PRINCIPAL FINANCIAL GROUP INC

FORM 10-Q
(Quarterly Report)

Filed 8/6/2003 For Period Ending 6/30/2003

Address	711 HIGH STREET
	DES MOINES, Iowa 50392
Telephone	515-247-5111
CIK	0001126328
Industry	Insurance (Life)
Sector	Financial
Fiscal Year	12/31

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

|X| QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2003

OR

|_| TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 1-16725

PRINCIPAL FINANCIAL GROUP, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

Delaware	42-1520346
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

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711 High Street, Des Moines, Iowa 50392
(Address of principal executive offices)

(515) 247-5111
(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes |X| No |_|

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes |X| No |_|

The total number of shares of the registrant's Common Stock, $0.01 par value, outstanding as of July 31, 2003 was 323,673,772.

PRINCIPAL FINANCIAL GROUP, INC.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PRINCIPAL FINANCIAL GROUP, INC.
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	JUNE 30, 2003	DECEMBER 31, 2002
	(Unaudited)	(Note 1)
	(IN MILLIONS, EXCEPT PER SHARE DATA)	
ASSETS		
Fixed maturities, available-for-sale	$37,400.2	$34,185.7
Fixed maturities, trading	104.3	101.7
Equity securities, available-for-sale	410.5	378.7
Mortgage loans	11,730.5	11,081.9
Real estate	1,412.2	1,229.0
Policy loans	808.1	818.5
Other investments	1,278.1	1,200.1
Total investments	53,143.9	48,995.6
Cash and cash equivalents	1,525.2	1,038.6
Accrued investment income	644.5	646.3
Premiums due and other receivables	438.8	459.7
Deferred policy acquisition costs	1,340.5	1,414.4
Property and equipment	459.0	482.5
Goodwill	157.5	106.5
Other intangibles	118.5	88.8
Mortgage loan servicing rights	1,434.2	1,518.6
Separate account assets	37,495.8	33,501.4
Other assets	1,863.8	1,608.9
Total assets	$98,621.7	$89,861.3
LIABILITIES		
Contractholder funds	$28,179.4	$26,315.0
Future policy benefits and claims	15,009.1	14,736.4
Other policyholder funds	755.0	642.9
Short-term debt	665.4	564.8
Long-term debt	1,360.2	1,332.5
Income taxes payable	178.2	-
Deferred income taxes	1,644.0	1,177.7
Separate account liabilities	37,495.8	33,501.4
Other liabilities	5,795.6	4,933.4
Total liabilities	91,082.7	83,204.1
STOCKHOLDERS' EQUITY		
Common stock, par value $.01 per share - 2,500.0 million shares authorized, 377.2 million and 376.7 million shares issued, and 325.1 million and 334.4 million shares outstanding in 2003 and 2002, respectively	3.8	3.8
Additional paid-in capital	7,133.4	7,106.3
Retained earnings	387.3	29.4
Accumulated other comprehensive income	1,420.6	635.8
Treasury stock, at cost (52.1 million and 42.3 million shares in 2003 and 2002, respectively)	(1,406.1)	(1,118.1)
Total stockholders' equity	7,539.0	6,657.2
Total liabilities and stockholders' equity	$98,621.7	$89,861.3

SEE ACCOMPANYING NOTES.

PRINCIPAL FINANCIAL GROUP, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	FOR THE THREE MONTHS ENDED JUNE 30,		FOR THE SIX MONTHS ENDED JUNE 30,	
	2003	2002	2003	2002
	(IN MILLIONS, EXCEPT PER SHARE DATA)			
REVENUES				
Premiums and other considerations	$ 876.6	$1,166.6	$1,782.1	$2,052.3
Fees and other revenues	689.0	437.2	1,321.0	870.1
Net investment income	857.7	823.2	1,693.7	1,634.3
Net realized/unrealized capital gains (losses)	(10.9)	(91.5)	(87.6)	6.6
Total revenues	2,412.4	2,335.5	4,709.2	4,563.3
EXPENSES				
Benefits, claims and settlement expenses	1,187.8	1,507.9	2,383.0	2,711.1
Dividends to policyholders	73.9	79.5	154.0	161.9
Operating expenses	865.6	599.8	1,664.9	1,192.0
Total expenses	2,127.3	2,187.2	4,201.9	4,065.0
Income from continuing operations before income taxes	285.1	148.3	507.3	498.3
Income taxes	82.5	31.9	148.3	138.2
Income from continuing operations, net of related income taxes	202.6	116.4	359.0	360.1
Income (loss) from discontinued operations, net of related income taxes	(0.4)	3.8	(1.1)	6.1
Income before cumulative effect of accounting change	202.2	120.2	357.9	366.2
Cumulative effect of accounting change, net of related income taxes	-	-	-	(280.9)
Net income	$ 202.2	$ 120.2	$ 357.9	$ 85.3

