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Prudential Financial, Inc. (PRU)

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MANAGEMENT DISCUSSION SECTION

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

I will now turn the call over to Mr. Bob McLaughlin. Please go ahead.

Robert McLaughlin

Head-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 International Businesses and PGIM, our global investment manager; Caroline Feeney, Head of US Businesses; Yanela Frias, Chief Financial Officer; and Rob Axel, Controller and Principal Accounting Officer. We will start with prepared comments by Charlie, Rob and Yanela, and then we will take your questions.

Today's discussion may include forward-looking statements. It is possible that actual results may differ materially from the predictions we make today. In addition, our presentation includes 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 slides 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.

And now, I'll turn it over to Charlie.

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

Thank you, Bob, and thanks to all of you for joining us today. First, I'd like to comment on the leadership changes we announced in the fourth quarter. The board appointed Andy Sullivan as Prudential's next CEO, effective March 31. He is an exceptional leader, and the board and I have every confidence he is the right person to take Prudential into the future.

Also, at the end of March, Caroline Feeney will take on an expanded role overseeing our global retirement and insurance businesses. Both Andy and Caroline have been highly engaged in setting and executing our strategy, so we expect a smooth transition. And Jacques Chappuis will be joining as CEO of PGIM, our Global Asset Management business. Both Caroline and Jacques will report directly to Andy.

This is an exciting and significant time for Prudential and the right time to elevate the next generation of leadership as we mark our 150th anniversary. Finally, I'd also note that just last week, we were recognized as the number one company among our life and health insurance peers for 2024 on Fortune's list of the World's Most Admired Companies.

Now, let's turn to our results. In 2024, we made significant progress on our path to becoming a higher growth, more capital-efficient company. We maintained our disciplined approach to capital deployment, while also continuing to invest in our businesses, and returned excess capital to shareholders. Our strategic progress and performance are backed by our financial strength.

Turning to slide 3. Our results for the full year reflect continued momentum as we further diversified our product suite and expanded our distribution capabilities to address the investment, insurance and retirement needs of our customers and clients around the world. Earnings for the fourth quarter were lower than we anticipated, but do not reflect the earnings power of our businesses. This was largely due to adverse underwriting experience, primarily driven by an elevated level of large individual life claims. Large claim activity will vary on a quarterly basis, but our fundamentals remain strong and the actions we are taking across our businesses create a solid foundation for future growth.

We reported strong full year sales across our retirement and insurance businesses, as well as strong investment performance and significant positive net flows in PGIM. PGIM reported robust affiliated and third-party flows for the full year 2024, benefiting from our broad capabilities across fixed income, equities and our diversified private alternatives platform, and fueled by the growing global retirement opportunity and the growth of our retirement and insurance businesses.

Our Retirement Strategies business continues to address the growing needs of the market as a leader in pension risk transfer and individual annuities. On the Institutional side, our pension risk transfer business had the highest annual level of sales for any single carrier since 2012. On the Individual side, we had our ninth consecutive quarter of sales growth.

We also continued to diversify our products and expand our distribution networks in Group Insurance and Individual Life, which resulted in continued sales momentum. And in our International Businesses, we continue to diversify our product portfolio in Japan, including retirement solutions, and we expanded our distribution channels in Brazil.

In addition to the momentum we are seeing across our businesses, during 2024, we successfully executed on a number of transactions that enhanced our capital flexibility, improved the quality of our earnings, and shifted our business mix. We completed two Guaranteed Universal Life reinsurance transactions, which reduced our cumulative exposure to this product by 60%. And just last month, we announced our second Prismic transaction to reinsure a $7 billion block of Japanese Whole Life policies, adding further scale to the Prismic platform.

Turning to slide 4. Our continued investments in our businesses are supported by our disciplined approach to capital deployment, which included returning nearly $3 billion to shareholders in 2024. In addition, the board has authorized share repurchases of up to $1 billion in 2025 and increased the common stock dividend for the 17th consecutive year.

Turning to slide 5. Our strategic progress is supported by our robust risk and capital framework. We maintained a AA rating, which reflects a healthy capital position, including holding more than $4 billion in highly liquid assets. We also maintained a well-diversified, high quality investment portfolio and a disciplined approach to asset liability management. We're operating from a position of strength and have entered 2025 with continued confidence in our strategy, our capabilities and our path to deliver long term, sustainable value for all our stakeholders.

Before I turn the call over to Rob, I want to acknowledge the extraordinary partnership we have shared over these past six years. Rob is retiring from Prudential in July, culminating a remarkable 42-year career with the firm, in which he has made innumerable and material contributions to our continued success and future growth.

And with that, I'll turn it over to Rob.

Robert Michael Falzon

Vice Chairman, Prudential Financial, Inc.

Thank you, Charlie. It's been a privilege. I'll provide an overview of our financial results and business performance for our PGIM, US and International Businesses. I'll begin on slide 6 with our financial results. Our pre-tax adjusted operating income was $1.4 billion, or $2.96 per share for the fourth quarter of 2024, and $5.9 billion, or $12.62 per share for the full year, up 6% from 2023. This reflects the execution of our strategy to grow our market-leading businesses and was driven by higher fee and spread income due to continued strong sales and flows, as well as the benefit of higher interest rates in equity markets, net of increased expenses to support the growth of our businesses.

Our GAAP net loss for the quarter was $57 million. This was primarily due to interest rate driven realized losses on the investment portfolio that will be transferred to Prismic in connection with our recently announced reinsurance transaction, as well as some modest repositioning of our investment portfolio in the quarter. 2024 adjusted operating return on equity of 13.1% improved 70 basis points from 2023. This reflects the strength of our businesses and the benefits from the deliberate actions we have taken to pivot to more capital-efficient and higher growth products.

