# FIN197 SEMINAR IN FINANCE

**TO:** PRINCIPAL FINANCIAL GROUP - BOARD OF DIRECTORS AND SENIOR MANAGEMENT
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**SUBJECT:** BROOKS CASE COMPETITION
**DATE:** 3/26/23

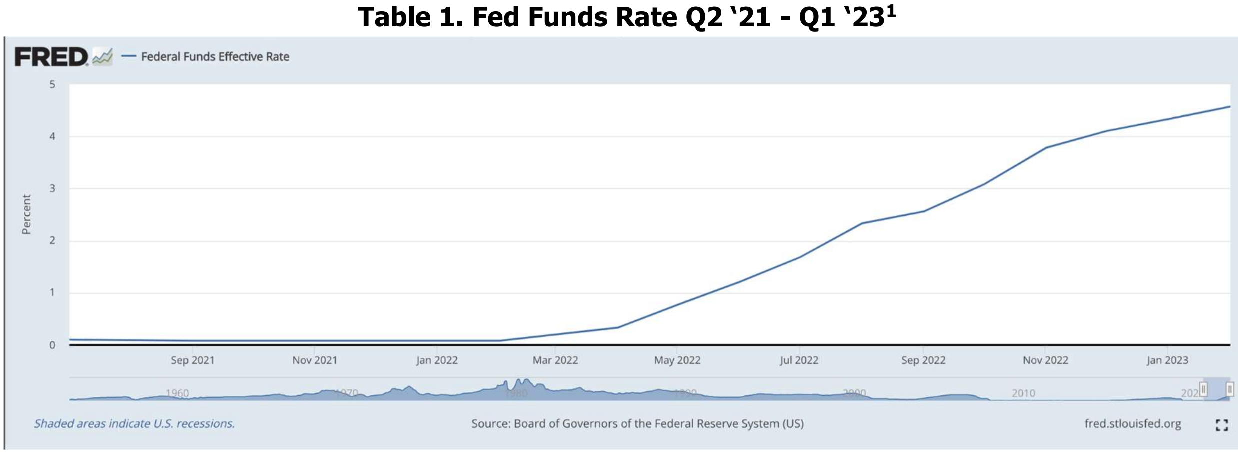
## EXECUTIVE SUMMARY

In this case the merger and acquisition of two separate entities by Principal Financial Group (PFG) was analyzed. The financial valuation of the target firms was conducted by assessing the valuations derived through a discounted cash flow and comparable company valuation and creating a range of acceptable pricing expectations. Through this analysis we are recommending that PFG submit an LOI for $386 million for Footprint Asset Management and pass on making an offer on Quant Impact Partners. Through negotiations PFG should not pay anymore that $449 million based on the current information. We also considered the ESG implications of this acquisition and found that they would also support the acquisition of Footprint Asset Management.

## I. M&A Strategy

PFG is a strategic buyer of these potential target firms having already established a foothold in the investment management space. This allows them to recognize synergies that private equity sponsors would not be able to recognize. As interest rates and the resulting cost of debt has increased over the last year it has made M&A activity more favorable for strategic buyers who aren't looking to perform a leveraged buyout. This was highlighted as groups such as Blackstone acquired Sphra in Q2 of 2021 for $1.4 billion but have not completed a comparable sized acquisition since, with the Fed Funds rate increasing from 0.1% in Q2 '21 to 4.75%-5% target Q1 '23.[1] Strategic groups however have still be able to acquire as they rates have increased.

**Table 1. Fed Funds Rate Q2 '21 - Q1 '23[1]**




To capitalize on this opportunity PFG could offer a deal that is not contingent on receiving financing, but does allow them to seek outside funding if they want. For the sellers this would be a good addition to have in their contract as it would prevent the acquirer from re-trading or even walking away from the deal if they can not organize the financing that they are looking for. When making an offer we wanted to ensure that it was greater than the previously outlined pricing expectations.

## II. Competitor Strategy

Based on the contents of this case, it has been made abundantly clear that there has been a heightened importance on ESG focused investing. As of December 2021, AUM in ESG funds was worth roughly $2.7 trillion, 81% of this being European. About 13% of this fund was from the United States which held $143 billion worth of capital inflows in Q4 '21.[2] This shows that the demand has been continuing to increase for this kind of product. ESG focused investing is becoming crucial in the economic approach of Principal Financial, as well as their vast pool of competition.

New market entrants have been slowly stepping into the industry, where some have chosen to acquire these specified companies rather than starting fresh. Through participating in mergers and acquisitions the acquiring company is able to focus on the parts of the business that are more profitable trying to start from the ground up. As a large firm, Principal's goals should be to maximize their potential for growing ESG investing by becoming an industry leader. Although acquiring these businesses will not put them at the top, it will extend their competitive advantage amongst other companies within the industry, and work to mitigate risk against the threat of new ESG market entrants.

