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Prudential Financial, Inc. (PRU)

Q1 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by, and welcome to the Prudential Quarterly Earnings Conference Call. At this time, all lines are in a listen-only mode. Later, we will conduct a question-and-answer session. Instructions will be given to you at that time. [Operator Instructions] And as a reminder, today's conference call is being recorded.

I would now like to turn the conference over to Mr. Darin Arita. Please go ahead.

Darin Arita

Senior Vice President, Head of Investor Relations, Prudential Financial, Inc.

Good morning, and thank you for joining our call. Representing Prudential on today's call are Charlie Lowrey, Chairman and CEO; Rob Falzon, Vice Chairman; Andy Sullivan, Head of US [Technical Difficulty] (00:47-01:05)

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

Okay. Now we can hear. Sorry everybody, we were having a little bit of technical difficulties. It's Charlie. Darin will start over.

Darin Arita

Senior Vice President, Head of Investor Relations, Prudential Financial, Inc.

Start over here. So, good morning, and thank you for joining our call. Representing Prudential on today's call are Charlie Lowrey, Chairman and CEO; Rob Falzon, Vice Chairman; Andy Sullivan, Head of US Businesses; Scott Sleyster, Head of International Businesses; Ken Tanji, Chief Financial Officer; and Rob Axel, Controller and Principal Accounting Officer. We will start with prepared comments by Charlie, Rob and Ken. And then we will take your questions.

Today's presentation may include forward-looking statements. It is possible that actual results may differ materially from the predictions we make today. In addition, this presentation may include references to non-GAAP measures. For a reconciliation of such measures to the comparable GAAP measures and a discussion of factors that could cause actual results to differ materially from those in the forward-looking statements, please see the slide titled forward-looking statements and non-GAAP measures in the appendix to today's presentation and the quarterly financial supplement, both of which can be found on our website at investor.prudential.com.

With that, I'll hand it over to Charlie.

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

Thank you, Darin, and thank you all for joining us this morning. As always, I hope you and your families have remained safe and healthy. Despite the ongoing challenges created by the pandemic, Prudential reported strong results for the first quarter, including record adjusted operating income and robust sales and flows across many of our businesses. Our performance reflects strong underlying demand for our products, continued execution on our strategic initiatives, the complementary nature of our retirement and life insurance businesses, which has helped us mitigate mortality risk, favorable markets, and the commitment of our employees around the world.

We're on track with our key transformation initiatives and have increased returns to shareholders, supported by our strong performance and the strength of our balance sheet. I'll cover each of these topics in more detail and begin with a brief review of the transformation initiatives we highlighted for you in February.

Turning to slide 3. We are on track to deliver \$750 million in cost savings by the end of 2023, \$400 million of which were targeted for 2021. Cost savings for the first quarter were \$110 million. The initiatives generating these cost savings are also producing better customer and employee experiences and as a result, enhancing the competitiveness of our businesses.

We are also in the process of reallocating \$5 billion to \$10 billion of capital by pursuing programmatic acquisitions to grow in asset management and in international emerging markets. In addition, we'll remain focused on investing in our other businesses, to expand our addressable market and to continue to improve expense and capital efficiency.

In parallel, we're actively executing on other means of changing our business mix and earnings profile by: pivoting to less market and rate-sensitive products such as our buffered annuity product, FlexGuard; running off certain blocks of business; and actively pursuing potential de-risking transactions. As a result, we expect Prudential to emerge as a higher growth, less market-sensitive and more nimble company. As we execute against our transformation initiatives, you can expect that we'll continue to demonstrate discipline in the redeployment of capital within our businesses and to our shareholders.

Turning now to slide 4. In the first quarter, we increased our shareholder dividend by 5% and repurchased \$375 million of common shares. In addition, based on our progress with our initiatives as well as the improving macroeconomic outlook and the more favorable equity market and interest rate environment, we announced a \$500 million increase to our 2021 share repurchase authorization. We expect to repurchase these additional shares starting in the second quarter. As a result, we now expect to return \$10.5 billion to shareholders through 2023.

Moving to slide 5. Our expanded shareholder return program is supported by our rock-solid balance sheet, which included \$5.4 billion in highly liquid assets at the end of the first quarter. Our operating subsidiaries continue to hold capital to support AA financial strength ratings, and we have a high-quality investment portfolio.

Turning to slide 6. We are also executing on behalf of our stakeholders through our commitment to environmental, social and governance actions. This work has long been reflected in our purpose as a company of solving the financial challenges of our changing world and is as important as ever.

Of recent note, on the environment, we have made significant progress reducing emissions, waste and paper. And we continually evaluate how we can improve our impact on the environment.

On social issues, we have invested further in our people with training and development programs and continued to maintain a high level of pay equity throughout the firm. We also achieved our three-year goal that we created in 2017 of increasing representation of diverse persons among our senior management by 5 points over that time period. We followed this by establishing new goals and are continuing to tie our goals to management compensation as we did in the prior period. And we're already making progress on our commitments to advance racial equity, which we announced last summer.

On governance, we continually refresh our board with people who are highly skilled and who also reflect the diverse communities and geographies that we serve. Today, 82% of our independent directors are diverse. You can see more details on how we're progressing against our goals and commitments in our ESG summary report that we published in March.

Before closing, I would like to thank all of our employees around the world. It's through their continued hard work and dedication that we've been able to support our customers and colleagues during these challenging times, all while advancing our company's transformation and purpose of making lives better by solving the financial challenges of our changing world.

With that, I'll turn it over to Rob for more specific details on our business performance.

Robert M. Falzon

Vice Chair & Director, Prudential Financial, Inc.

