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Prudential Financial, Inc. (PRU)

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CORPORATE PARTICIPANTS

Charlie F. Lowrey
Chairman & Chief Executive Officer, Prudential Financial, Inc.

OTHER PARTICIPANTS

Alex Scott
Analyst, Goldman Sachs

MANAGEMENT DISCUSSION SECTION

Alex Scott
Analyst, Goldman Sachs

Okay. So we'll go ahead and get the session started here. Yeah. First, I'd like to say thank you to everybody for joining us both in the room and virtually and Charlie Lowrey of Prudential Financial is here joining us to take some questions.

Charlie, thanks very much for being here, for joining us.

Charlie F. Lowrey
Chairman & Chief Executive Officer, Prudential Financial, Inc.

Well, thank you. Alex, thank you for having me and thank you for accommodating me virtually. I greatly appreciate.

QUESTION AND ANSWER SECTION

Alex Scott
Analyst, Goldman Sachs

Q

Absolutely. So I thought the first place maybe we could start is just on the transformation strategy that you all sort of embarked on over the last year or two. Maybe we could touch on some of the things you guys have accomplished to date on this strategy and some of the things that are still ahead of you.

Charlie F. Lowrey
Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Sure. No, happy to do that. So we've said our objective is to become a higher growth, less market-sensitive and more nimble company. And for the past couple of years, as you said, we've been focused on three areas and we'll continue to be focused on these three areas in the future. And those are the consistency of our performance, the execution on our transformation, which we'll talk about, and the discipline and balanced approach to the redeployment of capital. So let me go through each of those just quickly.

So in terms of consistency, we have beat consensus EPS estimates eight out of the last nine quarters and each of the last six quarters. And we felt that was – we feel that's extraordinarily important to gain credibility with the Street and just show people that we do what we say we're going to do.

Now, in terms of our transformation, which is the second area of focus, it has three pillars and the first pillar is our product pivots, which have been working very well. We discontinued the sales [ph] of our DA (01:54) living benefit guarantees and launched our buffered annuity product, FlexGuard, in 2020 and sales have exceeded $6 billion on that product.

In addition, our Individual Life sales continued to be strong and reflect our product pivot strategy with higher variable life sales. And we also exercise discipline through frequent pricing actions and despite healthy price increases that we've implemented. Our sales continue to benefit from having both a trusted brand on the one hand and from the strength of our distribution through multiple channels on the other. So that's the first pillar, which is the product pivots and repricing.

The second pillar are cost savings and there, we're ahead of schedule. We have $590 million of run rate sales at the end of the third quarter out of our $750 million target by the end of 2023 and we're expanding our market reach and creating better customer-inclined experiences through the process improvements and the efficiency initiatives. So it's both cost saves and a benefit to our clients.

And finally, the third pillar of our transformation area is changing our business mix, right, to be higher growth and a less market-sensitive company.

And at a high level, we've stated at the beginning of last year that we have a couple of goals. First, releasing redeployment, redeploying $5 billion to $10 billion of capital over a three-year period; and secondly, increasing the growth businesses to 30% and reducing legacy annuities to 10% of earnings. And we're achieving this through three ways one is the runoff of blocks; second is programmatic M&A; and the third is the impacts of the product repricings and pivots that we've talked about.

Now, just to give you kind of a snapshot of where we are on that journey, we're making significant progress in executing on changing the business mix. So first, on the dispositions, we have over $6 billion in proceeds of our $5 billion to $10 billion target, if you include the announced but not yet closed transactions where we've reached agreements to sell our full-service recordkeeping business and the block of our variable annuities. And these two deals are scheduled to close next year, with net proceeds of over $4 billion. What has [ph] flowed through (04:22) the sales of our insurance businesses in Korea and Taiwan, with net proceeds of about $1.8 billion. So that's on the disposition side.

