2023 Brooks Case Competition

TO: Principal Financial Group & Co.
FROM: Team 6 - Jordan Abrams, Francisco Dominguez, Cesar Martinez, and Sophia Preys
SUBJECT: ESG Principal Acquisition
DATE: 3/26/23

EXECUTIVE SUMMARY

Principal Financial has a strategic opportunity to enhance and improve their ESG standing by acquiring small ESG companies who also aim to align with Principal. One option is Quant Impact Partners (Quant) who strive for a Fossil Fuel Free" investment policy with their high-level investors and new contributors. The other option is Footprint Asset Management (Footprint) who believes in the adoption of green fuels and modern technology with their institutional investors, retail investors, small-medium businesses, and high-level investors. Between the two companies, the best investment for Principal is Quant due to the following factors:

- Principal's composite ESG improves by 0.5 due to the merger taking into account ESG weights.
- Quant's current and forecasted positive cash flows and income
- Strategically aligned with Principal's Taskforce

Quant Impact's minimum bid is $416M USD, we believe the recommended price for this acquisition will be $534M USD (taking into account synergies like compensation, administrative, current market risk with inflation and forecasted return and performance of Quant's investment). Principal does have several valuation options to use for this acquisition: cash on hand, debt financing or equity financing. Due to Principal's current liquidity position, it is best to acquire Quant using current cash and liquid assets.

I. ESG Strategy

Principal Financial Group's ESG Vision is to "help people today by advocating for security and inclusion, creating opportunity for future generations" and they accomplish this through their approach of growing "a sustainable and secure society through long-term, responsible actions." Utilizing an ESG strategy in investment management can be very beneficial for companies. It can reduce long-term risk because sustainable investments result in better performance and are more reliable. ESG investing is also more ethical and allows for investments in funds that align closely with investors' personal beliefs and values. Using an ESG strategy and approach can also impact a company by boosting morale among employees because they are all working together to ensure investments meet the ESG criteria.

There are also a few risks in ESG investing. Companies using an ESG strategy may have less standardization in comparison with other companies. This makes it hard to compare them to other companies since ESG is still a relatively new strategy and not a lot of companies have implemented it yet. Additionally, because it is not very popular, companies utilizing an ESG approach could have less investment opportunities than other companies because of investments that don't align with their ESG criteria. However, this isn't necessarily a bad thing because companies should be choosing investments that meet this criteria and would be most beneficial for their company.

Based on ESG metrics illustrated in Figure 1, we believe Quant Impact Partners is more compatible to Principal Financial Group's ESG strategy. Principal has a very low ESG score for Environmental. Their Social and Governance scores are above average, however their Shareholder Rights and Audit scores within the Governance category are lagging. Footprint Asset Management has a leading score for

Environmental and Social but a lagging score for Governance. Quant has an above average score for Environmental, Social, and Governance. While Footprint Asset Management has the highest weighted composite score between the three companies and Quant has the lowest composite score, we believe Quant would be more adaptable and beneficial to Principal's strategy. Quant has an above average and leading score for the areas where Principal is lagging: Social, Shareholder Rights, and Audit. While Footprint has a leading score for Social and an above average score for Shareholder Rights and could help boost Principal's score in those areas, they also have a lagging score for Audit. It would be more beneficial for Quant to boost Principal's Audit score through the acquisition.

Figure 1. Current ESG Scores

	PFG	Quant	Footprint
Environmental	0.20	0.78	3.56
Social	2.24	2.53	4.41
Governance	7.20	6.29	5.05
Shareholder Rights	4.29	6.30	6.07
Audit	8.32	8.71	4.78
Composite Score	3.18	3.17	4.30

II. Cultural

Principal Financial Group's purpose is to "foster a world where financial security is accessible to all" and their mission is to "help more people save enough, protect enough, and have enough." Based on these statements, both Quant Impact Partners and Footprint Asset Management seem to align well with Principal's culture. Quant uses ESG mutual funds to leverage their quantitative investment strategy. They use ESG data points to help make investment decisions. They also have a Fossil Fuel Free investment policy where investments in coal, oil, and gas industries are restricted. Their goal is to minimize the exploration, production, distribution, and power generation in those industries. Quant also wants to expand and diversify their customer base. This aligns with Principal's purpose and mission as it will help protect people. Quant has potential risk because of their high turnover rate of key employees. This is due to the recent departure of two equity fund portfolio managers and one debt fund portfolio manager. While this appears to increase their risk, this wouldn't be too influential in an acquisition as Principal would take on these responsibilities.

Footprint Asset Management has five mutual funds with an ESG research process. They want to partner with a larger asset manager to help meet scale efficiencies. They have an ESG analysis process that is utilized in their valuation process. This involves internal scoring for investments based on Footprint's ESG criteria. Footprint's risk comes with their large net outflows in 2022 and their fee rate schedule. This resulted in them having no new meaningful customers, however Principal could help them diversify their customer base.

III. Financial Analysis

From a risk perspective, we can expect Quant to have the cheaper stock price and a more risky stock option compared to Footprint. Footprint's stock price is calculated to be $12.39 per share price compared to the cheaper $9.31 for Quant.

Figure 3. Quant Stock Price 2021-2023

	2021	**2022**	**2023**	**Total Value**	
FCF	52.49	23.36	50.51		
DCF	48.16	19.93	39.81		
Total Value				823.28	
Present Value					931.53
Value (100 shares)					$9.31/share

IV. Recommendation

It is our recommendation that Principal Financial acquires Quant Impact. Although Quant Impact's minimum bid is $416M USD, we do not expect the small organization to easily accept a minimum bid offer. Due to the external and internal factors with this acquisition, the following synergies will be assumed:

- 10% Compensation Synergy
- 30% General and Administrative Synergy
- 75% capture of expected synergy benefits
- 5% Shock Lapse to Management and Advisory Fees upon announcement of deal (Negative Synergy)

In addition to synergies, inflation is still expected to rise quarter-after-quarter as T-bill rates have risen up to 4 percent and are expected to reach up to 4.5 percent by the end of Q1 2023. In regards to Quant's forecasted assets and revenues with their customer base (International, Large, Mid, Small, Balanced, Bond and Income funds), they expect a net performance loss of 17 percent within the next year.

When taking the following into consideration, our recommended price for this acquisition will be $534M USD.

Using cash on hand avoids diluting the ownership and control for Principal which can come with equity financing. Principal's current ratio and liquidity ratio equate to 0.29 as current assets of $290M offset current liabilities of $280M. Principal's cash on hand equates to 4,848 Million or 4.8B as of 2022. Subsequent funds can be used via cash to accomplish this purchase or if need be, with offloading some liquid assets. This can avoid the costs and risks associated with debt financing or dilution of equity ownership.

Appendix

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Figure 2. ESG Scores: Post-Merger

Upper target Leading Above median Below median Lagging	New PFG	Former PFG
Environmental	0.78	0.20
Social	2.29	2.24
Governance	7.33	7.20
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