	FOR THE THREE MONTHS ENDED JUNE 30,		FOR THE SIX MONTHS ENDED JUNE 30,	
	2003	2002	2003	2002
EARNINGS PER COMMON SHARE				
Basic and diluted earnings per common share:				
Income from continuing operations, net of related income taxes	$0.62	$0.33	$1.09	$ 1.00
Income (loss) from discontinued operations, net of related income taxes	-	0.01	-	0.02
Income before cumulative effect of accounting change	0.62	0.34	1.09	1.02
Cumulative effect of accounting change, net of related income taxes	-	-	-	(0.78)
Net income	$0.62	$0.34	$1.09	$ 0.24

SEE ACCOMPANYING NOTES.

PRINCIPAL FINANCIAL GROUP, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(UNAUDITED)

	COMMON STOCK	ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS (DEFICIT)	ACCUMULATED OTHER COMPREHENSIVE INCOME	TREASURY STOCK	TOTAL STOCKHOLDERS' EQUITY	OUTSTANDING SHARES
			(IN MILLIONS)				(IN THOUSANDS)
BALANCES AT JANUARY 1, 2002......	$3.8	$7,072.5	$ (29.1)	$ 147.5	$ (374.4)	$6,820.3	360,142.2
Shares issued, net of put options........................	-	14.8	-	-	-	14.8	569.4
Treasury stock acquired and sold, net......................	-	1.3	-	-	(267.1)	(265.8)	(9,305.9)
Comprehensive income:							
Net income.....................	-	-	85.3	-	-	85.3	
Net unrealized gains...........	-	-	-	12.8	-	12.8	
Provision for deferred income taxes.................	-	-	-	(3.1)	-	(3.1)	
Foreign currency translation adjustment.......	-	-	-	5.8	-	5.8	
Comprehensive income............						100.8	
BALANCES AT JUNE 30, 2002........	$3.8	$7,088.6	$ 56.2	$ 163.0	$ (641.5)	$6,670.1	351,405.7
BALANCES AT JANUARY 1, 2003......	$3.8	$7,106.3	$ 29.4	$ 635.8	$(1,118.1)	$6,657.2	334,419.3
Shares issued, net of call options........................	-	11.7	-	-	-	11.7	441.7
Stock-based compensation.........	-	12.2	-	-	-	12.2	
Treasury stock acquired and sold, net......................	-	3.2	-	-	(288.0)	(284.8)	(9,779.2)
Comprehensive income:							
Net income.....................	-	-	357.9	-	-	357.9	
Net unrealized gains...........	-	-	-	1,147.0	-	1,147.0	
Provision for deferred income taxes.................	-	-	-	(398.4)	-	(398.4)	
Foreign currency translation adjustment.......	-	-	-	36.2	-	36.2	
Comprehensive income............						1,142.7	
BALANCES AT JUNE 30, 2003........	$3.8	$7,133.4	$ 387.3	$1,420.6	$(1,406.1)	$7,539.0	325,081.8

SEE ACCOMPANYING NOTES.