Turning to the quarterly operating results from our businesses compared to the year ago quarter. PGIM, our global investment manager, had higher asset management fees, driven by strong net flows, market appreciation, favorable investment performance, and increasing contributions from the Deerpath Capital acquisition, and higher other related revenues driven by higher incentive fees. This was partially offset by higher expenses to support business growth.

Results of our US Businesses reflected higher expenses related to the one-time transaction impacts associated with the closing of both the Guaranteed Universal Life reinsurance transaction and the consolidation of our captive financing arrangements, less favorable underwriting results, driven by mortality experience and true-ups and lower net fee income. This was partially offset by higher net investment spread income, primarily driven by business growth.

Our International Businesses had less favorable underwriting results, primarily reflecting elevated US dollar product surrenders, with the continued weakness in the yen, and higher expenses to support business growth. These were partially offset by increased spread income due to higher yields from favorable market performance and reinvestment to the portfolio.

Turning to slide 7. PGIM, our global investment manager, has diversified capabilities in both public and private asset classes across fixed income, equities and alternatives. PGIM's investment performance remains strong, with 78% and 85% of assets under management outperforming their benchmarks over the last 5- and 10-year periods, respectively. PGIM's assets under management increased by 6% to $1.4 trillion from year-end 2023, driven by market appreciation, net flows and strong investment performance.

Total net flows in the quarter of $8.6 billion included affiliated net flows of $8.9 billion, driven by a large annuities mandate, partially offset by $300 million of third-party net outflows. Total net flows for full year 2024 were $38 billion, including $24 billion in affiliated flows and $14 billion from third-party clients. These inflows reflect the competitive positioning of both PGIM and our retirement business in the wake of large, albeit episodic, institutional pension plan activity.

As the investment engine of Prudential, PGIM's capabilities support the success and growth of our US and International Businesses in retirement, asset management and insurance. PGIM's asset origination capabilities, investment management expertise and access to institutional and other sources of private capital, including through our sponsored reinsurer, Prismic, are a competitive advantage, helping our businesses bring enhanced solutions and create more value for our customers.

Our retirement and insurance businesses, in turn, provide a source of growth for PGIM through affiliated net flows, as well as unique access to insurance liabilities. In addition, our diversified PGIM private alternatives platform, which has assets under management of nearly $250 billion, experienced 37% growth in private credit origination activity in 2024 compared to the prior year. This was driven by our direct lending businesses, including our acquisition of Deerpath Capital and the organic build-out of our private asset-backed financing business.

Turning to slide 8. Our US Businesses produce diversified sources of earnings from fees, net investment spread, and underwriting income, and benefit from complementary mix of longevity and mortality businesses. We continue to focus on growing our market-leading businesses by expanding our addressable market with new financial solutions delivered through a broader distribution footprint, leveraging capabilities across Prudential, and enhancing those capabilities to improve the experience of our customers and distribution partners, while driving operating efficiencies.

Retirement Strategies generated strong sales of $50 billion in 2024 across its institutional and individual lines of business. Institutional Retirement sales of $10 billion in the fourth quarter contributed to $36 billion of sales for the year, up 27% from the prior year. US-funded Pension Risk Transfer transactions for the year were over $16 billion, the highest annual level for any single carrier since we set the record in 2012.

Additionally, longevity risk transfer sales totaled over $10 billion this year. Individual Retirement posted $3.6 billion in sales in the fourth quarter, its best quarter of sales in over a decade. 2024 sales were over $14 billion, up 84% from the prior year. Our product pivots and innovation have resulted in continued strong sales of our registered index-linked annuities and fixed annuity product sales have doubled from the prior year. Additionally, we continue to reduce market sensitivity by running off our legacy variable annuities.

Group insurance sales totaled $550 million in 2024, up 4% from the prior year, driven by growth in supplemental health. We are executing our strategy of both product and client segmentation diversification, while leveraging technology to increase operating efficiency and enhance the customer experience. These actions to improve profitability and performance resulted in a benefits ratio of 83.1% for the year, which is at the low end of our target range.

In Individual Life, sales reached a quarterly record high of $326 million in the fourth quarter, and for the full year increased 23% from 2023. These increases include the benefit from the strength and breadth of our distribution capabilities, the expansion of our product offerings, including our pivot towards more capital-efficient products, and from an increased level of estate planning sales concentrated in the fourth quarter.

Turning to slide 9, our International Businesses include our Japanese life insurance companies, where we have a differentiated multi-channel distribution model, as well as other businesses aimed at expanding our presence in targeted high-growth emerging markets. In Japan, we are focused on providing high-quality service and expanding our distribution of product offerings.

Our needs-based selling approach and protection and retirement product focus continue to provide important value to our customers as we expand our product offerings to meet their evolving needs. In emerging markets, we are focused on creating a selective portfolio of businesses in regions where customer needs are growing, where there are compelling opportunities to build market-leading businesses and where the Prudential enterprise can add value.

Sales in our International Businesses for 2024 were up 6% compared to the prior year. Sales in Japan are benefiting from recent retirement and savings product launches, which are gaining traction with customers, resulting in a 14% increase in sales of these products compared to the full year of 2023. In addition, emerging markets sales increased 12% versus the prior year, driven by growth in Brazil as we continue to expand third-party distribution and benefit from the strong performance of our Life Planners.