Now, in terms of redeploying that capital, we're going to do that through disciplined and programmatic M&A through acquisitions and in two areas, one is PGIM and one is emerging markets. So in terms of PGIM, you've seen a couple of transactions we've done where we're expanding our capabilities. One was the Montana Capital Partners, which is $3 billion in AUM which is a private secondaries manager that expands PGIM's alternative capabilities, and the other is Green Harvest, which is a smaller company where there's a managed account platform providing customized solutions for high net worth individuals supporting our retail business. And then we're also, as I said, expanding our presence and scale in emerging markets. In this case, we bought a minority interest in a company, ICEA LION in Kenya.

And then finally, the final area of focus, if we're going to be prudent stewards of capital, we returned $3.5 billion to shareholders in dividends and buybacks year-to-date during the third quarter. In terms of our dividend, we've increased for 13 consecutive years or a 17% CAGR and right now, a 4.5% yield on book value.

And in terms of buybacks, we announced an additional $1 billion of buybacks this year. We are authorized to return $2.5 billion in 2021 versus the initial authorization of $1.5 billion. And we increased, as a result, our target through 2023 from $10 billion to $11 billion.

So finally, looking ahead, we'll continue to advance these three goals. These three goals are not going to change, and that includes our cost savings program. And we intend to maintain disciplined execution both in terms of dispositions and acquisitions, hence why we quoted a wider range in terms of the dispositions. And as we've always said, if we don't find assets that meet our strategic and financial criteria, we'll return the excess capital to investors as we have in the past and you've seen us do this past year. So that's a lot, but that gives you kind of a snapshot in context of where we are right now.

Alex Scott
Analyst, Goldman Sachs

Q

So maybe if we could just spend a moment on the cost savings piece of it that you mentioned, could you just discuss where you are in terms of the savings that you guys have looked to achieve and how we can think about that drop into the bottom line and maybe also if it changes the seasonality over time, just associated with more expenses in sort of the back half of the year?

Charlie F. Lowrey
Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Sure. So to date, we've reached $590 million in run rate cost savings and to be specific, these savings include $145 million achieved in the third quarter of this year and for a total of about $385 million for the year.

So while we're becoming more efficient, to answer the second part of your question, a portion of these savings are being reinvested to support future business growth and you've seen that in PGIM and other areas, but also to [ph] mimic (07:45) the impacts of low interest rates. Don't forget, we're still in a very low interest rate environment, relatively speaking, and so we're fighting back. And part of these cost savings are going to mitigate that.

Now, in terms of seasonality, there may be some marginal benefit, but it won't be a lot and I'll give you an example of marginal benefit. As part of the efficiencies, we went back to customers and said instead of opting out, we want you to opt in to certain things. And in the fourth quarter, there's just a ton of paper that goes out to people. By just changing the opt out and opt in, we're sending out less people. Now, that's at the margin so we don't anticipate a meaningful difference in seasonality, but there might be a margin [indiscernible] (08:36).

Alex Scott
Analyst, Goldman Sachs

Q

Got it. So maybe shifting to annuities, can you discuss the progress you've made in achieving the objective to reduce variable annuities with living benefits? And just in light of the recent transaction with Fortitude Re, I'd be interested in comments on sort of the expectations around runoff that you've discussed previously.

Charlie F. Lowrey
Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Sure. So with the Fortitude transaction, we're most of the way where we want to go to.

So, as stated, our goal is to cut in half the proportion of earnings coming from our legacy annuities business to 10% of total earnings, as I said before. We expect this will be achieved in a number of ways, in part by organic runoff of $3.5 billion to $4 billion of the block per quarter. Now, that's going to get us to about 40% to 45% of our goal, right? Then the sale of the block of our traditional variable annuities to Fortitude would add another 40% of our way to the goal.

So in total, this represents about – between the runoff and this sale, it represents 80% to 90% of our goal of reducing earnings from a legacy annuity business by half. At the same time, we have been able to pivot the less market-sensitive and higher growth solutions like FlexGuard. So on the one hand, you're increasing sales of less market-sensitive and higher growth product and on the other, you're decreasing kind of the denominator. So we're getting there in two ways.