Thank you, Charlie. I'll provide an overview of our financial results and business performance for our US, PGIM and international businesses. Turning to slide 7. I'll begin with our financial results for the first quarter. Our pre-tax adjusted operating income was a record high of \$2.1 billion, or \$4.11 per share on an after-tax basis. Earnings exceeded the year ago quarter across all of our businesses.

Results of our US businesses were up 38% and reflected higher net investment spread results driven by higher variable investment income and higher fee income, primarily driven by equity market appreciation, partially offset by less favorable underwriting experience-driven by COVID-19 related mortality.

PGIM, our global asset manager, had record high results, including a gain on the sale of our Italian joint venture. Our partner was acquired by another firm with an existing asset management business and expressed the desire to purchase our interest, which was a right it retained under the joint venture agreement.

Nonetheless, assets under management of \$1.5 trillion were up 12% from a year ago, driving asset management fees to a record level. And earnings in our international businesses increased 25%, reflecting business growth, higher net investment spread, more favorable underwriting results and higher earnings from our Chilean pension joint venture.

Turning to slide 8. Our US businesses produced diversified earnings from fees, net investment spread and underwriting income and benefit from our complementary mix of longevity and mortality businesses. As Charlie noted, we continue to make progress in shifting away from capital-intensive and interest rate-sensitive products.

Our product pivots have worked well with sales of our buffered annuity, FlexGuard, growing to \$1.6 billion in the first quarter, representing 84% of total annuity sales, up from \$1.2 billion in the fourth quarter of 2020. Our sales reflect increasing customer demand for investment solutions that offer the potential for appreciation from equity markets combined with downside protection.

In addition, we benefit from having a strong and trusted brand, as well as a highly effective distribution team that has significant reach with Prudential advisors and third party advisors. We are engaging with a broad range of advisors with FlexGuard. We also leverage our broad multi-dimensional relationships with our strategic partners that both distribute our products and manage the assets of our clients.

With respect to Individual Life, we increased sales by 9% compared to the year ago quarter as higher variable life sales offset lower sales of other policies. In particular, Universal Life sales consistent with our product pivot strategy.

In our Retirement business, account values were a record high, up 23% from a year ago, driven by business growth and market appreciation. Net flows in the quarter were \$6 billion, including a longevity reinsurance transaction in excess of \$8 billion.

With respect to Assurance, total revenues, our primary financial metric as we concentrate on scaling the business, were up 80% over the prior quarter. We grew all business lines, particularly in Medicare, where we expanded distribution to increase sales outside of the fourth quarter annual enrollment period.

Now turning to slide 9. PGIM continues to demonstrate the strength of its diversified active management platform as a top 10 global investment manager. PGIM's diversified global investment capabilities in both public and private asset classes across fixed income, alternatives, real estate and equities position us favorably to capture flows.

In addition, PGIM's investment performance remains attractive, with approximately 90% or more of assets under management outperforming their benchmarks over the last 3, 5, and 10 year periods. Our diversified capabilities and strong investment performance helps contribute to more than \$5 billion of third-party net flows during the quarter, including \$4 billion of retail and \$1 billion of institutional flows.

Offsetting the growth in net flows was a decrease in the market value of our fixed income assets, reflecting the increase in interest rates. As the investment engine of Prudential, PGIM also benefits from a symbiotic relationship with our US and international insurance businesses.

PGIM's asset origination capabilities and investment management expertise provide a competitive advantage, helping our businesses to bring enhanced solutions and more value to our customers. And our businesses, in turn, provide a differentiated source of growth for PGIM through affiliated flows that complement its successful third-party track record of growth.

PGIM's asset management fees increased 15% compared to the year ago quarter to a record level as a result of market appreciation and continued positive third-party net flows. This contributed to an 8-point increase in PGIM's net adjusted operating margin, including the gain on the sale of the Italy joint venture – excuse me, excluding the gain on the sale of the Italy joint venture compared to the year ago quarter, consistent with our expectation of 30% across the cycle.

Turning to slide 10. Our International Businesses include our Japanese life insurance operation, where we have a differentiated multi-channel distribution model as well as other operations focused on high-growth markets. While sales across both Life Planner and Gibraltar operations were lower than the prior year, reflecting the disruption from Japan's metropolitan areas being in a state of emergency this quarter as well as lower demand for our US dollar-denominated products following price increases last year, profitability increased significantly. We remain encouraged by the resiliency of our unique distribution capabilities, which has helped to continue to grow our inforce business.

And with that, I will now hand it over to Ken.

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Kenneth Yutaka Tanji

Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.

Thanks, Rob. I'll begin on slide 11, which provides insight into earnings for the second quarter of 2021, relative to our first quarter results. Pre-tax adjusted operating income in the first quarter was \$2.1 billion and resulted in earnings per share of \$4.11 on an after-tax basis. Then we adjust for the following items.

First, variable investment income outperformed expectations in the first quarter, which is worth \$275 million. Second, we adjust underwriting experience by \$160 million. This includes a placeholder for COVID-19 claims experience of an additional \$70 million, based upon 55,000 COVID-19 related fatalities in the US during the second quarter. Third, we expect expenses, and other items to be approximately \$500 million lower in the second quarter, primarily as a result of favorable items in the first quarter, including the \$378 million gain from the sale of PGIM's joint venture in Italy and seasonality.

Fourth, we anticipate net investment income will be reduced by \$10 million, reflecting difference between new money rates and disposition yields of our investment portfolio. These items combined get us to a baseline of \$2.89 per share for the second quarter. I'll note that, if you exclude items specific to the second quarter, earnings per share would be \$2.97. The key takeaway is that our underlying earnings power increased from last quarter, including the benefit from business growth and higher equity markets.