As we look ahead, we are well positioned across our businesses to be a global leader in expanding access to investing, insurance, and retirement security. We continue to focus on investing in growth businesses and markets, delivering industry-leading customer and client experiences, and creating the next generation of financial solutions to serve the diverse needs of a broad range of customers.

And with that, I'll now hand it over to Yanela.

Yanela del Carmen Frias

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

Thank you, Rob. I will begin on slide 10. Our significant capital position and strong regulatory capital ratios continue to support our AA financial strengths and our ability to expand our market-leading businesses. Our cash and liquid assets were $4.6 billion, which is above our minimum liquidity target of $3 billion, and we have substantial off-balance sheet resources.

Now, turning to slide 11, as I mentioned on last quarter's call, in order to provide greater insights into our financial outlook and align with our longer-term nature of our business, we are introducing new financial targets through 2027. Our significant growth in sales and flows, supported by the strength of our balance sheet and our commitment to become a higher growth, more capital-efficient company, position us well to achieve these targets. We expect this will lead to annual core earnings per share growth of 5% to 8%, which is based off of core adjusted operating income per share for 2024, and an adjusted return on equity of 13% to 15%.

We're also introducing an operating expense ratio for our global retirement and insurance businesses, an anticipated range of 8.5% to 10.5%, which we expect will trend down over the three-year period. The momentum in our sales and flows, combined with operating efficiencies and incremental buybacks, are expected to contribute to our earnings growth and returns over the three-year period, but this performance may not be linear due to the near-term strain from new business and the impact of runoff blocks.

In addition, we will remain thoughtful in our capital deployment, preserving our financial strength and flexibility by targeting to maintain highly liquid assets of over $3 billion at the holding company, while investing in our businesses for long-term sustainable, profitable growth.

We expect to deploy 30% to 40% of capital generated towards organic growth as we see significant opportunities in our chosen markets. After consideration of organic growth, this yields a free cash flow ratio of approximately 65% of net income, with 35% to 45% expected to be deployed to attractive and increasing dividends. This is a healthy return to shareholders that represents an annual payout of approximately 6% of adjusted book value as of year-end 2024.

Further, we expect to return 20% to 30% towards share repurchases, and the board authorized $1 billion of repurchases in 2025. Finally, we continue to proactively explore opportunities to invest in inorganic growth, while maintaining a disciplined approach to capital deployment in the current environment.

Turning to slide 12, our enterprise metrics will be supported by our business segment growth targets. We expect low-double-digit earnings growth in PGIM, backed by strong asset management fee growth of 6% to 9%, driven by net flows and market appreciation, and an adjusted operating margin of 25% to 30%. In the US Businesses, we expect mid-single-digit earnings growth, supported by account value and sales growth across businesses.

In Retirement Strategies, our account value growth assumes annual gross sales of $35 billion to $45 billion, which will be partially offset by annual net runoff of our pension and longevity risk transfer products of $8 billion to $10 billion and legacy variable annuities of $12 billion to $16 billion. In group insurance, we expect premium growth of 2% to 4%, and in Individual Life, we expect sales to be flat to 5% growth. And lastly, in our International Businesses, we expect low- to mid-single-digit earnings growth, driven by sales growth of 4% to 6% as we continue to diversify our product mix.

We also have included our key economic assumptions and other earnings considerations specific to 2025 in the appendix. We are confident in our ability to deliver on these financial objectives as we drive incremental organic growth in our businesses, while continuing to maintain our disciplined capital deployment approach.

So, turning to slide 13, and in summary, we continue to become a higher growth, more capital-efficient company. We will maintain our disciplined approach to capital deployment, and our growth is supported by the strength of our balance sheet.

And with that, we will be happy to take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We'll now be conducting a question-and-answer session. [Operator Instructions] Our first question today is coming from Suneet Kamath from Jefferies. Your line is now live.

Suneet Kamath
Analyst, Jefferies LLC

Q

Great. Thanks. I want to start out on the annuity outlook. I see the 20% to 25% account value growth. So, Caroline, I was just wondering if you could help us maybe translate that into sales growth expectations for the year. And the reason I ask is I think LIMRA is out saying sales will probably be down for the industry, and I just want to get a sense of how you're thinking about a PRU's outlook.

Caroline A. Feeney
Executive Vice President & Head-US Businesses, Prudential Financial, Inc.

A

Yeah. Terrific, Suneet. I will certainly take your question. So, clearly, it was another extremely strong year for annuities with over $425 billion in total industry sales last year. And I think what LIMRA might be referencing in terms of some of their outlook is this past quarter, the industry did see some softening of traditional fixed annuity sales, which is to be expected with rate decreases. So, what we're seeing is a shift from MYGAs, which are more sensitive to rates, to index products such as RILAs. But Suneet, what I would point out is that RILA sales were up over 35% across the industry last year. So, in our own business, we continue to see positive results. In the fourth quarter, we delivered roughly $3.5 billion in sales, which was our ninth consecutive quarter of sales growth.

So, from an outlook perspective, Suneet, as we've discussed previously, we continue to see those compelling tailwinds in the marketplace driven by aging demographics, plus a high volume of money in motion. And that includes an estimated $70 billion in fixed annuities that's coming due as well as over $7 trillion in money market fund balances. So, all of this just underscores the importance of our diversified product portfolio. As you know, Suneet, this has been a key focus for us over the past few years. And as a result, we now have the broadest individual product portfolio in our history. We actually have five different products with over $1 billion in annual sales. So, overall, we believe that tailwinds will continue to support strong sales. And certainly, we are well positioned to capture this demand, and thanks to the strength of our distribution and our well-established brand.