Alex Scott
Analyst, Goldman Sachs

Q

Got it. I think you also mentioned recently that you are still looking for opportunities to derisk [ph] in force box of (10:15) business. Just in light of the larger retirement and annuities transaction that you just did, are you still considering additional transactions that have that sort of size and magnitude to them or are we talking about things that are going to be more around the margin?

Charlie F. Lowrey
Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

A combination of both. So as we said, our overall goal is between $5 billion to $10 billion of capital that we wanted to free up to reposition, and we've already achieved over $6 billion so we don't feel we have to do anything more. We're within the range we originally talked about.

Having said that, we are very happy with the economics of the deals we've done and think that these deals reflect the high quality of the business we have. So we will look to do other transactions, but we'll only transact other deals if they make sense for our stakeholders, right, if they create shareholder value. We don't have to execute on additional transactions but to the extent we find ones that work, that do create economic value, we'll consider those.

Alex Scott
Analyst, Goldman Sachs

Q

And then the redeployment of capital is another topic that I wanted to come back to. I think you already provided some comments on just potential interest from an inorganic M&A standpoint. I know you've also talked about reinvesting and deploying capital back into the business for organic growth so I thought maybe you could expand on that and some of the areas of Prudential where you're looking for that organic growth and to make the investment.

Charlie F. Lowrey
Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Sure. So we continue to deploy capital in our own businesses organically to drive long-term growth. For example, during the third quarter, we completed a $5 billion [ph] fund in pensioners (12:00) transfer transaction, which is the fourth largest transaction in the history of the BRT market.

And just a slight advertisement, we've done the largest – the second largest and the fourth largest transaction now between GM, Verizon, and this one. So it shows our commitment to the market and our expertise and ability to execute at scale. So we'll continue to look for opportunities to do that.

We'll also continue to deploy capital to support our ongoing pivot to less interest rate-sensitive and higher growth products, including products like FlexGuard where we've invested significantly and are investing in the growth of that product and our variable life product.

And we'll also continue to invest organically in our growth businesses, which we define as PGIM, emerging markets, and insurance. So you'll see us continue to invest there. Quite frankly, investing organically is our preference. If we could do that for all the capital, we would. Obviously, we can't so we're going to look inorganically as well to add capabilities and scale in certain areas. But we want to invest organically as much as possible in a prudent fashion.

Alex Scott
Analyst, Goldman Sachs

Q

Got it. So maybe we can move to Japan. I'd be interested if you could talk about the dividend capacity there. I know there are some different things going on in terms of the regulatory regime and some of the solvency ratios that are transitioning. So I'd just be interested in your thoughts on some of that and how you expect, if at all, dividend capacity to be impacted.

Charlie F. Lowrey
Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Sure. We have a great business in Japan and it's a very, very solid business. It has consistently produced strong cash flows in the form of dividends, reinsurance, and affiliated lending so there are lots of leverage we can pull to get capital back to us.

And we are – we remain very active and engaged in the conversation of regulators and continue to closely monitor the development in Japan's economic solvency regime. That's expected to be effective in April 2025, so 3.5 years from now. So it's kind of premature to talk about the potential impacts, but it is fair to say that we are extremely involved in those conversations and obviously want to make sure they come out in a [ph] premium (14:28) fashion.

So we plan to continue deploying capital we've done previously and we will continue to invest in our business there. But our business, again, has many levers with which to deploy capital back to the parent as well.

Alex Scott
Analyst, Goldman Sachs
Q

Next topic I thought I would go to is Assurance IQ. I'd be interested if you could just discuss how's the enrollment process going. It's a little more geared towards the end of the year and what does the growth trajectory of that company look like from here?

Charlie F. Lowrey
Chairman & Chief Executive Officer, Prudential Financial, Inc.
A

So as we've talked about in the past, we do expect Assurance IQ revenues to be strongest in the fourth full quarter given the annual enrollment season, and we continue to invest in our platform. And coming into the annual enrollment period season this year, we had more agents than we did last year and those agents were operating at a much higher level of productivity right out of the gate.