While we have provided these items to consider, please note that there maybe other factors that affect earnings per share in the second quarter. I would also note that we continue to expect the full year 2021 corporate and other loss to be about \$1.5 billion.

On slide 12, we provided an update on the potential impact of the pandemic. Consistent with the information we provided on our fourth quarter call, the estimated sensitivity of operating income for 100,000 incremental US death due to the pandemic is about \$85 million. As I noted earlier, our second quarter baseline includes a net mortality impact of \$70 million due to COVID-19. The actual impact will depend on a variety of factors such as infection and fatality rates, geographic concentration and the continued speed, acceptance and effectiveness of the vaccine rollout.

Turning to slide 13. We continued to maintain a robust capital position and adequate sources of funding. Our capital position continues to support a AA financial strength rating, and we have substantial sources of funding. Our cash and liquid assets were \$5.4 billion, which is greater than three times annual fixed charges. And other sources of funds include free cash flow from our businesses and other continuing capital facilities.

Turning to slide 14 and in summary, we are on track with our key initiatives, and we maintain disciplined capital management while returning additional capital to shareholders, and we continue to benefit from the support of our rock-solid balance sheet.

Now I'll turn it to the operator for your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question will come from the line of Tom Gallagher with Evercore. Your line is open.

Thomas Gallagher

Analyst, Evercore ISI

Q

Good morning. Charlie, just wanted to see if we can get an update on potential timing and sizing of risk transfer deals, where things stand now for freeing up capital. And also same question on the programmatic M&A you're targeting.

Robert M. Falzon

Vice Chair & Director, Prudential Financial, Inc.

A

Hey, Tom, it's Rob. Let me take a first shot at that, if you don't mind. So thank you for the question. First, actually, let me start with a reminder. A large portion of the broader business mix objectives that we have are actually going to achieve – be achieved organically. The internal growth objective we have which is essentially to double the growth of our – double the size of our growth businesses, about one-third of that is – of that targeted increase will come from the organic growth in those businesses.

And then with respect to the targeted reduction, specifically bringing our annuities business down to around 10% or so of total contribution, 40% to 45% of that comes from the runoff of our legacy block. The – we didn't expect capital redeployment in the form of – on the growth side, programmatic acquisitions. And then on the reduction side, reinsurance and/or sales to largely close the remainder of the gap. And as Charlie indicated in his opening remarks, we are actively executing on that, including through de-risking transactions on the reduction side.

While we're making progress, we're not yet in a position, Tom, where we're going to speak any more specifically. Although, I'd like to reiterate what we said before. First, these transactions are generally complex and therefore, they require time. And secondly, we intend to remain disciplined, transacting both with respect to dispositions as well as acquisitions to ensure that we're creating value for our shareholders in any transaction that we undertake. It's why we indicated, sort of, a relatively broad range of the \$5 billion to \$10 billion and a multi-year period for accomplishing that.

Probably, the last thing I'd want to mention is that the product repricings and pivots that we've been undertaking are also important levers to changing that business mix. And maybe, Andy, if you don't mind, you can just sort of give a quick update on that.

Andrew Sullivan

Executive Vice President and Head of U.S. Businesses, Prudential Financial, Inc.

A

Sure, Rob. So Tom, good morning. So I'll make this very specific, so let's talk about annuities. So as we've talked about step one in derisking is the runoff. And that started with ceasing of sales. So you saw this quarter where we only had 1% of our sales that came from traditional variable annuities with guaranteed living benefits. And we very successfully have pivoted over to FlexGuard. We will expect to see about a \$3 billion per quarter runoff in that traditional variable annuity block of business. This quarter we saw about \$3.8 billion.

As we pivot into FlexGuard, we're putting into the market a very different type of product that better balances consumer value with shareholder value. And we could not be more pleased with the success of that product. We had a 14.5% market share back in 4Q. And as you saw, our sales have continued to expand, where we had \$1.6 billion in sales this quarter. That is really coming off the strength of our brand and the strength of our distribution, and we're very happy with the returns and the risk profile of that new business that we're putting on the book. So it's a very good example of how step one is all about the runoff and pivot.

Operator: Thank you. Next we will go to the line of Elyse Greenspan with Wells Fargo. And your line is open.

Elyse Greenspan*Analyst, Wells Fargo Securities LLC*

Q

Hi. Thanks. My first question, maybe following up on Tom's question, just on the M&A side of things. You guys mentioned PGIM and emerging markets as areas where you would [ph] look to (21:36) deals. As you're executing on that plan, can you just give us a sense of what you're seeing out there from the M&A perspective as you're kind of looking to execute there?

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

A

Sure, Elyse. This is Charlie. Let me just take a step back, if you will, and put what we're doing into context. And then I'll answer your specific question. But as we look at the journey we're on, if you will, we as a management team are laser-focused on three goals. Well, the first is to deliver strong and consistent performance, and hopefully you've seen that.

The second is to execute on the transformation that Rob and Andy just talked about and there are three parts to that. One is pivoting our products to be less market-sensitive and capital sensitive. The second is to execute on our cost efficiency goals, and you saw that we expanded our goals by 50% last year and are ahead of track. And the third is to lean into the higher-growth markets, as Rob talked about, the reallocation of the \$5 billion to \$10 billion of capital. So that's the second goal.