PRINCIPAL FINANCIAL GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	FOR THE SIX MONTHS ENDED JUNE 30,	
	2003	2002
	(IN MILLIONS)	
OPERATING ACTIVITIES		
Net income	$ 357.9	$ 85.3
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss (income) from discontinued operations, net of related income taxes	1.1	(6.1)
Cumulative effect of accounting change, net of related income taxes	-	280.9
Amortization of deferred policy acquisition costs	101.8	67.0
Additions to deferred policy acquisition costs	(166.5)	(160.0)
Accrued investment income	1.8	(12.4)
Premiums due and other receivables	23.7	65.2
Contractholder and policyholder liabilities and dividends	1,064.0	1,029.9
Current and deferred income taxes	264.4	339.2
Net realized/unrealized capital (gains) losses	87.6	(6.6)
Depreciation and amortization expense	52.0	50.0
Amortization of mortgage servicing rights	221.1	140.9
Stock-based compensation	10.5	-
Mortgage servicing rights valuation adjustments	562.9	163.5
Other	242.1	(99.1)
Net adjustments	2,466.5	1,852.4
Net cash provided by operating activities	2,824.4	1,937.7
INVESTING ACTIVITIES		
Available-for-sale securities:		
Purchases	(5,371.0)	(7,347.0)
Sales	1,798.5	3,712.2
Maturities	1,921.6	2,107.4
Net cash flows from trading securities	-	(41.2)
Mortgage loans acquired or originated	(34,743.3)	(20,757.9)
Mortgage loans sold or repaid	34,185.0	20,985.0
Purchase of mortgage servicing rights	(643.6)	(466.5)
Proceeds from sale of mortgage servicing rights	34.4	3.9
Real estate acquired	(161.7)	(126.5)
Real estate sold	45.6	157.7
Net change in property and equipment	(8.4)	(32.4)
Net proceeds from sales of subsidiaries	2.1	1.4
Purchases of interest in subsidiaries, net of cash acquired	(88.1)	(49.0)
Net change in other investments	(92.5)	490.8
Net cash used in investing activities	$ (3,121.4)	$ (1,362.1)

PRINCIPAL FINANCIAL GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
(UNAUDITED)

	FOR THE SIX MONTHS ENDED JUNE 30,	
	2003	2002
	(IN MILLIONS)	
FINANCING ACTIVITIES		
Issuance of common stock, net of call and put options	$ 11.7	$ 14.8
Acquisition and sales of treasury stock, net	(300.0)	(265.8)
Issuance of long-term debt	1.9	10.7
Principal repayments of long-term debt	(8.4)	(46.9)
Net proceeds of short-term borrowings	107.8	(111.4)
Investment contract deposits	5,052.1	4,088.7
Investment contract withdrawals	(4,081.5)	(3,660.8)
Net cash provided by financing activities	783.6	29.3
Net increase in cash and cash equivalents	486.6	604.9
Cash and cash equivalents at beginning of period	1,038.6	561.2
Cash and cash equivalents at end of period	$ 1,525.2	$ 1,166.1

SEE ACCOMPANYING NOTES.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2003
(UNAUDITED)

1. NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of Principal Financial Group, Inc. and its majority-owned subsidiaries have been prepared in conformity with accounting principles generally accepted in the U.S. ("U.S. GAAP") for interim financial statements and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months and six months ended June 30, 2003, are not necessarily indicative of the results that may be expected for the year ended December 31, 2003. These interim unaudited consolidated financial statements should be read in conjunction with our annual audited financial statements as of December 31, 2002, included in our Form 10-K for the year ended December 31, 2002, filed with the United States Securities and Exchange Commission ("SEC"). The accompanying consolidated statement of financial position at December 31, 2002, has been derived from the audited consolidated statement of financial position but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

Reclassifications have been made to the June 30, 2002, financial statements to conform to the June 30, 2003, presentation.

SEPARATE ACCOUNTS

At June 30, 2003 and December 31, 2002, the separate accounts included a separate account valued at $927.8 million and $1.0 billion, respectively, which primarily includes shares of our stock that were allocated and issued to eligible participants of qualified employee benefit plans administered by us as part of the policy credits issued under the demutualization. These shares are included in both basic and diluted earnings per share calculations. The separate account shares are recorded at fair value and are reported as separate account assets and separate account liabilities in the consolidated statement of financial position. Activity of the separate account shares is reflected in both the separate account assets and separate account liabilities and does not impact net income.

STOCK-BASED COMPENSATION

At June 30, 2003, we have four stock-based compensation plans. We applied the fair value method to all stock-based awards granted subsequent to January 1, 2002. For stock-based awards granted prior to this date, we used the intrinsic value method.

1. NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Awards under our plans vest over periods ranging from three months to three years. Therefore, the cost related to stock-based compensation included in the determination of net income for the three months and six months ended June 30, 2003 and 2002, is less than that which would have been recognized if the fair value based method had been applied to all awards since the inception of our stock-based compensation plans. Had compensation expense for our stock option awards and employees' purchase rights been determined based upon fair values at the grant dates for awards under the plans in accordance with Statement of Financial Accounting Standards ("SFAS") No. 123, ACCOUNTING FOR STOCK-BASED COMPENSATION, our net income and earnings per share would have been reduced to the pro forma amounts indicated below. For the purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period.