So Medicare Advantage remains a very strong opportunity for us. Last year, we had a little under 1% share in that marketplace, and the market is growing by 10% a year. So we think we are well-positioned to take advantage of that market and to have Assurance continue to grow top line revenue significantly.

Alex Scott
Analyst, Goldman Sachs
Q

Next, maybe if we could flip over to PGIM. I would just be interested in any commentary you could provide on sort of the outlook for flows in that business and some of the things you're doing that continue to get good organic growth.

Charlie F. Lowrey
Chairman & Chief Executive Officer, Prudential Financial, Inc.
A

Sure. I love this business. So I have a lot of passion around it. Asset management – really asset management business needs three things to succeed. It needs good performance. It needs to have the right capabilities and it needs to have the relevant products. And we have had exceptional investment performance, with 94% of our funds outperforming in the 3, 5, and 10-year benchmarks. So the performance has been stellar in PGIM.

PGIM's – then let's move to capabilities. PGIM's diversified capabilities across public and private asset classes, especially higher yielding and income-generating strategies across equities position us, I think, very [ph] able (16:50) to capture loans. And we continue on the product side to develop new products within those capabilities like some of the organic investment that I was talking about before.

The result of all that has been about $55 billion of net positive third-party flows over the past five years and $11 billion on a year-to-date basis through the third quarter. And flows can be episodic. There's no question about it. But on a long-term basis, we believe that PGIM's diversified suite of strategies, that its proven performance track record and the continued investment in the global asset generation and distribution capabilities where we are making those investments, will help us and enable us to continue to generate flows.

And while we're pleased with the organic growth in PGIM, which is driven in part by what we think is competitive advantage which is our multi-manager business model, we'll continue to look to accelerate our growth through programmatic M&A in terms of scale and distribution and capabilities.

Alex Scott
Analyst, Goldman Sachs

Q

Got it. And maybe shifting to group life, something I've been talking to a lot of the companies about as we've had these conversations at the conference is the mortality and sort of this skew to a younger age that's occurred as we move through the pandemic. And so I'd just be interested if you could discuss that topic and what you're seeing, how it's impacting your book of group life insurance.

Charlie F. Lowrey
Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Yeah. So it is definitely impacting us. There's no question about it and the elevated level of mortality in the third quarter was primarily driven by three things, right? One is the Delta variant impacting younger age individuals. The second is our own national account [ph] growth (18:43) which experienced claims that were highly concentrated among first line employees. So think about healthcare, retail, manufacturing, people that are out there every day serving their clients. And the third is distribution of claims where in places where the vaccination rates are lower.

So I think where we would expect that those underlying drivers are going to continue in the near-term, there's nothing we see that will change that, unfortunately. I wish there was but that's kind of where we are right now.

Alex Scott
Analyst, Goldman Sachs

Q

Got it. And then maybe switching over to long duration targeted improvements, we have these accounting changes coming in 2023 and would be interested if there's anything that you can provide there in terms of the discussion on the impacts.

Charlie F. Lowrey
Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Yeah. Not a lot, actually. We continue to evaluate the new standards and refine our methods as we move towards the effective date, and the effective date is still honestly over a year away. So, the impact is going to be subject to rates at the time of the effectivity as well as the actions we've been taking and will continue to take to shift our business mix to be less market-sensitive. So, we've taken some significant actions and may take more as time goes on. And that's going to affect, well, the ultimate result.

So, overall, what I'd say is we're making good progress on implementing the new standards, but it's too early to provide estimates or additional information at this point.

Alex Scott
Analyst, Goldman Sachs

Q

Understood. Okay. In anticipation of these changes, I think investors are increasingly focused on cash flow and the capital that's being deployed. So, I'd just be interested if you could talk about that a little bit, maybe talk about the amount of cash flow you're returning. And does that include the capital that's being deployed in organic growth and how should we think about that?