Suneet Kamath
Analyst, Jefferies LLC

Q

Got it. And then, I just wanted to pivot to Prismic. Obviously, we saw the internal reinsurance deal. Presumably, that's going to consume some of their time and capital. I guess the question is, how quickly do you think Prismic could sort of pivot to maybe some third-party deals, particularly in Japan? Is it going to take some time for them to integrate this transaction? Or just any thoughts around that would be helpful.

Robert Michael Falzon
Vice Chairman, Prudential Financial, Inc.

A

Suneet, it's Rob. I'll address that. So, yeah, we closed the second transaction, as we, I think, had indicated with Japan-based. A number of important reasons for doing that, but more broadly is, as we think about the Japan opportunity, including the third-party opportunity in Japan, we think it's a significant growth opportunity for Prismic, both from our own book and third-party reinsurance. Japan's the third-largest life market in the world, and it's been relatively underserved by third-party reinsurers. So, there's an opportunity there, and that opportunity is sort of accelerating by virtue of the introduction of the ESR regime and its impact on legacy books that have been sold not just by us, but across the industry.

ESR has a non-economic treatment of long-duration, foreign currency denominated products that's in the Japan marketplace, but the industry has sold a lot of that and continues to sell it because of the demand that our customers have for the product. And so, addressing those books and those flows, those sales, are going to be something that the industry has to grapple with, and we think we're well-positioned to do so.

Our brand – our local presence and the market intelligence that we've got create a competitive advantage. Prismic, as we've indicated in the last quarter, we've stood up a dedicated licensed team in Japan. And then by virtue of, as I indicated upfront, by closing on our own Whole Life book, it's given us the experience and confidence to execute third-party blocks and further establishes our credibility in the marketplace.

But I would emphasize more generally, we're optimistic that we can grow Prismic through the multiple levers that we've got, Suneet. So, that includes ongoing balance sheet optimization, both in the US and Japan. It includes, importantly, flow, so new sales solutions across our businesses, and third-party blocks, particularly in Japan.

Suneet Kamath
Analyst, Jefferies LLC

Q

Got it. Okay. Thanks.

Operator: Thank you. Next question today is coming from Tom Gallagher from Evercore ISI. Your line is now live.

Thomas Gallagher
Analyst, Evercore ISI

Q

Good morning. A few questions on free cash flow. So, the 65% free cash flow conversion, why is 30% to 40% of that needed for growth capital when most of the businesses that I would think of requiring capital are growing sub-5%?

Yanela del Carmen Frias
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.

A

Hi, Tom. It's Yanela. So, let me take that. So, we continue to see strong opportunities in our chosen markets, and we're leaning into those opportunities as evidenced by our strong sales and flows really across our businesses. So, as an example, on a full year basis, we had a 39% increase in sales for Retirement Strategies, 23% increase in sales for Individual Life. And these strong sales are contributing to earnings, but we do face near-term headwinds due to strain from new business, specifically distribution costs that are not deferred and the impact of runoff.

So, I would emphasize that we're investing in strong growth that is materializing in earnings, but we have near-term headwinds related to new business strain and runoff. And as these headwinds moderate, we would expect an upward trajectory in our core earnings growth. But even with these headwinds, we have a 5% to 8% growth rate in core earnings, we're paying a healthy dividend, and we have a healthy level of buybacks.

Thomas Gallagher
Analyst, Evercore ISI

Q

Got it. And Yanela, just a follow-up, making sure I'm understanding what the intention is here when I'm solving for buybacks and dividends, if I take the 75% of the 65% free cash flow conversion, that would equate to about 50% of GAAP earnings that will be returned through buybacks and dividends over the next three years. Is that the rough math? And just a related question, I think you used to use operating income, now you're using net income. Is there anything to read into with the change in that conversion? Thanks.

Yanela del Carmen Frias
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.
A

Yeah. So, I mean, if you look at our capital allocation priorities that we shared, so attractive – dividends are 35% to 45%, share repurchase is 20% to 30%, so I think you're just adding those two when you get to the 75%. And so, in terms of the change to net income, while AOI is our primary basis for assessing operating results, we do think that over the near term, GAAP net income will be a closer proxy for free cash flows. And that is because there are items that are excluded from AOI that do impact statutory capital, which is the primary driver of cash flows. So for example, realized gains and losses that arise due to normal course portfolio management activity or mark-to-market on hedging instruments impact both GAAP and stat.

Now, conversely, there are some components of GAAP net income that don't impact cash – cash flows, but our free cash flow ratio is an overtime calculation, Tom, and we do anticipate that much of the non-economic volatility largely evens out over time, leaving us with net income being a good indicator of cash flows in the near term for us.

Thomas Gallagher
Analyst, Evercore ISI
Q

Okay. Thank you.

Operator: Thank you. Next question is coming from Ryan Krueger from KBW. Your line is now live.

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

Hey. Thanks. Good morning. My first question was just on the ULSG transaction you completed and the Japan Prismic transaction that announced between the two of them, you're freeing up several hundred million dollars, I think over $500 million, but kept the buyback at $1 billion for 2025. Can you give more color on how you may use that capital over time? Are you holding it for potential opportunistic M&A, or is there – are there any other considerations where you could use that for?

Yanela del Carmen Frias
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.
A

Hi, Ryan. It's Yanela. So, the potential uses of the capital will be consistent with our capital allocation priorities that we detailed with our financial targets, and will be consistent with essentially our priorities in terms of how we think about capital deployment. So, we look to strike a balance between preserving financial strength and flexibility, investing in our businesses for long-term growth, and returning capital to shareholders.