	FOR THE THREE MONTHS ENDED JUNE 30,		FOR THE SIX MONTHS ENDED JUNE 30,	
	2003	2002	2003	2002
	(IN MILLIONS, EXCEPT PER SHARE DATA)			
Net income, as reported	$ 202.2	$ 120.2	$ 357.9	$ 85.3
Add: Stock-based compensation expense included in reported net income, net of related tax effects	6.1	1.9	9.1	4.3
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects	6.9	3.7	10.8	7.7
Pro forma net income	$ 201.4	$ 118.4	$ 356.2	$ 81.9
Basic and diluted earnings per share:				
As reported	$ 0.62	$ 0.34	$ 1.09	$ 0.24
Pro forma	0.62	0.33	1.08	0.23

RECENT ACCOUNTING PRONOUNCEMENTS

The Financial Accounting Standards Board (the "FASB") issued Interpretation No. 46, CONSOLIDATION OF VARIABLE INTEREST ENTITIES ("FIN 46"), in January 2003. FIN 46 provides guidance related to identifying variable interest entities and determining whether such entities should be consolidated. In addition, FIN 46 also provides guidance related to the initial and subsequent measurement of assets, liabilities and noncontrolling interests of newly consolidated variable interest entities and requires disclosures for both the primary beneficiary of a variable interest entity and other beneficiaries of the entity. FIN 46 is effective immediately for variable interest entities created, or interests in variable interest entities obtained, after January 31, 2003. For those variable interest entities created, or interests in variable interest entities obtained, on or before January 31, 2003, the guidance in FIN 46 must be applied in the first fiscal year or interim period beginning after June 15, 2003. We have initiated an assessment and are currently evaluating interests in entities that may be considered variable interest entities. While the ultimate impact of adopting FIN 46 on the consolidated financial statements is still being reviewed, we anticipate consolidation of Principal Residential Mortgage Capital Resources, LLC ("PRMCR"), which currently provides an off-balance sheet source of funding for our residential mortgage loan production, by September 30, 2003. If FIN 46 was effective as of June 30, 2003, the impact would be the consolidation of approximately $3.7 billion in assets and liabilities related to PRMCR.

2. FEDERAL INCOME TAXES

The effective income tax rate on net income for the three months and six months ended June 30, 2003 and 2002, is lower than the prevailing corporate federal income tax rate primarily due to income tax deductions allowed for corporate dividends received and interest exclusion from taxable income, partially offset by state income taxes.

3. COMPREHENSIVE INCOME

Comprehensive income is as follows:

	FOR THE THREE MONTHS ENDED JUNE 30,		FOR THE SIX MONTHS ENDED JUNE 30,	
	2003	2002	2003	2002
	(IN MILLIONS)			
COMPREHENSIVE INCOME:				
Net income	$ 202.2	$ 120.2	$ 357.9	$ 85.3
Net change in unrealized gains and losses on fixed maturities, available-for-sale	978.4	406.5	1,385.2	46.9
Net change in unrealized gains and losses on equity securities, available-for-sale	16.6	(14.4)	14.0	7.5
Adjustments for assumed changes in amortization patterns:				
Deferred policy acquisition costs	(90.8)	(66.6)	(138.9)	(25.1)
Unearned revenue reserves	4.0	3.4	6.1	0.6
Net change in unrealized gains and losses on derivative instruments	3.7	(26.6)	18.1	(14.0)
Adjustments to unrealized gains for Closed Block policyholder dividend				

4. CONTINGENCIES, GUARANTEES AND INDEMNIFICATIONS

LITIGATION

We are regularly involved in litigation, both as a defendant and as a plaintiff but primarily as a defendant. Litigation naming us as a defendant ordinarily arises out of our business operations as a provider of asset management and accumulation products and services, life, health and disability insurance, and mortgage banking. Some of the lawsuits are class actions, or purport to be, and some include claims for punitive damages. In addition, regulatory bodies, such as state insurance departments, the SEC, the National Association of Securities Dealers, Inc., the Department of Labor and other regulatory bodies regularly

4. CONTINGENCIES, GUARANTEES AND INDEMNIFICATIONS (CONTINUED)

make inquiries and conduct examinations or investigations concerning our compliance with, among other things, insurance laws, securities laws, ERISA and laws governing the activities of broker-dealers.