Charlie F. Lowrey
Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Sure. What we said is that our free cash flow target has been 65% of our earnings over time. It moves up and down a little bit which, to your point, is net of the capital invested in our businesses to support our organic growth. And we feel comfortable with that level going forward despite all the machinations that you see about, all the different accounting changes and everything else happening. We feel that that's a reasonable number for us.

Now, in any given year, it may be slightly more, maybe slightly less. But over time, we think that 65% cash flow relative to our earnings is a good number.

Alex Scott
Analyst, Goldman Sachs
Q

Got it. Maybe we could go back to Japan. Could you talk about sort of the impacts of COVID-19 on face-to-face sales and some of the things that have been a challenge there on the growth front and how you see that recovering? If there's anything we should be thinking about in terms of product cycles or new products and that sort of thing.

Charlie F. Lowrey
Chairman & Chief Executive Officer, Prudential Financial, Inc.
A

Yeah. So we've actually been quite surprised by the resiliency of our Japan business because, as you said, the Japan business and our business in particular, with its different distribution channels, has relied very much on face-to-face distribution. That was one of our – that is one of our competitive advantages.

However, during COVID, we were able to make a significant and frankly profound shift to non-face-to-face distribution where our life planners and life plan consultants were able to transition to a medium like this and continue with their sales. And it really – it speaks volumes to the strength of the relationships that our life planners and life plan consultants have with their clients.

So in many ways, Alex, it was an accelerant for what's happening around the world in terms of the digitization, if you will, of sales. So that aspect of it actually went far better than we might have imagined. It was more difficult, quite frankly, to recruit people and so you've seen our recruiting numbers go down a little bit. They've started to come back up again but that's where if we were affected, we were more affected there than the lockdown. So again, the resiliency of our Japan business was both surprising and gratifying with the acceleration and the rate of change they were able to implement to talk to their clients in different ways.

Alex Scott
Analyst, Goldman Sachs
Q

So another topic I had for you. I mean one of the fascinating things in insurance right now is you have this dynamic where many insurance companies are shedding risk. You have asset managers, on the other hand, that are trying to grow their insurance risk at a pretty rapid pace in some cases and so I'd just be interested. When you think about your business like what really ultimately led to the decision to choose to be one that's shedding risk instead of a company that's choosing to maybe grow more rapidly?

Charlie F. Lowrey
Chairman & Chief Executive Officer, Prudential Financial, Inc.
A

Well, I would change the question a little bit in that I don't think those two are mutually exclusive. So I think you can shed risk on the one hand as we want to become less market-sensitive and yet invest in growth businesses so that we actually grow faster in the long-term. And that's one of the premises that we want to have.

So we think that we are very well-positioned in terms of being at the intersection of asset management and insurance, and we're extraordinarily well-positioned to benefit on that trend based on our mix of business. If you look at our insurance businesses, which are world-class, if you look at our asset manager, [indiscernible] (25:13) asset manager in the world with extraordinary performance, we're right at that intersection.

So we are shedding risk in terms of some of the more market-sensitive businesses, but we're investing both organically and inorganically in our asset management business, in our other businesses to create the liabilities, namely our insurance and our annuities business and then in emerging markets. So at the end of the day, we want to become a higher growth, less market-sensitive, more nimble company. That's the journey we're on, and we're executing towards that.

Alex Scott
Analyst, Goldman Sachs

Q

I thought maybe I'd also ask you about Prudential Financial's ESG initiatives that you have. It's something we've increasingly get questions on and so I figured I'd just give you an opportunity to talk to us maybe your ESG initiatives.

Charlie F. Lowrey
Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Sure. I'll go through all three of them. So very quickly on the E side, we came out right in about a month ago with new commitments to be net zero by 2050, carbon neutral by 2040, with interim goals in between. So we're set up on a phase one and phase two basis. We're working on phase three. So I think we are in line with many of our peers in the financial industry and around the world in terms of our commitment to get to that place.