## III. Financial Analysis

Comparable Company Valuation

When looking at comparable companies we were looking for small-cap financial companies that had a strong focus on ESG in their investment decisions. We also looked at the acquiring companies that were strategic buyers rather than sponsors of the deals. Two of these comparable transactions were done by insurance companies which would be comparable to Principal acquiring one of these target companies.

When building out the comparables it was difficult to find the prices that they sold for even though the acquirer was a public company with appropriate filings. The acquisition was noted in the footnotes but we could not find the official price. For the multiples we chose to focus on the enterprise value to EBITDA as these financial companies are mature enough not to focus on the enterprise value to sales approach. With this we chose to use the multiple of 9 times EBITDA to value the equity in the deal. With this assessment the equity in Quant would be worth $400.9M and Footprint would be worth $368 million. This is where we got the pricing for the LOI for Footprint, and this supported the assumption that Quant would not be an appropriate acquisition as their minimum pricing expectation is greater than this.

Discounted Cash Flow Valuation

When looking at the discounted cash flows of the firms we found that Footprint would be a better acquisition than Quant. When modeling the cash flows starting in 2023 we added the cost saving synergies along with the more hurtful synergies of revenues. We also modeled for a base case, revenue and expense growth of 2%. With this though we ended up building a sensitivity analysis to see how the NPV of the investment would change if the expense and income growth differed from the 2% that was previously considered for the base case.

When modeling Quant we did get a negative NPV so PFG should not accept this project.[3] Through the sensitivity analysis of Quant we also saw that the acquisition at current pricing expectations would be difficult as there would be many ways that the NPV would still be negative if there was not a large amount of income growth to ensure that the acquisition would be a positive NPV project.[4]

**Table 3. DCF of Quant[3]**

| Revenues | | | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 | 2032 | 2033 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Management & Advisory Fees | | 70.27 | 71.67 | 73.10 | 74.57 | 76.06 | 77.58 | 79.13 | 80.71 | 82.33 | 83.97 | 85.65 |
| | Incentive Fees | | 27.82 | 28.38 | 28.95 | 29.53 | 30.12 | 30.72 | 31.33 | 31.96 | 32.60 | 33.25 | 33.92 |
| | Investment Income (Loss) | | | | | | | | | | | | |
| | Principal Investments | | (1.82) | (1.82) | (1.82) | (1.82) | (1.82) | (1.82) | (1.82) | (1.82) | (1.82) | (1.82) | (1.82) |
| | Total Investment Income | | (1.82) | (1.82) | (1.82) | (1.82) | (1.82) | (1.82) | (1.82) | (1.82) | (1.82) | (1.82) | (1.82) |
| | Interest & Dividend Revenue | | 2.22 | 2.22 | 2.22 | 2.22 | 2.22 | 2.22 | 2.22 | 2.22 | 2.22 | 2.22 | 2.22 |
| | Other | | 1.48 | 1.48 | 1.48 | 1.48 | 1.48 | 1.48 | 1.48 | 1.48 | 1.48 | 1.48 | 1.48 |
| | **Total Revenues** | | **98.14** | **100.10** | **102.10** | **104.15** | **106.23** | **108.35** | **110.52** | **112.73** | **114.98** | **117.28** | **119.62** |
| Expenses | | | | | | | | | | | | | |
| | Compensation & Benefits | | | | | | | | | | | | |
| | Compensation | | 21.98 | 22.42 | 22.87 | 23.33 | 23.79 | 24.27 | 24.76 | 25.25 | 25.76 | 26.27 | 26.80 |
| | Incentive Fee Compensation | | 16.25 | 16.58 | 16.91 | 17.25 | 17.59 | 17.95 | 18.31 | 18.67 | 19.05 | 19.43 | 19.81 |
| | **Total Compensation & Benefits** | | **38.24** | **39.00** | **39.78** | **40.58** | **41.39** | **42.22** | **43.06** | **43.92** | **44.80** | **45.70** | **46.61** |
| | General, Administrative, & Other | | 7.94 | 8.10 | 8.27 | 8.43 | 8.60 | 8.77 | 8.95 | 9.13 | 9.31 | 9.49 | 9.68 |
| | Interest Expense | | 4.71 | 4.80 | 4.90 | 5.00 | 5.10 | 5.20 | 5.30 | 5.41 | 5.52 | 5.63 | 5.74 |
| | Fund Expense & Distribution Fees | | 4.90 | 4.99 | 5.09 | 5.20 | 5.30 | 5.41 | 5.51 | 5.62 | 5.74 | 5.85 | 5.97 |
| | Miscellaneous Expenses | | (14.60) | -14.89 | -15.19 | -15.49 | -15.80 | -16.12 | -16.44 | -16.77 | -17.10 | -17.44 | -17.79 |
| | **Total Expenses** | | **41.19** | **42.01** | **42.85** | **43.71** | **44.59** | **45.48** | **46.39** | **47.31** | **48.26** | **49.23** | **50.21** |
| | Income Before Taxes | | 58.53 | 58.09 | 59.25 | 60.43 | 61.64 | 62.87 | 64.13 | 65.41 | 66.72 | 68.05 | 69.41 |
| | Taxes | | 8.02 | 7.96 | 8.12 | 8.28 | 8.44 | 8.61 | 8.79 | 8.96 | 9.14 | 9.32 | 9.51 |
| | Net Income | | 50.51 | 50.13 | 51.13 | 52.15 | 53.20 | 54.26 | 55.34 | 56.45 | 57.58 | 58.73 | 59.90 |
| | | | $ 50,511,148 | $ 50,130,782 | $ 51,132,497 | $ 52,154,246 | $ 53,196,430 | $ 54,259,458 | $ 55,343,746 | $ 56,449,720 | $ 57,577,813 | $ 58,728,469 | $ 59,902,137 |
| | NPV | -$50,970,051.23 | | | | | | | | | | | |
| | IRR | 6.41% | | | | | | | | | | | |