As part of our shareholder distribution philosophy, a core level of share repurchases will generally be sustainable. But keep in mind that that may vary with opportunities for attractive capital deployment or reductions in free cash flow in times of stress. So, we constantly monitor developments in economic and market conditions. We will follow our risk management and capital management playbooks with discipline to be prepared for opportunities and risks as well.

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

Thank you. And then there was a recent lawsuit against the plan sponsor that involved the pension risk transfer transaction with Prudential. There have been some other lawsuits against other plan sponsors from other pension risk transfer providers that have had some negative impact, it seems, on activity. Do you think this will have any impact on Prudential's transaction pipeline, or do you view this more as a one-off issue?

Caroline A. Feeney
Executive Vice President & Head-US Businesses, Prudential Financial, Inc.
A

Yeah. So, Ryan, it's Caroline, and I'll take your question. And while I won't comment on the impact on any other peer companies, I will say clearly that litigation like this threatens the ongoing health of the pension risk transfer industry. It's particularly harmful for plan sponsors who are looking to de-risk their pension obligations and for the retirees, whose pensions are protected through these transactions. So, fundamentally, companies like Prudential, who are governed by the insurance regulatory system, are simply better holders of these types of risks.

Our industry has an extensive history of fulfilling the promises made to retirees, since we here at Prudential actually pioneered this business in a transaction with the Cleveland Public Library, which was now over 100 years ago, Ryan. So while we're not a named party in the lawsuit, let me just reiterate that this lawsuit does not accurately represent Prudential or the quality and the security of the industry.

In terms of the impact going forward, from a new business perspective, Ryan, we still see strong funded statuses, and we see favorable market conditions. So, we have every reason to believe there will continue to be an active pipeline. And with our ability to work with plan sponsors of all different types and sizes, we are well positioned to continue to be a market leader in this space.

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

Thanks. Appreciate the response.

Operator: Thank you. Next question is coming from Elyse Greenspan from Wells Fargo. Your line is now live.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC
Q

Hi. Thanks. Good morning. I know you guys said the 5% to 8% EPS growth outlook, right, is not expected to be linear, I think, was the word, and obviously there could be some variations by year. But how would you think going into 2025, your expectations there relative to the 5% to 8% target?

Yanela del Carmen Frias
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.
A

Yeah. Hi, Elyse. It's Yanela. So, I would start by saying that we feel confident about our 5% to 8% EPS growth target off of core earnings. We see strong opportunities and tailwinds and we're executing on those opportunities as evidenced by our strong sales and flows. But as you pointed out and as I said in my opening remarks, this growth will not be linear and we do have near-term headwinds, mainly due to strain of sales and runoff. So, the 5% to 8% is an average over the three-year period. It could be lower or higher in any given year. And naturally, as the headwinds of some of our runoff blocks moderate and our growth investments take hold, we would expect an upward trajectory in our core earnings over that three-year period.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC
Q

Thanks. And then my second question is just on Prismic in Japan. You guys did announce a recent transaction. Beyond that, as we deal with the upcoming capital changes in Japan, do you guys expect to do additional transactions with Prismic there?

Robert Michael Falzon
Vice Chairman, Prudential Financial, Inc.
A

Elyse, it's Rob. I'll take that question. We're continuing to work on an active pipeline of multiple reinsurance transactions. They include ongoing balance sheet optimization from our own book, both in the US and Japan. We're working on flow solutions as well across our businesses, again, in the US and Japan. And we are looking at third-party blocks with a focus there being really almost exclusively in Japan. So, our expectation is that, yes, we'll continue to have opportunities with Prismic to address what we see as a significant market opportunity, not just in our own book, but across the industry in Japan.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC
Q

Thank you.

Operator: Thank you. Next question is coming from Wes Carmichael from Autonomous Research. Your line is now live.

Wes Carmichael
Analyst, Autonomous Research US LP
Q

Hey. Good morning. I wanted to follow up on Japan and maybe the progress that's being made on ESR implementation. I think your Japanese SMR ratios are in excess of 700% today, but could you give us any insight on your view of current excess capital in Japan if you had to implement ESR today?

Yanela del Carmen Frias
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.
A

Hi, Wes. It's Yanela. So, yeah, the JFSA's plan is to adopt ESR for the fiscal year beginning April 1, 2025, with the first mandatory reporting date being March 31, 2026. We expect upon implementation of ESR that our capital levels will continue to be above target levels that would support AA financial strength ratings. And as we said before, our intent is to start providing information about our ESR position in the summer.

We have executed some transactions, affiliated reinsurance transactions, to help mitigate the volatility. And like we always do, we constantly seek to optimize our balance sheet and manage our risks in capital and reserving regimes that best match the economics of our products. So, we don't anticipate a significant change in our capital position in those entities.

Andrew F. Sullivan
Executive Vice President & Head-International Businesses and Global Investment Management, Prudential Financial, Inc.
A

Hey, Wes, it's Andy. Let me just add that in Japan, we offer a broad product portfolio that meets the needs of our customers, and we're continuing to innovate and expand on that portfolio, including with ESR-friendly offerings. So, the bottom line for us is these product capabilities, when combined with our strong underwriting, our asset liability management, and our hedging, we have everything that we need to continue to profitably grow well in Japan.

Wes Carmichael
Analyst, Autonomous Research US LP

Q

Got it. Thank you. And maybe, Andy, as a follow-up for you, as you think about taking the reins of Prudential at the end of March, how are you thinking about your direction as a leader of the business? Any color on where you're most focused strategically in your first few months as CEO?

