Principal Financial Group (PFG)

Updated October 26th, 2018 by Jonathan Weber

Key Metrics

Current Price:	$50	**5 Year CAGR Estimate:**	16.4%	**Volatility Percentile:**	59.4%
Fair Value Price:	$61	**5 Year Growth Estimate:**	8.1%	**Momentum Percentile:**	6.2%
% Fair Value:	83%	**5 Year Valuation Multiple Estimate:**	3.9%	**Growth Percentile:**	78.0%
Dividend Yield:	4.4%	**5 Year Price Target**	$89	**Valuation Percentile:**	84.4%
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Total Return Percentile:**	92.2%

Overview & Current Events

Principal Financial Group is a financial corporation that operates several businesses including insurance, primarily life insurance, and investment management (specifically retirement solutions and asset management). Principal Financial Group was founded in 1879, is headquartered in Des Moines, IA, and is currently valued at $14.1 billion.

Principal Financial Group has reported compelling third quarter earnings results on October 25. Retirement and income solutions revenues rose by 11% thanks to higher fees and higher spreads. Principal's Global Investors business saw an even better 81% revenue growth rate. Principal's International segment and its Specialty Benefits units grew as well. The life insurance business was the only segment where revenues declined (by 2%). The revenue increase, coupled with lower taxes and a lower share count, allowed Principal Financial Group to grow its earnings-per-share by 30% year over year, to $1.67. The company has announced a dividend of $0.54 per share during October, a 2% raise.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$1.63	$2.69	$2.63	$2.76	$2.69	$3.55	$4.41	$4.26	$4.55	$5.04	***$5.50***	***$8.10***
DPS	$0.45	$0.50	$0.55	$0.70	$0.78	$0.98	$1.28	$1.50	$1.61	$1.87	***$2.10***	***$3.40***
Shares	260	319	320	301	293	298	299	298	288	289	***280***	***265***

Principal Financial Group recorded a highly compelling average annual earnings-per-share growth rate of 13.4% between 2008 and 2017. Growth was a bit uneven, though, there were some years where the company's profitability declined. Principal Financial Group is active in two different businesses, asset management and insurance.

The company's asset management business, where Principal Global Investors and Retirement & Income Solutions are the main components, benefits from solid assets under management (AuM) growth. A rising amount of new customers helps drive AuM. Net inflows totaled $0.2 billion during the third quarter. The company's asset management business is attractive for investors, as Principal's actively managed funds, ETFs, and other vehicles performed better than the median of their asset class in 89% of cases over the last five years. As Principal produces above-average returns for its customers, customers are attracted to letting Principal manage their money. With its insurance business Principal Financial Group has been able to grow its premiums and fees in the past as well, and with rising interest rates the float the company holds can be invested at higher returns. This should positively impact Principal Financial Group's investment income going forward. Principal Financial Group has also boosted its earnings-per-share growth by repurchasing shares over the last couple of years. The company plans to do the same in the future.

Principal Financial Group has increased its dividend every quarter over the last two years, and regularly, although not every quarter, before that. The dividend was grown by 16% annually since 2008 and should continue to grow.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	26.5	7.5	10.1	10.3	10.0	11.1	11.2	11.9	10.1	12.8	***9.1***	***11.0***
Avg. Yld.	1.0%	2.5%	2.1%	2.5%	2.9%	2.5%	2.6%	3.0%	3.5%	2.9%	***4.4%***	***4.0%***

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Principal Financial Group's valuation has been in a relatively narrow range after the financial crisis. Shares were mostly valued at a low-double-digits earnings multiple. Shares currently trade at ~9 times this year's earnings, which is a sizeable discount relative to the fair valuation. Shares should benefit from multiple expansion going forward. Investors get a sizeable dividend yield of 4.4%, with regular dividend increases, on top of that.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
Debt/A	98.1%	94.2%	93.2%	93.6%	94.0%	95.3%	95.3%	95.7%	95.5%	94.9%	***95.0%***	***95.0%***
Payout	27.6%	18.6%	20.9%	25.4%	29.0%	27.6%	29.0%	35.2%	35.4%	37.1%	***38.2%***	***42.0%***
Std. Dev.	80.7%	122%	37.1%	27.3%	22.8%	16.0%	20.6%	20.9%	26.8%	13.3%	***18.0%***	***17.0%***