The third goal is to be good stewards of capital. Balancing the return of capital to shareholders with investing both organically and inorganically in our businesses. And we think that by achieving that balance, we can maximize shareholder value over time. So those are the three goals: strong and consistent performance; executing on our transformation; and being good stewards of capital. And that will hopefully give you a framework around which we couldn't look at any of the actions that we take, including as you talked about the programmatic M&A, which Andy now can talk about.

Andrew Sullivan*Executive Vice President and Head of U.S. Businesses, Prudential Financial, Inc.*

A

Yes. So thanks, Charlie. And Elyse, I'll build upon it. So first, when it comes to PGIM, I'd be remiss if I didn't say that we've had just great success organically growing this business. We've seen somewhere in the neighborhood of \$55 billion in flows over the last five years due to the strength of our platform. And we will continue to invest in that organic growth. Having said that, this is an area we've identified where we want to augment through M&A. And we're – that all starts with being very clear on our priorities and clear on our spots.

As we talked about last quarter, we're very interested in expanding upon our already good capabilities in alternatives as well as continuing to expand on our track record of success globally. Those are areas we're focused on because if you look at the overall asset management industry, they are faster growth areas of this

space. As we're looking, everything and anything we look at would – obviously, we need to vet for a cultural fit and to make sure it fits with our multi-manager model.

The way that I talk to my team and my team, we talk about this as being in the flow and in the know and what I mean by that is we need to make sure that we see all potential opportunities, both what's already in the marketplace, but what might be in the marketplace. And I can tell you that we are very confident that we are in the know and in the flow. We will be very programmatic and disciplined in deploying capital towards these acquisitions. And we are very confident that it will meaningfully add to PGIM over time.

Elyse Greenspan*Analyst, Wells Fargo Securities LLC*

Q

Okay. That's great. And my second question, in terms of the plans that you guys laid out, the exiting and the downsizing of businesses, it was all kind of focused on the US Individual Solutions side of the house. But as we think about the workplace solutions, be that retirement or group, are those businesses that – if there was an opportunity via a transaction to monetize some of the assets. Is that something that you would consider? Or are you still more focusing on annuities and life as you look to free up capital?

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

A

So it's Charlie again, Elyse. We've spoken about the fact that we've taken a broad strategic review on our businesses within the context of having a business mix that is less market sensitive, less capital-intensive and higher growth. And we're going to be really thoughtful and diligent about how we execute on the process with the goal of maximizing value for shareholders. So when there's more to report, we'll let you know, but we're in the process of doing that.

Elyse Greenspan*Analyst, Wells Fargo Securities LLC*

Q

Okay. Thanks for the color.

Operator: Thank you. Our next question comes from the line of Andrew Kligerman with Credit Suisse. And your line is open.

Andrew Kligerman*Analyst, Credit Suisse Securities (USA) LLC*

Q

Hey, good morning, everyone. Just following up on Elyse's question. If you could give a little more clarity on the full-service retirement business, is that considered a core capital-light business?

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

A

So this is Charlie, Andrew. Again, we're not going to comment on any particular business. What I'll do is go back to our original premise, which is that we've looked at all businesses. We're considering a business mix in totality that's going to be higher growth, less capital intensive, less market-sensitive – intensive and less volatile over time. And we've evaluated all our businesses within that context. And as we go through that process, as we make decisions and execute, you will be one of the first to know, along with all your other colleagues.

Andrew Kligerman*Analyst, Credit Suisse Securities (USA) LLC*

Q

Maybe you can – all right. Let me know a little before them. But anyway, moving on to Assurance IQ, I mean, these revenues look phenomenally robust. And yet this quarter, you generated a pre-tax loss of \$39 million. Could you give a sense of when you'd like to kind of turn the corner on profitability? Or is it still a little too early to say?

Andrew Sullivan*Executive Vice President and Head of U.S. Businesses, Prudential Financial, Inc.*

A

So Andrew, it's Andy. Thank you for your question. First, let me make sure I point out that in this quarter we had \$10 million of one-time non-recurring expense. And just to give you a feel and a flavor for that. That, as an example, we ended a couple of vendor contracts in distribution as we're maturing our model. As far as the path we're on to drive the business towards ultimate – our ultimate revenue and margin objectives, nothing has changed. We bought this business and platform for its long-term strategic capabilities that it provides us, both from expanding the addressable market as well as for shifting our mix to a more fee-oriented mix.

So as such, we're investing and managing the business for the long term. We continue to invest in broadening and deepening the product portfolio. We continue to invest in deepening and making more capable the distribution system. And the results in the quarter, you see evidence of that.

I'll point back to what we said last quarter, the key metric is revenue growth as we scale this platform up. And as you saw, we had 80% quarter-to-quarter revenue growth and had revenues grow in all lines. So we have a plan. We're executing against it. We're seeing the metrics go the right way. We need to scale the platform. And as such, in the near term, we will see operating losses.

Andrew Kligerman*Analyst, Credit Suisse Securities (USA) LLC*

Q

Great. Thank you.

Operator: Thank you. Our next question comes from the line of Ryan Krueger with KBW. And your line is open.

Ryan Krueger*Analyst, Keefe, Bruyette & Woods, Inc.*

Q

Hi. Good morning. I noticed that you stopped breaking out the wellness implementation cost this quarter. Can you give us any context for why you did that and also – I guess as we look, if we think about the corporate segment losses of \$1.5 billion for 2021, should we expect that to decline in the following years as implementation costs also decline?