On the social side, I think we are second to none. So we have – we're one of few firms that has a $1 billion impact investing portfolio that we've had for years. We announced that our foundation just achieved $1 billion in grants. And our commitment to Newark and the communities in which we live and work is profound.

In addition, we've come out with our racial – nine racial equity commitments. You can see them on our website and we're working towards that in terms of inclusion and diversity and coming out with statements on things which we think are inalienable rights, whether they're voting rights or other things. So we have made profound changes there in terms of our commitments.

And if you look at our diversity statistics which we are completely transparent on, whether it's the [indiscernible] (27:40) data or pay equity or our diversity statistics, those are all in our sustainability report for anybody to look at. So, you can see where we are, what our goals are, and what we're trying to achieve.

And then in terms of governance again, governance, again, the transparency with which we are approaching these topics are – I think are world-class and it's all in our sustainability report. We get high marks on that report and we believe in sort of ruthless transparency, if you will, so that people can see exactly where we are, what we're trying to achieve and how we are progressing towards those goals.

Alex Scott
Analyst, Goldman Sachs

Q

And then maybe just a more broad question. What are some of the headwinds but also opportunities that you can see in front of you? What are some of the opportunities that excite you the most about the strategy you've embarked on and sort of hitting critical mass in the strategy?

Charlie F. Lowrey
Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

So, I think we've made good progress to date on what we want to achieve and it's those three areas that I talked about initially, the consistency, the transformation, and being prudent stewards of capital.

The opportunities are, given our business mix, that we can have both organic and inorganic ways of achieving that. So, there is more to do in terms of some of the dispositions if it makes sense economically and therein lies one of the – both the challenges, Alex, and the opportunity, right? So, the opportunity is we have what we think are very good books of business that we'd like to potentially dispose of but will we get the right price and do we think it is good for shareholders. So that's one of the sort of pros and cons, if you will.

And then on the acquisition side, we think there are going to be some very good acquisitions, but they're pricey right now. And we're not going to do things that don't make sense for shareholders. So if we can actually acquire things that make sense, that add to our capabilities and scale, we'll do it. If not, as we said, if we can't find those opportunities, then we'll return the capital to shareholders.

So, lots of good opportunities. Pricing is the issue on both sides and we'll see if we can make it work. We've had success so far in terms of some of the acquisitions we've been able to make and in terms of the disposition where we think we've created significant value for shareholders. But those are the two sides of the coin that we'll be looking at.

Charlie F. Lowrey
Chairman & Chief Executive Officer, Prudential Financial, Inc.

Q

Great. And maybe one more back on Assurance IQ I had for you is you talked about some of the growth you've seen. You talked about the Medicare Advantage product in particular. I guess when I think about some of the other products that you're selling, that Prudential would be the insurance company writing the policies and it's spurring growth around your business. Can you talk about how that's evolving, the products that you've sort of put on that platform and then how you expect that to unfold in terms of growth?

Charlie F. Lowrey
Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Sure. So we've put a simplified life insurance product on the platform. It has begun to sell. We're working on a whole variety of, well, two things. We're working on a variety of different products to put on the platform, and we're working on sort of experimenting, if you will, with what works best.

So we have a simplified life product on the platform. It has been selling. We're tweaking it as we go and sort of learning as we go. One of the reasons why we wanted to buy Assurance is because it is a really good [ph] incubator (31:40) and you can get real-time feedback on products that you put on the platform and see what works and what doesn't and how you can tweak it and then export some of that knowledge in some of the technology to other businesses as well around the world what you've been doing.

So what I'd say is we're in the early stages of refining those products, but we are putting them on. We are learning from them and we are selling them.

Alex Scott
Analyst, Goldman Sachs

Got it. Okay. Well, I think I'll leave it there. Thank you so much for joining us and all the responses.

Charlie F. Lowrey
Chairman & Chief Executive Officer, Prudential Financial, Inc.

Well, thank you. And again, thank you for accommodating me virtually. I really appreciate it and wish I was there and have a great conference.

Alex Scott
Analyst, Goldman Sachs

Thank you. Thanks, everyone.