**Table 4. Quant Sensitivity[4]**

| Income Growth | Expense Growth (Decrease) | | | | | |
|---|---|---|---|---|---|---|
| | -5% | -2.5% | 0% | 2.5% | 5% | 7.5% |
| -5% | $ (141,016,324) | $ (161,511,997) | $ (184,982,162) | $ (211,881,085) | $ (242,728,574) | $ (278,118,374) |
| -2.5% | $ (92,208,769) | $ (112,704,443) | $ (136,174,608) | $ (163,073,531) | $ (193,921,020) | $ (229,310,820) |
| 0% | $ (36,317,886) | $ (56,813,560) | $ (80,283,724) | $ (107,182,648) | $ (138,030,137) | $ (173,419,937) |
| 2.5% | $ 27,738,104 | $ 7,242,430 | $ (16,227,734) | $ (43,126,658) | $ (73,974,147) | $ (109,363,947) |
| 5% | $ 101,197,045 | $ 80,701,371 | $ 57,231,206 | $ 30,332,283 | $ (515,206) | $ (35,905,006) |
| 7.5% | $ 185,472,857 | $ 164,977,183 | $ 141,507,019 | $ 114,608,095 | $ 83,760,606 | $ 48,370,807 |

When modeling Footprint we did get a positive NPV so PFG would want to accept the project at the current pricing.[5] PFG could continue to bid until they had a perfectly $0 NPV which would come at $448 million which would be the highest amount they could pay given the current information. The sensitivity analysis was also supportive as there was more than half the scenarios when the NPV of the project would be positive at the current pricing expectations that were provided in the case.