Andrew F. Sullivan
Executive Vice President & Head-International Businesses and Global Investment Management, Prudential Financial, Inc.

A

Yeah. So, Wes, thank you for the question, and let me start by saying this is an absolute honor and it's a privilege, and I couldn't be more excited about what's ahead of us. As you would expect, we have a rigorous transition plan that we're marching through, and that transition is going very well. It obviously helps that I've been a member of this executive team now for over five years. But having said that, we always have a lot of work to get done in front of us. We absolutely intend to continue to raise the performance of the company over time, given the strong opportunities that we see in the marketplace. So, what I'd say is I'm not yet in the role, so it would be premature to share additional information right now, but I look forward to sharing more with you in the future calls as the team settles in.

Wes Carmichael
Analyst, Autonomous Research US LP

Q

Got it. Thanks. Congrats, Andy.

Operator: Thank you. [Operator Instructions] Our next question is coming from John Barnidge from Piper Sandler. Your line is now live.

John Barnidge
Analyst, Piper Sandler & Co.

Q

Good morning. Thank you for the opportunity. My question's on the free cash flow conversion and the 0% to 10% opportunistic M&A. I know PRU maintained its ownership in the second round of Prismic. Is that going to be the main consumer of that 0% to 10% of opportunistic M&A, or does there remain interest in high growth emerging markets internationally in asset management as previously expressed by the company in prior years?

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

A

So, John, it's Charlie. I will take your question. I say thank you. I'm excited to get a question, so that's great. Taking a step back for a moment, as always, organic growth is job number one, as you heard from some of the other management. But we're open to opportunistic and selective M&A that accelerates our strategy and meets our financial objectives as we go forward. In the past, we've executed on many acquisitions that have significantly grown the company. And we've pursued these acquisitions for a whole variety of reasons, such as expanding our capabilities, broadening our distribution, increasing scale, or adding key talent.

And as we look forward, we're going to focus on organic growth opportunities to expand our product breadth and distribution capabilities, scale our existing businesses, including through Prismic, as you suggest, which provides us access to third-party capital. And we will be both strategic and selective in our M&A interests, which remain consistent in terms of focusing on our programmatic acquisitions for PGIM or emerging markets, and focusing on distribution capabilities or scale.

John Barnidge
Analyst, Piper Sandler & Co.

Q

Thank you. That's helpful. And with the pipes kind of laid with that second transaction in Prismic, are you beginning to kind of warehouse liabilities and investors for subsequent rounds so the friction is less?

Robert Michael Falzon
Vice Chairman, Prudential Financial, Inc.

A

John, it's Rob. We don't have a specific plan for warehousing liabilities in the way that you described it. What we have is that we have brand quality and scale in our insurance and retirement businesses, both in the US and in Japan. And so, we both have significant back books, and we have a significant volume of sales, as evidenced by the growth that we've witnessed just in this last year and quarter with the sales across our businesses. And so, we don't have a bespoke warehouse, instead what we have is a business system which is generating significant amounts of liabilities, which lend themselves to opportunities for Prismic on a go-forward basis.

John Barnidge
Analyst, Piper Sandler & Co.

Q

Thanks.

Operator: Thank you. Next question is coming from Jack Matten from BMO. Your line is now live.

Jack Matten
Analyst, BMO Capital Markets Corp.

Q

Hi. Good morning. Just one follow-up on the free cash flow conversion. You mentioned the headwinds from new business strain and the impact of runoff. I guess, just to clarify, are those comments related to GAAP earnings or are you referring to the cash flow conversion ratio? Because the new business strain, although that makes sense to me, but I would have thought that the blocks running off would have had a higher cash flow conversion rate since you're not incurring any new business strain. So, just want to make sure I'm understanding those impacts correctly.

Yanela del Carmen Frias
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.

A

Yeah, Jack, it's Yanela. So, yes, I was referring to the GAAP earnings, AOI – core earnings specifically, in my answer to the runoff and the new business strain.

Jack Matten
Analyst, BMO Capital Markets Corp.

Q

Got it. Thank you. And then just a question on the intermediate term growth outlook within the international operations and your guidance for low- to mid-single-digit earnings growth, I guess, does that outlook assume that products surrender rates normalize off of the more recent and elevated levels? And any other drivers that you would call out as driving an uptick in kind of your growth trajectory in those markets?

Andrew F. Sullivan
Executive Vice President & Head-International Businesses and Global Investment Management, Prudential Financial, Inc.

A

Yeah, it's Andy. I'll take the question. So, as we look at the growth at a low- to mid-single-digit earnings rate, the growth is really driven by a few things: favorable net spread results that flow from higher yields and stronger alternative investment income, stronger underwriting results as our sales momentum is continuing, and obviously a continued expense discipline. Those positive forces are going to more than counteract the near-term pressure that we are expecting to continue from the US dollar product surrenders in Japan. Those – we did see in Q4 the lowest level of surrenders of any quarter in 2024. So, we think and believe over time that will stabilize. Net-net we expect solid growth, but we are having to overcome some of these headwinds.

Jack Matten
Analyst, BMO Capital Markets Corp. Q

Thank you.

Operator: Thank you. Next question is coming from Alex Scott from Barclays. Your line is now live.