A lawsuit was filed on September 27, 2001, in the United States District Court for the Northern District of Illinois, seeking damages and other relief on behalf of a putative class of policyholders based on allegations that the plan of conversion of Principal Mutual Holding Company from a mutual insurance holding company into a stock company violates the United States Constitution.
The action is captioned ESTHER L. GAYMAN V. PRINCIPAL MUTUAL HOLDING COMPANY, ET AL. On April 16, 2002, the Court granted our Motion to Dismiss and ordered the lawsuit be dismissed in its entirety. On April 17, 2002, a Judgment was entered to that effect. The Plaintiffs filed an appeal on May 15, 2002, with the 7th Circuit Court of Appeals. On November 22, 2002, the 7th Circuit Court of Appeals affirmed the District Court's decision. The Plaintiffs filed a Petition for a Writ of Certiorari on April 21, 2003, requesting the United States Supreme Court to review the decision of the 7th Circuit Court of Appeals. The Petition for a Writ of Certiorari was denied by the United States Supreme Court on June 23, 2003.

While the outcome of any pending or future litigation cannot be predicted, management does not believe that any pending litigation will have a material adverse effect on our business, financial position or net income. The outcome of litigation is always uncertain, and unforeseen results can occur. It is possible that such outcomes could materially affect net income in a particular quarter or annual period.

GUARANTEES AND INDEMNIFICATIONS

In the normal course of business, we have provided guarantees to third parties primarily related to a former subsidiary, joint ventures and industrial revenue bonds. These agreements generally expire from 2003 through 2019. The estimated maximum exposure under these agreements as of June 30, 2003, was $171.0 million; however, we believe the likelihood is remote that material payments will be required and therefore have not accrued for a liability on our consolidated statements of financial position. Should we be required to perform under these guarantees, we generally could recover a portion of the loss from third parties through recourse provisions included in agreements with such parties, the sale of assets held as collateral that can be liquidated in the event that performance is required under the guarantees or other recourse generally available to us, minimizing the impact to net income.

In connection with the 2002 sale of BT Financial Group, we agreed to indemnify the purchaser, Westpac Banking Corporation ("Westpac") for, among other things, the costs associated with potential late filings made by BT Financial Group in New Zealand prior to Westpac's ownership, up to a maximum of A$250.0 million Australian dollars (approximately U.S. $170.0 million as of June 30, 2003). New Zealand securities regulations allow Australian issuers to issue their securities in New Zealand provided that certain documents are appropriately filed with the New Zealand Registrar of Companies. Specifically, the regulations require that any amendments to constitutions and compliance plans be filed in New Zealand. In April 2003, the New Zealand Securities Commission ("the Commission") opined that such late filings would result in certain New Zealand investors having a right to return of their investment plus interest at 10% per annum from the date of investment. Consequently, the Commission has advised that it has initiated an inquiry into the matter, both with regard to BT Financial Group and other similar issuers. We view these potential late filings as a technical matter as we believe investors received the information that is required to be provided directly to them. In addition, we believe this technical issue may affect many in the industry and result in a favorable legislative or judicial solution. Finally, we are reviewing the applicability of the indemnification regarding this matter. Although we cannot predict the outcome of this matter or reasonably estimate losses, we do not believe that it would result in a material adverse effect on our business or financial position. It is possible, however, that it could have a material adverse effect on net income in a particular quarter or annual period.

4. CONTINGENCIES, GUARANTEES AND INDEMNIFICATIONS (CONTINUED)

In the normal course of business, we are subject to indemnification obligations related to the sale of residential mortgage loans. Under these indemnifications, we are required to repurchase certain mortgage loans that fail to meet the standard representations and warranties included in the sales contracts. The amount of our exposure is based on the potential loss that may be incurred if the repurchased mortgage loans are processed through the foreclosure process. Based on historical experience, total mortgage loans repurchased pursuant to these indemnification obligations are estimated to be approximately 0.04% of annual mortgage loan production levels. Total losses on the mortgage loans repurchased are estimated to approximate 25% of the unpaid principal balance of the related mortgage loans. As of June 30, 2003, $3.3 million has been accrued for representing the fair value of such indemnifications issued after January 1, 2003, in accordance with FASB's Interpretation No. 45, GUARANTOR'S ACCOUNTING AND DISCLOSURE REQUIREMENTS FOR GUARANTEES, INCLUDING INDIRECT GUARANTEES OF INDEBTEDNESS OF OTHERS.

