question. I actually just woke up and so I can now answer the question. So, a couple of things there. As you remember from our last call, we really started that entity to really support new business, both on the term life side, as well as PRT. It really is going to allow us to look at more growth opportunities for the same amount of capital usage.

And so, if you actually just think about the first quarter, all of our new business for term was seeded over to the Bermuda entity. PRT is a little bit different in that we evaluate that on a case by case basis to understand whether that Bermuda entity is advantageous. And there actually wasn't any of our first quarter sales that utilized Bermuda, but we're still optimistic that will continue to be a good move for us, as we continue to grow those businesses but doing it in a more capital-efficient way.

Dan Houston: Does that help Mike?

Michael Ward: Yeah, that’s great. Thank you. Thanks for the questions.

Operator: Thank you. The next question is coming from Wes Carmichael of Autonomous Research. Please go ahead.

Wes Carmichael: Hey, thanks for taking my follow up. And maybe, let’s keep Deanna woken up. But on variable investment income, it was softer in the quarter, which I think is probably to be expected with lower real estate transactions, but maybe not quite to the magnitude that it was. So just hoping you could maybe share your perspective in the next couple of quarters on what your expectations are there.

Deanna Strable: Yeah, thanks, Wes, for coming back in. You're correct. We did have some pressured variable investment income in the quarter. Actually, the drivers were a little bit different than what we have seen. If you look at it in total, it was a little bit lower than what we would have seen in the second half of the year, more similar to the first half of ‘23, but some of the drivers were a little bit different. Again, we continue to see minimal prepays in the quarter. We also saw lower real estate activity in the quarter.

But the real--the two bigger drivers of the underperformance in the current quarter, actually, the majority of that actually came in Principal International, which would be something that we wouldn't anticipate repeating for the rest of the year, where they do have within their general accounts some real estate funds. And we took a mark to market on that, which caused that $13 million of lower than expected variable investment income in the quarter.

And then the other place where we did see positive returns but lower than expected within our alts portfolio and, in particular, our private equity holdings. And so, as I look for the rest of the year, as I mentioned that PA IP should more normalize. We'll likely continue to see pressured prepays but, again, we did lower our actual run rate expectations for prepays as we came into 2024, just understanding the interest rate environment, as well as the specifics of our bond portfolio.

But I think alts is the one that it's just harder to predict, and we will expect some more quarterly volatility relative to that. Just to size it a little bit, on alts, in the quarter we saw about a 5% to 6% annualized return and again, our run rate is more in that 8% to 9% return, and PE was even lower but still positive than that 5% to 6%. Hope that helps.

Wes Carmichael: Yeah, thanks so much. And maybe just at a higher level question but with higher rates now, I guess one area where the insurance industry or the retirement industry has seen more growth has been in retail annuities. I know you guys exited the fixed annuity business when you did your new LSG transaction, but curious if there's any consideration of maybe re-entering that market, especially now with a Bermuda entity.

Dan Hoston: Chris.

Chris Littlefield: Yeah, Wes, thanks for that. We continue to participate in the variable annuity market, and the only other thing I'd point out is in mid-year last year, we did launch a registered indexed linked annuity product, which shows up a little bit more as in our spread-based. That is a business that has grown nicely since its launch, and we see nice momentum in that RILA business. If you've been following the annuity trend, you know that the RILA space is the largest growing portion of the RILA market.

So we do like that product. We think it's a nice product, provides a nice risk profile, but that's probably the extent of it. We are not looking to launch new retail fixed annuities. We're focused on the variable annuity and the RILA offerings, at this point.

Dan Houston: Thanks Wes, appreciate it.

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

Dan Houston: Well, we feel good about the start of the year and we remain laser like focused on delivering our 2024 outlook, including profitable growth, leveraging technology and innovating products.

We want to make sure that we are maintaining our disciplined approach to capital employment, which I discussed earlier. And of course, we always want to be mindful of aligning our expenses with revenues. And so, with that, I look forward to visiting in any follow up and appreciate the support for the company. Have a good day.

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