## Table 5. DCF of Footprint[5]

| | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Revenues | | | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 | 2032 | 2033 |
| | Management & Advisory Fees | | 111.451625 | 113.68 | 115.95 | 118.27 | 120.64 | 123.05 | 125.51 | 128.02 | 130.58 | 133.20 | 135.86 |
| | Incentive Fees | | 6.6870975 | 6.82 | 6.96 | 7.10 | 7.24 | 7.38 | 7.53 | 7.68 | 7.84 | 7.99 | 8.15 |
| | Investment Income (Loss) | | | | | | | | | | | | |
| | Principal Investments | | 3.16 | 3.16 | 3.16 | 3.16 | 3.16 | 3.16 | 3.16 | 3.16 | 3.16 | 3.16 | 3.16 |
| | Total Investment Income | | 3.16 | 3.16 | 3.16 | 3.16 | 3.16 | 3.16 | 3.16 | 3.16 | 3.16 | 3.16 | 3.16 |
| | Interest & Dividend Revenue | | 3.52 | 3.52 | 3.52 | 3.52 | 3.52 | 3.52 | 3.52 | 3.52 | 3.52 | 3.52 | 3.52 |
| | Other | | 2.35 | 2.35 | 2.35 | 2.35 | 2.35 | 2.35 | 2.35 | 2.35 | 2.35 | 2.35 | 2.35 |
| | **Total Revenues** | | **130.32** | **132.68** | **135.09** | **137.55** | **140.06** | **142.61** | **145.22** | **147.88** | **150.60** | **153.37** | **156.19** |
| Expenses | | | | | | | | | | | | | |
| | Compensation & Benefits | | | | | | | | | | | | |
| | Compensation | | 30.73 | 31.34 | 31.97 | 32.61 | 33.26 | 33.92 | 34.60 | 35.29 | 36.00 | 36.72 | 37.45 |
| | Incentive Fee Compensation | | 3.91 | 3.98 | 4.06 | 4.15 | 4.23 | 4.31 | 4.40 | 4.49 | 4.58 | 4.67 | 4.76 |
| | **Total Compensation & Benefits** | | **34.63** | **35.32** | **36.03** | **36.75** | **37.49** | **38.24** | **39.00** | **39.78** | **40.58** | **41.39** | **42.22** |
| | General, Administrative, & Other | | 11.10 | 11.33 | 11.55 | 11.78 | 12.02 | 12.26 | 12.51 | 12.76 | 13.01 | 13.27 | 13.54 |
| | Interest Expense | | 8.25 | 8.42 | 8.58 | 8.76 | 8.93 | 9.11 | 9.29 | 9.48 | 9.67 | 9.86 | 10.06 |
| | Fund Expense & Distribution Fees | | 6.58 | 6.71 | 6.84 | 6.98 | 7.12 | 7.26 | 7.41 | 7.56 | 7.71 | 7.86 | 8.02 |
| | Miscellaneous Expenses | | (1.47) | -1.50 | -1.53 | -1.56 | -1.59 | -1.62 | -1.65 | -1.68 | -1.72 | -1.75 | -1.79 |
| | **Total Expenses** | | **59.10** | **60.28** | **61.49** | **62.72** | **63.97** | **65.25** | **66.56** | **67.89** | **69.24** | **70.63** | **72.04** |
| | Income Before Taxes | | 71.22 | 72.40 | 73.60 | 74.83 | 76.09 | 77.36 | 78.67 | 80.00 | 81.35 | 82.74 | 84.15 |
| | Taxes | | 9.76 | 9.92 | 10.08 | 10.25 | 10.42 | 10.60 | 10.78 | 10.96 | 11.15 | 11.34 | 11.53 |
| | Net Income | | 61.46 | 62.48 | 63.52 | 64.58 | 65.66 | 66.77 | 67.89 | 69.04 | 70.21 | 71.40 | 72.62 |
| | | | $ 61,462,410 | $ 62,481,434 | $ 63,520,838 | $ 64,581,030 | $ 65,662,426 | $ 66,765,450 | $ 67,890,534 | $ 69,038,120 | $ 70,208,658 | $ 71,402,607 | $ 72,620,434 |
| | NPV | $111,680,011 | | | | | | | | | | | |
| | IRR | 15.37% | | | | | | | | | | | |

## Table 6. Footprint Sensitivity

| Income Growth | Expense Growth (Decrease) | | | | | |
|---|---|---|---|---|---|---|
| | -5% | -2.5% | 0% | 2.5% | 5% | 7.5% |
| -5% | $ 18,245,761 | $ (11,160,963) | $ (44,835,417) | $ (83,429,378) | $ (127,688,649) | $ (178,465,124) |
| -2.5% | $ 77,029,595 | $ 47,622,871 | $ 13,948,417 | $ (24,645,543) | $ (68,904,814) | $ (119,681,289) |
| 0% | $ 144,344,594 | $ 114,937,870 | $ 81,263,415 | $ 42,669,455 | $ (1,589,816) | $ (52,366,291) |
| 2.5% | $ 221,493,649 | $ 192,086,925 | $ 158,412,470 | $ 119,818,510 | $ 75,559,239 | $ 24,782,764 |
| 5% | $ 309,967,621 | $ 280,560,897 | $ 246,886,443 | $ 208,292,483 | $ 164,033,211 | $ 113,256,737 |
| 7.5% | $ 411,469,437 | $ 382,062,714 | $ 348,388,259 | $ 309,794,299 | $ 265,535,028 | $ 214,758,553 |

## IV. SWOT Analysis

| **Strengths** | **Weaknesses** |
|---|---|
| - Principle is a strategic buyer rather than sponsor<br>- ESG investing is increasing in our economy<br>- Demand for ESG products is growing | - Company culture<br>- Shift from private to public |
| **Opportunities** | **Threats** |
| - Grow Environmental impacts and Governance<br>- Grow in lower priority materiality<br>- Internal growth in ESG at PFG | - Risk of losing bidding deal to competitors<br>- Risk of new market entrants / further competition |

## IV. Conclusion

PFG should pursue an acquisition of Footprint Asset Management. We would recommend offering $386 million to try to get the deal under contract. The maximum price that PFG could pay for Footprint and it to be a profitable endeavor based on DCF is $449 million. By completing this transaction PFG is able to grow their ESG presence within Governance and Environmental. This acquisition is an important shift for PFG and has a positive outlook for future growth. Quant Impact Partners may have brought some good change to the ESG of PFG, however the financials and the culture wouldn't have the same positive impact that Footprint is projected to cause.