We are also subject to various other indemnification obligations issued in conjunction with certain transactions, primarily the sale of BT Financial Group and other divestitures, the sale of servicing rights in our mortgage banking business, acquisitions, and financing transactions whose terms range in duration and often are not explicitly defined. Certain portions of these indemnifications may be capped, while other portions are not subject to such limitations. Generally, a maximum obligation is not explicitly stated; therefore, the overall maximum amount of the obligation under the indemnifications cannot be reasonably estimated. While we are unable to estimate with certainty the ultimate legal and financial liability with respect to these indemnifications, we believe the likelihood is remote that material payments would be required under such indemnifications and therefore such indemnifications would not result in a material adverse effect on our business, financial position or net income. The fair value of such indemnifications issued after January 1, 2003, was insignificant.

5. SEGMENT INFORMATION

We provide financial products and services through the following segments: U.S. Asset Management and Accumulation, International Asset Management and Accumulation, Life and Health Insurance and Mortgage Banking. In addition, there is a Corporate and Other segment. The segments are managed and reported separately because they provide different products and services, have different strategies or have different markets and distribution channels.

The U.S. Asset Management and Accumulation segment provides retirement and related financial products and services primarily to businesses, their employees and other individuals and provides asset management services to our asset accumulation business, the life and health insurance operations, the Corporate and Other segment and third-party clients.

The International Asset Management and Accumulation segment offers retirement products and services, annuities, long-term mutual funds and life insurance through subsidiaries in Argentina, Chile, Mexico, Hong Kong and India and joint ventures in Brazil, Japan and Malaysia. Prior to October 31, 2002, the operating segment included BT Financial Group, an Australia based asset manager. We sold substantially all of BT Financial Group, effective October 31, 2002. As a result, the results of operations (excluding corporate overhead) for BT Financial Group are reported as other after-tax adjustments for all periods presented.

The Life and Health insurance segment provides individual and group life insurance, group health insurance and individual and group disability insurance throughout the U.S.

The Mortgage Banking segment originates and services residential mortgage loan products for customers in the U.S.

5. SEGMENT INFORMATION (CONTINUED)

The Corporate and Other segment manages the assets representing capital that has not been allocated to any other segment. Financial results of the Corporate and Other segment primarily reflect our financing activities, income on capital not allocated to other segments, intersegment eliminations, income tax risk assumptions and certain income, expenses and other after-tax adjustments not allocated to the segments based on review of the nature of such items.

Management uses segment operating earnings for goal setting, determining employee compensation, and evaluating performance on a basis comparable to that used by securities analysts. We determine segment operating earnings by adjusting U.S. GAAP net income for net realized/unrealized capital gains and losses, as adjusted, and other after-tax adjustments which management believes are not indicative of overall operating trends. Net realized/unrealized capital gains and losses, as adjusted, are net of income taxes, related changes in the amortization pattern of deferred policy acquisition costs, recognition of front-end fee revenues for sales charges on pension products and services, net realized capital gains and losses distributed, minority interest capital gains and certain market value adjustments to fee revenues. Segment operating revenues exclude net realized/unrealized capital gains and their impact on recognition of front-end fee revenues and certain market value adjustments to fee revenues. While these items may be significant components in understanding and assessing the consolidated financial performance, management believes the presentation of segment operating earnings enhances the understanding of our results of operations by highlighting earnings attributable to the normal, ongoing operations of the business.

The accounting policies of the segments are consistent with the accounting policies for the consolidated financial statements, with the exception of capital allocation and income tax allocation. We allocate capital to our segments based upon an internal capital model that allows management to more effectively manage our capital. The Corporate and Other segment functions to absorb the risk inherent in interpreting and applying tax law. The segments are allocated tax adjustments consistent with the positions we took on our tax returns. The Corporate and Other segment results reflect any differences between the tax returns and the estimated resolution of any disputes.