Kenneth Yutaka Tanji*Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.*

A

Hey Ryan, it's Ken. We're making really good progress on our transformation and cost-saving initiative, and that's being driven by our transformation office, and we're making great progress. We're – we included the implementation cost that we expect this year in our estimated loss for Corporate & Other of \$1.5 billion. So it's in there. And it's comparable to the amount that we had in 2020. At this stage, we don't expect the magnitude to vary significantly. So that's why we didn't feel the need to continue to separate and isolate it out. We are, as I mentioned, making very good progress towards our objective of achieving \$750 million of cost saves by 2023.

And over this period, we would expect to have implementation costs included in our Corporate & Other segment to continue.

Ryan Krueger*Analyst, Keefe, Bruyette & Woods, Inc.*

Q

Thanks. And then on your Retirement business, can you give us any rough breakdown since there's kind of a couple of different businesses in your reporting segment, what the rough breakdown in terms of earnings contribution is from Full Service compared to Institutional Investment Products?

Kenneth Yutaka Tanji*Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.*

A

We have an excellent Full Service business, but it's part of our overall Retirement segment. We haven't historically separated that out. It is part of that business line, and we're not going to separate that, those specifics out for just the Full Service segment.

Ryan Krueger*Analyst, Keefe, Bruyette & Woods, Inc.*

Q

Got it. All right. Thank you.

Operator: Thank you. Our next question comes from the line of Suneet Kamath with Citi. And your line is open.

Suneet Kamath*Analyst, Citigroup Global Markets, Inc.*

Q

Great. Thanks. My first question is, I'm just trying to reconcile something, which is at the 2019 Investor Day, we spent a lot of time on the financial wellness initiative and how you're tracking a lot of these meetings that you were hosting with the employees of your corporate customers.

So I'm trying to reconcile that strategy with comments that we're hearing today that a lot of your US or your US businesses are under review, including the Retirement business. Because it felt to me that those two things were interconnected. So I'm trying to figure out, is there a change in that financial wellness strategy? Or what's going on?

Andrew Sullivan*Executive Vice President and Head of U.S. Businesses, Prudential Financial, Inc.*

A

So, Suneet, it's Andy. I'll take your question. Financial wellness absolutely remains a key component of our organic growth strategy in the company. As we articulated at that Investor Day, and as you heard me say often, we're working to bring more solutions to more people and to address a broader swath of the American marketplace. That is both through the workplace, through the advisor channel and direct-to-consumer.

As we talked about, our financial wellness capabilities that we've built out have really helped to activate a couple of value levers. And the two predominant ones would be institutional value, and the second would be converting individuals in the workplace to long-term loyal customers of Prudential.

We've seen those value levers activated. We've talked in the past about institutional value that's been delivered, both from the net revenue growth in the Group Insurance business, but also from the growth of our Full Service platform. And we are seeing the conversion to individual product sales from the financial wellness value product.

So you should think of it as it is an important component of the organic piece of our strategy to grow and expand our addressable market. But it is that. It's a component of the broader strategy as we push the business system to be higher growth, less capital-intensive and less market sensitive.

Suneet Kamath

Analyst, Citigroup Global Markets, Inc.

Q

Okay. And then on the capital reallocation, I think when we were talking about growth businesses last quarter, you highlighted three: Emerging markets, PGIM and Assurance IQ. I think, Charlie, in your prepared remarks this morning, you didn't mention Assurance IQ. Should we take from that that you're currently not planning on allocating more capital to either Assurance IQ or other sort of insured tech types of operations?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Yeah. I think that's a fair comment. In other words, as we think about programmatic M&A, in particular, as we've talked about it this morning, it's investing primarily in our other businesses in the US and International. And what we mean by programmatic M&A is very – it's a very specific strategy. We're going to be highly selective, and we're going to do targeted acquisitions that add either scale or augment capabilities to our existing businesses like PGIM and like emerging markets.

Robert M. Falzon

Vice Chair & Director, Prudential Financial, Inc.

A

Hey Suneet, it's Rob. I'll just add to Charlie's comments, which is to say that differentiate what – the objective that we articulated was to have the combination of the three businesses that you mentioned equal to 30% of our earnings in the timetable that we have targeted. And then, we separately said, with regard to redeployment of capital, however, that we're focused on PGIM and emerging markets. We did not, at that point in time, call out Assurance as an area for capital deployment.

Suneet Kamath

Analyst, Citigroup Global Markets, Inc.

Q

Okay. Thanks.

Operator: Thank you. Our next question will come from the line of Erik Bass with Autonomous Research. And your line is open.

Erik Bass

Analyst, Autonomous Research

Q

Hi. Thank you. Can you provide some more details on your current emerging markets businesses and where they stand in terms of scale and profitability? How much earnings are you generating from emerging markets today? And how do you expect that to grow organically over the next three years?

Scott Garrett Sleyster

Executive Vice President and Head of International Businesses, Prudential Financial, Inc.

A

Thanks, Erik. This is Scott. I'll go ahead and take that question. Well, first of all, from a big picture perspective, following the sale of Korea, about 94%, 95% of our earnings come from Japan. So that's why we spend a lot of time focused on Japan.

Within the emerging markets, I think I've said before that the bulk of the earnings from those – from that sector comes from a combination of Brazil and Chile. So the good news is in our emerging markets platform is that we feel like we're in a lot of the right countries, and we've actually worked pretty hard to get the right partners in those countries where partners were required.

The challenge that we faced is that we originally started in a lot of those markets with [ph] tried (36:58) agency or an LP model, and we've now broadened that out to add independent agency and Bancassurance. But we're starting from a rather small platform. So the good news is we are seeing rapid growth in the emerging markets.

For example, our in-force grew at high single-digit in Brazil and double-digit in Mexico last year. But for most of our emerging markets, we're starting off of a rather small base. And that's why Charlie talks about it in the context of markets that we'd like to grow. We tend to think we're in the right places. We have licenses and partners, and that's why we think a bolt-on strategy is probably the best strategy for growing those markets. Thanks.