Alex Scott
Analyst, Barclays Capital, Inc. Q

Hi. I wanted to drill into the PGIM drivers of earnings growth in the low-double digits that you provided. It looks like revenue is more mid-single digits. So, I just wanted to understand the margin improvement that you're expecting there. It looks to be pretty substantial, and I just wanted to understand like what are some of the things that are tangible that you're doing to improve the expense base?

Andrew F. Sullivan
Executive Vice President & Head-International Businesses and Global Investment Management, Prudential Financial, Inc. A

So, thanks, Alex. It's Andy. So, let me talk about our PGIM margins. And let me just start by saying we are pleased with the progress that we've made improving the margins every quarter through 2024, ending the year with a 25.6% margin, so really good progress. That being said, I think as we've talked about in previous quarters, overall our margins are still depressed as a result of the higher rate environment and the impact that has on both fixed income and from the slowdown in the real estate market. But the path for us is very clear. We expect to expand our margins towards 30%, really led by three main drivers.

First, an improving fixed income and real estate environment. That will drive fees and it will drive a normalization of flows and fundraising. Second, we expect continued traction in our growth investments, where we're seeing very real progress, particularly in our private credit work. And third, we do have a continued discipline on expenses. That's been a laser focus for us, and we are balancing finding efficiencies with reinvesting in growth. So, the bottom line is we do expect our margins are going to continue to expand from here, from both our intentional actions, but also from an improvement in the cycle.

Alex Scott
Analyst, Barclays Capital, Inc. Q

Got it. Okay. And then, similar question on the expense ratio improvement that was part of the intermediate guide for the insurance businesses, how do we think about calculating that and understanding the way that that will influence the bottom line results across the different segments?

Yanela del Carmen Frias
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc. A

Hey, Alex. This is Yanela. So, the expense ratio, what I would start with is, as of the full year 2024, we are already close to meeting the top end of that range. In terms of calculating it, we share in the materials how we calculate it. Now, we don't currently disclose the split between variable and operating G&A. We will start doing that to help you calculate the ratio. But I would also speak to the fact that there has been upward pressure on our G&A, but that has been really driven by variable distribution expenses resulting from our strong sales. And these variable expenses have corresponding revenues that we generally have a positive impact on the operating expense ratio. So, we do anticipate that over time, our continuous improvement approach and that the investments that we're making to grow and transform our businesses will continue to contribute efficiencies, which will be evident through the positive trends in the ratio over time. So, that's what we expect in the ratio.

I do want to go back to Jack's question on the runoff and the cash flow, though. So, yes, when I was speaking about the runoff, I was speaking about the impact on core earnings. But runoff also does impact cash flows because, obviously, the fees that we receive on those legacy variable annuities is also going away.

Alex Scott
Analyst, Barclays Capital, Inc.

Q

Okay. Thank you.

Operator: Thank you. Next question is coming from Mike Ward from UBS. Your line is now live.

Michael Augustus Ward
Analyst, UBS Securities LLC

Q

Hey. Thank you. Good morning. One question just on the life sales, pretty big jump in sales in the quarter. Wondering what product lines that was in, and if we're seeing that big growth, like if it's estate planning type sales, could that actually open up for a little bit more earnings volatility going forward? Thanks.

Caroline A. Feeney
Executive Vice President & Head-US Businesses, Prudential Financial, Inc.

A

Sure. Mike, it's Caroline, and I'll take your question. So, as you say, our Individual Life business finished the year strong. We had record sales of over $325 million in the fourth quarter, which is an increase of 60% over the prior year quarter. For the full year, Mike, our sales were up nearly 25% versus the prior year. And most importantly, you asked about products and where we're seeing that. We're actually achieving those sales increases across virtually every product in our well-diversified portfolio while continuing to generate attractive returns.

You also mentioned estate planning, and the significant sales increase we saw this past quarter did benefit from some increased estate planning activity. I don't think that that brings any additional volatility to us. What I would say is I think it's quite possible that we may continue to see some of our customers continue to focus here based on a couple of macro factors that are driving this activity.

Overall, Mike, we're very pleased in the growth and the quality of our life new business. The last point that I will note is that we are seeing a flight to quality across the industry, and we are well positioned to continue to benefit thanks to our established brand and our distribution strength.

Michael Augustus Ward
Analyst, UBS Securities LLC

Q

Great. Thank you. Thank you so much. That's helpful. Maybe just on the capital strain, Yanela, I know you clarified this, but I would have thought that there's at least some sort of capital relief – or release upon runoff business. I'm guessing it's sort of just the – or the fees are more significant in that component, but any clarity on that would be helpful. Thanks.

Yanela del Carmen Frias
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.

A

Yeah. When there's runoff, there's capital release, but we are also reinvesting capital into the growth of the business and the new sales. So when we talk about 30% to 40% of organic growth funding, that is – that includes the piece that we're freeing up and the cash flows we're generating.

Michael Augustus Ward
Analyst, UBS Securities LLC

Q

Okay. Thanks.

Operator: Thank you. Next question is coming from Wilma Burdis from Raymond James. Your line is now live.

Wilma Burdis
Analyst, Raymond James & Associates, Inc.

Q

Hey. Good morning. Could you talk about the morbidity margins in Japan and the potential opportunities to free up some of that capital? And along the same lines, can you talk about why Prismic reinsured a more recent block of business from Japan when the legacy products are more pressured by ESR? And just maybe talk about the goals there. Thanks.

Robert Michael Falzon
Vice Chairman, Prudential Financial, Inc.