The following tables summarize selected financial information on a continuing basis by segment and reconcile segment totals to those reported in the consolidated financial statements:

	AS OF JUNE 30, 2003	AS OF DECEMBER 31, 2002
	(IN MILLIONS)	
ASSETS:		
U.S. Asset Management and Accumulation	$ 77,647.6	$ 70,371.9
International Asset Management and Accumulation	2,531.3	2,202.5
Life and Health Insurance	11,857.0	11,356.3
Mortgage Banking	4,119.5	3,740.1
Corporate and Other	2,466.3	2,190.5
Total consolidated assets	$ 98,621.7	$ 89,861.3

5. SEGMENT INFORMATION (CONTINUED)

	FOR THE THREE MONTHS ENDED JUNE 30,		FOR THE SIX MONTHS ENDED JUNE 30,	
	2003	2002	2003	2002
	(IN MILLIONS)			
OPERATING REVENUES BY SEGMENT:				
U.S. Asset Management and Accumulation....	$ 869.0	$1,135.7	$ 1,755.0	$1,997.8
International Asset Management and Accumulation............................	113.0	93.6	189.8	169.5
Life and Health Insurance.................	1,001.8	984.5	2,014.1	1,963.0
Mortgage Banking..........................	452.5	209.7	857.0	418.4
Corporate and Other.......................	(6.2)	6.7	(6.9)	17.2
Total segment operating revenues........	2,430.1	2,430.2	4,809.0	4,565.9
Net realized/unrealized capital losses, including recognition of front-end fee revenues and certain market value adjustments to fee revenues............	(17.7)	(94.7)	(99.8)	(2.6)
Total revenue per consolidated statements of operations..............	$ 2,412.4	$2,335.5	$ 4,709.2	$4,563.3
REVENUES FROM EXTERNAL CUSTOMERS:				
U.S. Asset Management and Accumulation....	$ 811.5	$1,029.4	$ 1,633.3	$1,797.7
International Asset Management and Accumulation............................	111.3	122.9	182.5	206.1
Life and Health Insurance.................	1,000.7	952.5	1,999.2	1,915.7
Mortgage Banking..........................	449.7	209.7	851.8	418.4
Corporate and Other.......................	39.2	21.0	42.4	225.4
Total external revenues.................	$ 2,412.4	$2,335.5	$ 4,709.2	$4,563.3
INTERSEGMENT REVENUES:				
U.S. Asset Management and Accumulation....	$ 12.9	$ 13.4	$ 26.2	$ 28.0
International Asset Management and Accumulation............................	-	-	-	-
Life and Health Insurance.................	(1.5)	(1.6)	(2.8)	(3.1)
Mortgage Banking..........................	2.8	-	5.2	-
Corporate and Other.......................	(14.2)	(11.8)	(28.6)	(24.9)
Total..................................	$ -	$ -	$ -	$ -

5. SEGMENT INFORMATION (CONTINUED)

	FOR THE THREE MONTHS ENDED JUNE 30,		FOR THE SIX MONTHS ENDED JUNE 30,	
	2003	2002	2003	2002
	(IN MILLIONS)			
OPERATING EARNINGS (LOSS) BY SEGMENT:				
U.S. Asset Management and Accumulation ...	$ 108.2	$ 102.1	$ 205.7	$ 202.3
International Asset Management and Accumulation............................	12.1	3.9	18.7	5.1
Life and Health Insurance.................	62.9	61.7	122.0	116.0
Mortgage Banking..........................	45.1	24.8	97.4	51.3
Corporate and Other	(10.4)	(6.0)	(15.4)	(5.7)
Total segment operating earnings........	217.9	186.5	428.4	369.0
Net realized/unrealized capital losses, as adjusted.............................	(15.3)	(70.1)	(69.4)	(6.9)
Other after-tax adjustments (1)...........	(0.4)	3.8	(1.1)	(276.8)
Net income per consolidated statements of operations.............	$ 202.2	$ 120.2	$ 357.9	$ 85.3

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(1) For the three months ended June 30, 2003, other after-tax adjustments of ($0.4) million included the negative effect of a change in the estimated loss on disposal of BT Financial Group.

For the three months ended June 30, 2002, other after-tax adjustments of $3.8 million included the positive effect of the income from discontinued operations of BT Financial Group.

For the six months ended June 30, 2003, other after-tax adjustments of ($1.1) million included the negative effect of a change in the estimated loss on disposal of BT Financial Group.

For the six months ended June 30, 2002, other after-tax adjustments of ($276.8) million included (1) the negative effects of (a) a cumulative effect of accounting change related to the implementation of SFAS 142, GOODWILL AND OTHER INTANGIBLE ASSETS, ($280.9 million) and (b) expenses related to the demutualization ($2.0 million); and (2) the positive effect of the income from discontinued operations of BT Financial Group ($6.1 million).