Erik Bass

Analyst, Autonomous Research

Q

Thank you. And then, a follow-up on sticking with the International Businesses. In the Life Planner business, you continue to show healthy growth in Life Planners at POJ, but the total Life Planner count is down year-over-year. I'm assuming the decline is coming from Brazil. So just was hoping you could provide some more color on what's going on and what we should infer about the underlying growth trends in that business?

Scott Garrett Sleyster

Executive Vice President and Head of International Businesses, Prudential Financial, Inc.

A

Yeah, Erik, that's a good follow-up. And your observation is correct. I believe I commented last quarter, but we systemically or consistently kind of go through our LP models, and we change our contract terms. And we do that to maintain productivity, sometimes adapt to regulatory changes, customer and regulatory needs and the like.

And we did implement some new contract terms in Brazil last year. We were expecting a decline to follow that. That, in fact, did occur. And so that really was the change. Actually, Japan Life Planner growth was actually up in POJ, 4% year-over-year, and that's our biggest market. And quarter-over-quarter, we were back up slightly in Brazil.

So I would view that as kind of a contract-related change. Further, I would say that if you look back three or four years ago, in Brazil, almost all of our sales were coming from the Life Planner channel. And we've had a lot of growth in our bank segment. And increasingly, we've been making progress in our group segment. So that recently, almost 30% of our sales have been coming from outside the Life Planner model. So we're actually quite pleased with how things are going in Brazil. Thanks.

Erik Bass

Analyst, Autonomous Research

Q

Thank you.

Operator: Thank you. Next, we will go to the line of Yaron Kinar with Goldman Sachs. And your line is open. Please go ahead.

Yaron Kinar*Analyst, Goldman Sachs*

Q

Thank you. Good morning, everybody. My first question goes to the increase in the buyback authorization. Less so about, I think, 2021, but the thought of, kind of, seeing that, I think \$0.5 billion increase flow through to your kind of three year target. I guess conceptually, I want to maybe get your sense. Is this something that you think you'll be revisiting on a quarterly basis based on the performance of the company? Or is this kind of a one-off? How should we think of this new \$10.5 billion target?

Kenneth Yutaka Tanji*Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.*

A

Yeah. Hi. This is Ken. We've had a very consistent approach to capital management. We use both share repurchases and dividend as a way to distribute capital to shareholders. We've prioritized dividends. And our earnings have been about three-time dividends. Our free cash flow has been about 65% of our earnings and about two times our dividend. So, while we seek to use dividends and grow them, we'll use a level of share repurchases, but it will vary over time. Our recent decision to increase that by \$0.5 billion and again, just not just for 2021, but we also, as you mentioned, increased our three-year outlook. It really reflects where we are at this point in time with our capital position, as well as our outlook on the economy. And again, it's consistent with returning excess capital to shareholders. As time passes, we will continue to reassess our capital position and determine if adjustments are appropriate. So again, it's just – it's really consistent with the approach we've had for many years. And if we have excess capital, we'll make the practice of returning that to shareholders.

Yaron Kinar*Analyst, Goldman Sachs*

Q

Okay. But a quarter ago, you're also talking about the other pillar there, which was the \$5 billion to \$10 billion that you deploy into shifting business mix and in shifting to a more capital-light structure. So, I'm just trying to think of, is this additional \$0.5 billion, does that mean that you're seeing less opportunity to deploy into shifting business mix? Or is it just that you are identifying more excess capital than you initially thought, and therefore, are increasing the other pillar?

Kenneth Yutaka Tanji*Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.*

A

Yeah. It's really a reflection of our current position of excess capital. As Rob mentioned, we're making great progress towards our objective of \$5 billion to \$10 billion of capital relocation and again, it's a wide range because we want – we will be disciplined about transactions to release and redeploy. So, it's primarily the result of how we feel about our current capital position and the economic outlook.

Yaron Kinar*Analyst, Goldman Sachs*

Q

Understood. And then my second question goes to PGIM. So clearly, very strong net flows, but our tale of – I don't want to say a tale of stories, but you are seeing very, very robust retail flows, which I think is pretty consistent with what we are hearing in the market, whereas institutional flows slowed down a little bit sequentially. And I think that – I don't know if I should call that a trend or not. But maybe any color you can give us in terms of what you're seeing in both institutional and retail? And are you seeing trends there?

Andrew Sullivan*Executive Vice President and Head of U.S. Businesses, Prudential Financial, Inc.*

A

So, Yaron, it's Andy. Thanks for your question. Yeah. And I would not draw any conclusions or say we're seeing any trends. I guess, the way we would frame it is we are a very diversified business across our multi managers, across both public and private sectors. We serve a very wide range of clients.

The only thing I'd say on the institutional side is, obviously, institutional clients can tend to be more lumpy, and you'll get variability quarter-to-quarter versus on the retail side. On the retail side, we have seen a lot of money in money markets, and we think that could be a tailwind coming – continuing to come into the marketplace.

But more broadly, we have a broad suite of products. And I think at the end of the day, we're very confident that we'll be a net winner from a flow's perspective, given the strength and the balance that we have across product types and across institutional and retail. But to your question of should you draw any trends or conclusions, I would say no.

Yaron Kinar

Analyst, Goldman Sachs

Great. Thank you.

Operator: Thank you. Our next question comes from the line of Humphrey Lee with Dowling & Partners and your line is open.