A

Wilma, it's Rob. I'll jump in on the second part of that question first, and then someone might want to jump in on the first part. With respect to the block that we selected for Prismic and treatment under ESR, what I would note is that it was, again, a longer duration dollar-denominated product. So under ESR, that is in fact the type of product where we have significant margins, but those margins aren't necessarily reflected well from an economic standpoint under ESR. And so, it actually presented itself as a good test case block for us, given that our view is, across the industry, that type of product, meaning dollar-denominated, longer duration, is the area where people – where other players in the marketplace will be feeling some strain under ESR, and therefore a good opportunity for us to sort of get the pipes set up, demonstrate that we could do it, and learn from that process and create the credibility we need for third parties as well.

With respect to your first question on the mortality margins, maybe Andy wants to jump in on that part of the question.

Andrew F. Sullivan
Executive Vice President & Head-International Businesses and Global Investment Management, Prudential Financial, Inc.

A

Yeah. And Wilma, I'll be upfront, I didn't fully follow what you meant by your question, but what I would tell you is our morbidity experience in Japan has been within our expected ranges. And as I said earlier, what we've really been experiencing in the underwriting line is the enhanced headwinds and pressure from a surrender perspective. But that being said, we've done a lot of work to broaden out our product portfolios. We've been very successful at enhancing our yen offerings, and that's really shown the strength in sales over the last couple of years.

Wilma Burdis
Analyst, Raymond James & Associates, Inc.
Q

Okay. Thank you. And then just trying to put a little bit of a finer point on 2025, should we expect the EPS growth to be at the lower end of the 5% to 8% EPS range, or should the growth be even more weighted toward the back half of that 2027 range? Thanks.

Yanela del Carmen Frias
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.
A

Yeah. Wilma, it's Yanela. So, as I mentioned, it's not linear. And also we have the near-term headwinds, so if you take into account near-term headwinds, then I would say, yes, 2025 being closer to the near-term would have higher headwinds than the out-years.

Wilma Burdis
Analyst, Raymond James & Associates, Inc.
Q

Thank you.

Operator: Thank you. Next question is a follow-up from Wes Carmichael from Autonomous Research. Your line is now live.

Wes Carmichael
Analyst, Autonomous Research US LP
Q

Hey. Thanks so much for taking my follow-up. Andy, you just mentioned on surrender activity in Japan, and I just wanted to touch on that for a second. That's been impacted, I think, by the move in the yen. And in your assumptions, you're assuming a pretty meaningful strengthening of the yen/dollar to ¥135. So, I guess, can you talk about what we might see, or how to expect that to play out in guidance if you don't see a pretty significant strengthening in the yen?

Andrew F. Sullivan
Executive Vice President & Head-International Businesses and Global Investment Management, Prudential Financial, Inc.
A

Yeah. Sure, Wes. Let me take that in a couple parts. So, first, let me take the guidance around the assumption of the yen going to ¥135. So that – our yen assumption is really based on the forward curve. And as we sit here today and look at that, that sits in and around ¥135. So, the market believes the yen will appreciate based on both the economic growth of Japan and the interest rate increases in Japan.

But I would remind you, no matter which way these yen rates go, we've been intentionally diversifying the portfolio, as I just said. And our yen sales in Japan as a percent of the total are up 10% year-over-year to 35%. So, we do expect these surrender headwinds to lessen as we look forward and the yen to appreciate given the economic environment, but no matter which way those go, we have a broad set of offerings across yen and US dollar, and we know that demand for our products is going to stay strong.

Wes Carmichael
Analyst, Autonomous Research US LP
Q

Oh, thank you. That's really helpful. And I guess, my last follow-up, on Individual Life underwriting, it was a little bit worse in the quarter. But if I look back over the past couple of years, it's been a pretty meaningful headwind as you call it out in your slides. So, I realize there's some seasonality and you guys have done a couple of transactions, but can you give us any help on how you're expecting to kind of get that back to a headline profitability?

Caroline A. Feeney
Executive Vice President & Head-US Businesses, Prudential Financial, Inc.

A

Yes. So, Wes, I'll take your questions. It's Caroline. So for this past quarter, as Charlie mentioned in his opening comments, we had several large case claims from permanent policies, from our legacy Hartford block. And so, this resulted in the adverse mortality, that negative underwriting that you saw, which can happen episodically. What I would say, though, in terms of underwriting overall more broadly, we do continue to see encouraging signs that COVID-19 has transitioned to an endemic state with more predictable seasonal fluctuations in mortality, such as what we typically see during the flu season.

The other thing that I would add, Wes, is clearly you have seen us continue to successfully execute on our strategy to reduce market sensitivity and increase capital flexibility with actually de-risking and now reducing the size of our GUL in-force by roughly 60%. So, we are very pleased with the transactions we've completed. We will continue to be very proactive in terms of managing our in-force block of business. And so, that is a major priority for us, and so our de-risking transactions have gone a long way towards smoothing out expectations.

Operator: Thank you. We've reached the end of our question-and-answer session. I'd like to turn the floor back over to Mr. Lowrey for any further or closing comments.

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

Thank you. And thank you for joining us today. I'll close with a few final thoughts. It has been a privilege to lead Prudential as CEO for the past six years. I'm proud of what we've accomplished to become a higher growth and more capital-efficient company that is well-positioned for long-term sustainable growth. And I offer my profound thanks to our employees around the world who care for our customers, our clients, our communities, and for each other every day. I'm confident that this will continue under the next generation of leadership, and I look forward to supporting Andy and the leadership team in my role as Executive Chairman.

Thank you for joining our call today and for your time.

Operator: Thank you. That does conclude today's teleconference and webcast. You may disconnect your line at this time, and have a wonderful day. We thank you for your participation today.