6. STOCKHOLDERS' EQUITY

In May 2003, our board of directors authorized the repurchase of up to $300.0 million of our outstanding common stock. The repurchases will be made in the open market or through privately negotiated transactions, from time to time, depending on market conditions.

7. EARNINGS PER SHARE

The computations of the basic and diluted per share amounts for our continuing operations were as follows:

	FOR THE THREE MONTHS ENDED JUNE 30,		FOR THE SIX MONTHS ENDED JUNE 30,	
	2003	2002	2003	2002
	(IN MILLIONS)			
Income from continuing operations	$202.6	$116.4	$359.0	$360.1
Weighted-average shares outstanding:				
Basic	326.9	356.8	329.1	358.6
Dilutive effect:				
Stock options	0.5	0.5	0.5	0.4
Restricted stock units (1)	-	-	-	-
Diluted	327.4	357.3	329.6	359.0
Income from continuing operations per share:				
Basic	$ 0.62	$ 0.33	$ 1.09	$ 1.00
Diluted	$ 0.62	$ 0.33	$ 1.09	$ 1.00

(1) The dilutive effect was less than 0.1 million shares.

The calculation of diluted earnings per share for the three months and six months ended June 30, 2003 and 2002, excludes the incremental effect related to certain stock-based compensation grants due to their anti-dilutive effect.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following analysis discusses our financial condition as of June 30, 2003, compared with December 31, 2002, and our consolidated results of operations for the three months and six months ended June 30, 2003 and 2002, prepared in conformity with accounting principles generally accepted in the U.S. ("U.S. GAAP"). The discussion and analysis includes, where appropriate, factors that may affect our future financial performance. The discussion should be read in conjunction with our Form 10-K, for the year ended December 31, 2002, filed with the United States Securities and Exchange Commission and the unaudited consolidated financial statements and the related notes to the financial statements and the other financial information included elsewhere in this Form 10-Q.

FORWARD-LOOKING INFORMATION

Our narrative analysis below contains forward-looking statements intended to enhance the reader's ability to assess our future financial performance. Forward-looking statements include, but are not limited to, statements that represent our beliefs concerning future operations, strategies, financial results or other developments, and contain words and phrases such as "anticipate," "believe," "plan," "estimate," "expect," "intend," and similar expressions. Forward-looking statements are made based upon management's current expectations and beliefs concerning future developments and their potential effects on us. Such forward-looking statements are not guarantees of future performance.

Actual results may differ materially from those included in the forward-looking statements as a result of risks and uncertainties including, but not limited to the following: (1) a decline or increased volatility in the securities markets could result in investors withdrawing from the markets or decreasing their rates of investment, either of which could reduce our net income, revenues and assets under management; (2) our investment portfolio is subject to several risks which may diminish the value of our invested assets and affect our sales, profitability and the investment returns credited to our customers; (3) competition from companies that may have greater financial resources, broader arrays of products, higher ratings and stronger financial performance may impair our ability to retain existing customers, attract new customers and maintain our profitability; (4) a downgrade in Principal Life Insurance Company's ("Principal Life") financial strength ratings may increase policy surrenders and withdrawals, reduce new sales and terminate relationships with distributors and cause some of our existing liabilities to be subject to acceleration, additional collateral support, changes in terms, or creation of additional financial obligations; (5) our efforts to reduce the impact of interest rate changes on our profitability and surplus may not be effective; (6) if we are unable to attract and retain sales representatives and develop new distribution sources, sales of our products and services may be reduced; (7) our international businesses face political, legal, operational and other risks that could reduce our profitability in those businesses; (8) our reserves established for future policy benefits and claims may prove inadequate, requiring us to increase liabilities; (9) our ability to pay stockholder dividends and meet our obligations may be constrained by the limitations on dividends Iowa insurance laws impose on Principal Life; (10) we may need to fund deficiencies in our closed block ("Closed Block") assets which benefit only the holders of Closed Block policies; (11) changes in laws, regulations or accounting standards may reduce our profitability; (12) litigation and regulatory investigations may harm our financial strength and reduce our profitability; (13) fluctuations in foreign currency exchange rates could reduce our profitability; (14) applicable laws and our stockholder rights plan, certificate of incorporation and by-laws may discourage takeovers and business combinations that our stockholders might consider in their best interests; and (15) a downgrade in our debt ratings may adversely affect our ability to secure funds and cause some of our existing liabilities to be subject to acceleration, additional collateral support, changes in terms, or creation of additional financial obligations.