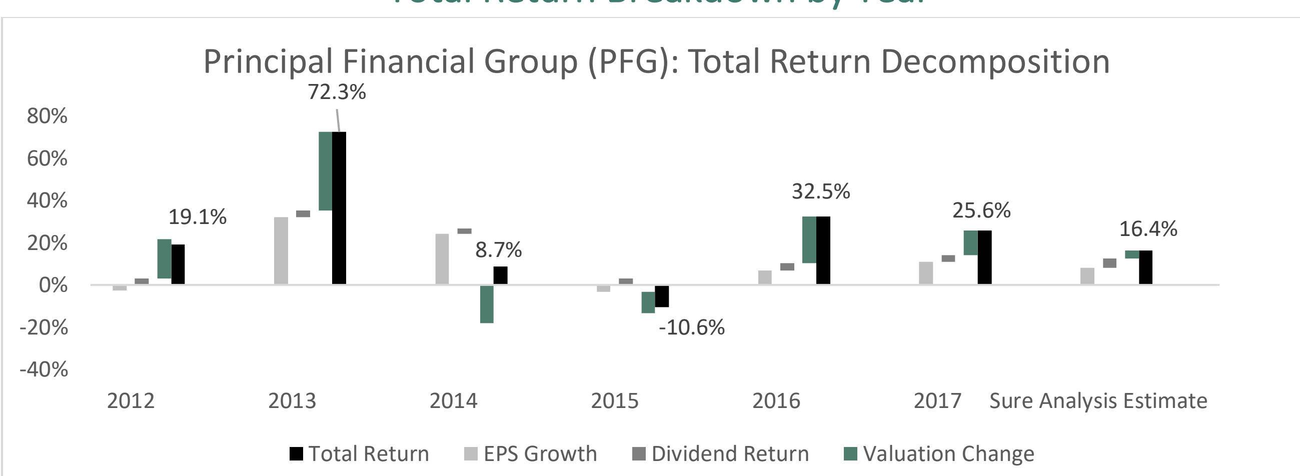
Principal Financial Group is highly leveraged because it is an insurer. The company's insurance liabilities (float) are really an asset, as the company gets to use this money and benefit from interest income. Due to net interest income being positive, investors do not have to worry about the company's leverage at all. Rising interest rates will lead to higher returns for the company's investments, and are therefore not a headwind, despite a high liabilities to assets ratio. Over the last decade Principal Financial Group has increased its dividend payout ratio continuously, but at less than 40% of earnings the payout ratio still is not high at all. The company will likely continue to grow the dividend payout ratio.

The strong performance of Principal Financial Group's actively managed funds, ETFs, and other products is a competitive advantage, as this increases the likelihood of customers choosing Principal to manage their assets. Even though Principal Financial Group's stock was extremely volatile during the last financial crisis, its actual underlying performance was not impacted much, operating earnings declined by just 10% from 2007 to 2008 and started to rise again in 2009. This compares very favorably to the much weaker performance of many other financial corporations.

Final Thoughts & Recommendation

Principal Financial Group is a financial corporation that is active in two markets. The company is well-positioned, and has been a low-risk investment in the past – during the last financial crisis it remained very stable compared to many of its peers. Going forward the company will benefit from rising interest rates, which will allow for rising interest income. Through a combination of some earnings-per-share growth, multiple expansion tailwinds, and a relatively high dividend yield Principal Financial Group should be able to deliver attractive total returns. Shares earn a buy recommendation at current prices.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	9936	8849	9198	8671	9215	9290	10478	11964	12394	14093
SG&A Exp.	N/A	N/A	2988	2971	2934	3293	3574	3672	3733	3894
D&A Exp.	145	139	165	120	132	154	170	193	187	196
Net Profit	458	623	663	638	807	913	1144	1234	1317	2310
Net Margin	4.6%	7.0%	7.2%	7.4%	8.8%	9.8%	10.9%	10.3%	10.6%	16.4%
Free Cash Flow	2120	2217	2770	2656	3042	2162	2967	4241	3703	4023
Income Tax	-5	100	105	198	135	188	319	178	230	-72

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets ($B)	128.2	137.76	145.63	147.36	161.83	208.19	219.09	218.66	228.01	253.94
Cash & Equivalents	2608	2240	1877	2834	4177	2372	1864	2565	2720	2471
Accounts Receivable	988	1065	1063	1197	1084	1241	1213	1429	1362	1470
Goodwill & Int. Ass.	1301	1238	1180	1373	1458	2559	2331	2368	2346	2384
Total Liab. ($B)	125.7	129.74	135.75	137.99	152.13	198.41	208.86	209.28	217.72	241.02
Long-Term Debt	1791	1686.2	1691.6	1670	2712.1	2752	2559.2	3446.3	3177.1	3217.9
Shareholder’s Equity	2473	7893.4	9727.7	9017.8	9683.3	9684.1	10184	9311.6	10227	12849
D/E Ratio	0.72	0.21	0.17	0.19	0.28	0.28	0.25	0.37	0.31	0.25

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	0.3%	0.5%	0.5%	0.4%	0.5%	0.5%	0.5%	0.6%	0.6%	1.0%
Return on Equity	9.3%	12.0%	7.5%	6.8%	8.6%	9.4%	11.5%	12.7%	13.5%	20.0%
ROIC	6.8%	8.9%	6.2%	5.6%	6.9%	7.3%	9.0%	9.6%	10.0%	15.6%
Shares Out.	260	319	320	301	293	298	299	298	288	289
Revenue/Share	38.05	29.61	28.48	27.30	30.68	31.15	35.08	40.15	42.34	48.08
FCF/Share	8.12	7.42	8.58	8.36	10.13	7.25	9.93	14.23	12.65	13.73

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.