Humphrey Hung Fai Lee

Analyst, Dowling & Partners Securities LLC

Good morning and thank you for taking my questions. My first question is related to retirement in general. I think, in your 10-K, you indicated that the spread compression in your food service business is a key headwind to earnings for retirement. Just looking back at the past couple of years or at least the past several quarters in terms of the interest rate headwind that you highlighted, how should we think about the portion of spread compressions in food service versus that in the IIP business?

Kenneth Yutaka Tanji

Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.

Hey, Humphrey, it's Ken. We do see spread compression in our Retirement business, and that's a combination of full-service in our institutional business. In the baseline roll forward that we provided, you'll see that. Of the \$10 million impact, half of that or \$5 million is in our retirement segment. But we don't split that out between full-service and institutional.

Humphrey Hung Fai Lee

Analyst, Dowling & Partners Securities LLC

I guess, kind of, directionally which one would you say will be heavier [ph] quant (45:44) of that?

Kenneth Yutaka Tanji

Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.

Yeah. Again, we don't want to get down – get into the breakdown of that.

Humphrey Hung Fai Lee

Analyst, Dowling & Partners Securities LLC

Okay. I guess, as just a follow-up to just the fixed income portion of the business in general. How should we think about the capital that you have that's currently backing the stable value business in full service?

Kenneth Yutaka Tanji

Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.

A

Again, we – our full-service business is part of our overall retirement segment. That's where the earnings are reported and the capital is held, but we're not going to break down the split of it by subsegment.

Humphrey Hung Fai Lee

Analyst, Dowling & Partners Securities LLC

Q

Okay. All right. Thank you.

Operator: Thank you. Our next question comes from the line of Tracy Benguigui with Barclays. And your line is open.

Tracy Benguigui

Analyst, Barclays Capital

Q

Thank you. Wondering if you could reconcile some comments made. On one hand, you mentioned deemphasizing higher market and rate-sensitive business. But on the other hand, Charlie, you mentioned previously that many of your businesses are [ph] sacred cows (46:49) that you look at everything. So, it would be helpful to understand how open-end your quest is or if you have a pecking order in mind?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Thanks, Tracy, for the question. Yeah, we – I'll just go back to what I said before, which is we have looked and are looking at all our businesses. Our objective is to create and maximize shareholder value over time. We're not going to talk about a pecking order, if you will, of businesses at this time. But rest assured that we're looking carefully at all our businesses and understanding specifically how they fit into an overall business mix and the objective that we articulated in the first quarter, which was to expand our higher growth businesses, and to reduce annuities and our market-sensitive businesses to a smaller extent. So that's about all we want to say at this point, but we are in the process of doing that. And as I said before, you all will know when there's more to report.

Tracy Benguigui

Analyst, Barclays Capital

Q

Okay. Understood. Moving to a different topic. I mean, there's a lot of talk about COVID-19. But I'm wondering if you had experienced better non-COVID-19 mortality losses for the quarter, I understand the first quarter is usually a heavy flu quarter. But looking at CDC data, it looks like excess mortality ex-COVID was unusually low. Did you have that experience?

Kenneth Yutaka Tanji

Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.

A

Hey, Tracy, this is certainly an unusual stretch of time during a pandemic. But generally, we did not see any significant or credible trend or variance in our underwriting experience, other than what seems to be related to COVID. So, really can't give you any other comments other than that.

Tracy Benguigui

Analyst, Barclays Capital

Okay. Thank you.

Q

Operator: Thank you. Next we will go to the line of John Barnidge with Piper Sandler. And your line is open.

John Barnidge

Analyst, Piper Sandler & Co.

Thank you very much. And don't worry, it's not a question about risk transfers. So, I was curious with some short-term disability claims seemingly then going to long-term disability because of the natural things that occur with economic shock lapses a few quarters out. Can you talk about your expectations with that as well as associated elevated administrative expenses?

Q

Andrew Sullivan

Executive Vice President and Head of U.S. Businesses, Prudential Financial, Inc.

Sure, John, it's Andy, and appreciate the new topic to cover. So, as you would expect last year, given the impact of COVID in the pandemic, we absolutely saw an increase in short-term disability claims. We've actually seen those claims volumes coming back down, obviously, as the pandemic is getting more under control with vaccines and the like. We continue to expect due to our experience, the impact on the economy to have an effect on long-term disability claim incidents.

A

We have not seen that tick up as of yet. That does not necessarily mean that we won't. There's generally a six-month healing period on the long-term disability plan. That's why you saw us put up an IBNR last quarter, and we put up an additional IBNR this quarter. So, we're still expecting that. And that directly flows to your question about increased administrative expenses. One of the things that we consider very, very important to managing this business is having the right number of claims professionals, nurses, and [indiscernible] (50:35) specialists. We have beefed up our staffing in the claims part of the business to be ready to properly help individuals return to work that go on long-term disability claims. And you're seeing that reflected in the elevated admin ratio.

Darin Arita

Senior Vice President, Head of Investor Relations, Prudential Financial, Inc.

And will that do it for you, John?

A

John Barnidge

Analyst, Piper Sandler & Co.

Sorry, I was on mute. Thank you. A follow-up to that related to it. Do you think the corporate push, not PRU, but industry-wide, to return to office in, say, the summer to fall may actually add another layer dynamic to that long-term disability dynamic?

Q

Andrew Sullivan

Executive Vice President and Head of U.S. Businesses, Prudential Financial, Inc.

So, John, it's Andy. I'll take your question. That's a really hard one to predict. And where my thoughts going at is we have a very diversified book of business across size, segments and geographies. And I think, the patterns of what we're going to see from a return to the workplace perspective are going to be pretty varied across those different industry size, segments and geographies. So really hard to tell what influence that might have on the disability claims incidents side.

