



ANALYST QUICK NOTES

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Prudential Financial Inc. (NYSE: PRU: BUY)

Target Price: \$125

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Overview

- After attending Prudential's Investor Day, we are confident in the company's strong ROE and positive regulatory outlook.

News Highlights

- On June 6, we attended Prudential's Investor Day presentation in New York.
- Highlights included confidence in continued strong ROE performance, capital deployment, and readiness for a changing regulatory environment.
 - In particular, we liked CFO Rob Falzon's confidence in its 12%-13% ROE target. He said the use of levers outside of organic growth to boost returns above 13% would be unhealthy. Meanwhile, 1Q ROE was 14%.
- We liked the focus on active management fees (versus the popular passive investment, but lower-margin trend), operational growth, and commitment to exiting non-bank SIFI oversight.
- On May 3, Prudential's 1Q adjusted EPS rose to \$2.79 from \$2.18 a year earlier and beat the consensus estimate of \$2.64. Operating earnings rose 24% to \$1.2 billion. Earnings were helped by higher asset management fees, growth across the company's businesses, and solid international performance.

Thesis

- The PRU stock has performed well since the election on expectations that the Trump administration will lower corporate taxes and reduce financial regulations, which may help to eliminate Prudential's SIFI designation. In addition, prospects for economic stimulus have pushed Treasury yields higher and should lead to increased returns on PRU's \$840 billion bond portfolio. Over the long term, we like the company's growth prospects, especially in international markets.

- Biggest catalyst: SIFI removal. If capital reserves are removed, PRU can free up that money and either invest in the business or return capital to shareholders, which would lift the share price. The company believes it will ultimately exit SIFI oversight via:
 - Changes to Dodd-Frank. On June 8, Congress passed the Financial CHOICE Act that would repeal Dodd Frank, while the Senate is creating its own bill.
 - The designation could be rescinded by the FSOC upon annual review.
 - Alternatively, Prudential could take legal action and is looking to the MetLife legal challenge for precedent.
- Second catalyst: Margin growth as the company slowly earns more on its investment holdings as interest rates rise and pricing improve.
- Third catalyst: International growth. The segment has sustained underlying earnings growth despite flat results from adverse impacts of negative currency translation. Those negative currency effects have increased international demand for U.S. based investment products. International Insurance COO Charles Lowrey COO said that Prudential was already in the international markets it wants to be in and that it would expand via acquisitions in the countries where it already has a presence.

Now what?

- We look to legislation out of D.C., such as tax reduction and lower regulation, to move the stock. Regulations are already headed in a positive direction, while the Healthcare vote could signal confidence in tax reforms getting passed.
 - MetLife's court outcome in its appeal over its SIFI designation will affect Prudential. A decision should come over the next year.
 - Despite a 20%+ rise in the PRU stock price since the November election, we still see room to run, as we are confident in the company's ROE abilities and the recently more favorable regulatory landscape.

Earnings and Growth

- Our EPS estimates are for \$10.64 in 2017, which we recently raised from \$10.63, due to a better-than-expected first quarter, expected benefits from higher bond yields and management's positive guidance. We lowered our 2018 estimate, however, to \$11.10 from \$11.12, as we see pricing and low investment returns remaining a concern.

Valuation

- Shares trade at a discount P/E to peers. We like the company's superior ROE profile and believe that a higher multiple is appropriate.
 - P/E: 10.2x our 2017 estimate vs. 11.1x for peers.
 - Price/book: 1.0 vs. 1.2 for peers.
 - Yield: 2.8% vs. 2.0 for peers.
 - Target price of \$125 implies a multiple of 11.8-times our 2017 EPS estimate, which we feel more accurately reflects PRU's operating performance.
 - Risks: Negative regulatory developments, a strain on deployable capital, strong USD.
 - We see a 16% upside + 2.8% yield = 19% total return.
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