A

John Barnidge

Analyst, Piper Sandler & Co.

Q

Thank you very much for your answers.

Operator: Thank you. Our next question will come from the line of Josh Shanker with Bank of America. And your line is open.

Josh Shanker

Analyst, Bank of America Securities-Merrill Lynch

Q

Yeah. Thank you for slipping me in here at the end. Two quick ones, I think. The first one is, obviously, first quarter is very interesting from an interest rate perspective move, and it affected the mark-to-market results at the PGIM strategies in a negative sort of way. I guess, I'm – look, there might be an argument that interest rates are going to continue to rise, probably not at the pace they did in the first quarter. But does PGIM have the right set of strategy to entertain inflows in a rising interest rate economy that PGIM customers will embrace?

Andrew Sullivan

Executive Vice President and Head of U.S. Businesses, Prudential Financial, Inc.

A

So, Josh, it's Andy. Thanks for your question. So yeah, as you're referring to, if we were to see a consistently rising rate environment, that very likely has an impact on fixed income flows in general across the space and could impact growth for that sector. But I'd go back to something I said earlier, which is we're a top 10 asset manager with a very broad and well-diversified portfolio in both publics and privates.

And in any economic environment, we feel that we'll be a net winner across those set of businesses from a net flow's perspective. So, we feel very well positioned. And then obviously, I'd be remiss if I didn't add. Remember, a rising rate environment overall is a net positive for production.

Josh Shanker

Analyst, Bank of America Securities-Merrill Lynch

Q

That's – I understand that. And two, I just understand the financial advisor new sales on the annuity side of the business. Obviously, the buffer annuity sales have been very strong. But I just want to break down, if I have a variable annuity with living benefits with Prudential, can I keep contributing into it? And how much of the new sales are legacy living benefits customers, who are putting more money into their older policies?

Andrew Sullivan

Executive Vice President and Head of U.S. Businesses, Prudential Financial, Inc.

A

Yes. So again, it's Andy. Thanks for the question. So, depending on the product, depending on the regulatory territory, there are various rules on what we call those sub pays, how much additional money can be dropped into the policies. We have actually closed off to the degree we're able, and it is, to a large degree, sub pays going into those products. That's why when we report that only 1% is in the traditional variable annuities with guaranteed living benefits, that is reflective of the sub pays as well. So, when we're really talking about runoff, those products truly are not only sales to new customers, but additional money is being dropped in, it really is a hard stop on them.

Josh Shanker

Analyst, Bank of America Securities-Merrill Lynch

Q

Okay. Thanks for both the answers.

Operator: Thank you. We will go to a follow-up from Tom Gallagher with Evercore ISI. And your line is open.

Thomas Gallagher

Analyst, Evercore ISI

Q

Thanks. Andy, just a follow-up on the buffer annuity sales, which are now the majority of your annuity sales. That's obviously a very big pivot into that product. Can you talk a bit about the risk profile of that business, the capital intensity of this product compared to your legacy VA business? And why you obviously feel a lot of confidence with this volume of sales if you're looking to exit legacy VA. But maybe just to compare and contrast about why you have confidence and clarity on the risk profile there.

Andrew Sullivan

Executive Vice President and Head of U.S. Businesses, Prudential Financial, Inc.

A

Yeah, Tom. So, it's Andy. And maybe I'll take sort of two sides to that question, risk and return. From a risk perspective, the product is vastly different from our traditional variable annuities, like the highest daily income. If you think about it, we're sharing risk with the consumer.

We're giving them a buffer on the downside for a little bit of upside, but they have the tail downside risk. And obviously, the upside is capped. So, at the end of the day, we're not taking interest rate risk like we were in HDI. The interest rate risk because of the design of the product could be nearly perfectly hedged with simple options. So, the risk profile we're very, very comfortable with from a go-forward perspective.

Your question around returns, I think what I've talked about in previous quarters. We did a lot of work to be able to more rapidly price our products and adjust our product pricing. We're quite pleased with the returns that we're seeing on the business that we're selling. And obviously, that might be begging the question of, well, why have you been so successful? So, let me hit that.

Number one, we are one of the very best and top brands in the space with a lot of history through the third-party advisor channels. Number two, we have great distribution people and relationships, inclusive of Prudential advisers, which is a very big strategic advantage for us. And that has led to the sales results and the very, very positive results. But we like the risk profile and we like the return.

Robert M. Falzon

Vice Chair & Director, Prudential Financial, Inc.

A

Hey, Tom, it's Rob. Just to add on to one thing Andy said, you talked about the interest rate risk profile. Just implied in his comments as well, but to make sure it's clear, the equity risk profile is also quite low. We're able – the structure of the buffer is something that we're able to actively hedge with options in the marketplace. So, we're not taking that equity market risk on ourselves. Thanks.

Thomas Gallagher

Analyst, Evercore ISI

Q

Okay. Thanks, guys.

Operator: Thank you. And with that, Mr. Lowrey, I'd like to turn it back over to you for any closing comments.

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

Thank you very much. So, thank you for your time and interest today. I hope we've conveyed the increased sense of momentum and the steady progress around our transformation initiatives. We remain confident in our strategy and the additional steps we're taking to build a nimbler and higher growth business, and one which continues to focus on the evolving needs of our customers. We look forward to sharing more details on our progress with you in the coming quarters. And thank you again for joining us today.

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Operator: Thank you. And ladies and gentlemen, that does conclude your conference call for today. Thank you for your participation and for using AT&T Executive Teleconference Service. You may now disconnect.

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