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Lincoln National Corp. (LNC)

Business Update Call

CORPORATE PARTICIPANTS

Albert S. Copersino

Vice President & Head-Investor Relations, Lincoln National Corp.

Dennis R. Glass

President, Chief Executive Officer & Director, Lincoln National Corp.

Randal J. Freitag

Executive Vice President, Chief Financial Officer & Head-Individual Life, Lincoln National Corp.

OTHER PARTICIPANTS

Erik Bass

Analyst, Autonomous Research

Thomas Gallagher

Analyst, Evercore Group LLC

Humphrey Lee

Analyst, Dowling & Partners Securities LLC

Joshua Shanker

Analyst, BofA Securities, Inc.

Ryan Krueger

Analyst, Keefe, Bruyette & Woods, Inc.

Michael Ward

Analyst, UBS

MANAGEMENT DISCUSSION SECTION

Operator: Good day and thank you for standing by. Welcome to the Lincoln National Conference Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference over to your speak today, Al Copersino, Head of Investor Relations. Please go ahead.

Albert S. Copersino

Vice President & Head-Investor Relations, Lincoln National Corp.

Thank you, Shannon. Good morning and thank you for joining us on short notice. This morning we issued a press release announcing our reinsurance transaction with Resolution Life. Before we begin, I have an important reminder. Any comments made during the call regarding future actions, performance, or financial results, including the expected impacts of the reinsurance transaction and intended use of the capital generated are forward-looking statements under the Private Securities Litigation Reform Act of 1995.

These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from current expectations. These risks and uncertainties include those described in the cautionary statement disclosures in our press release issued this morning as well as those detailed in our 2020 Annual Report on Form 10-K, most recent quarterly reports on Form 10-Q, and from time to time in our other filings with the SEC. These forward-looking statements are made only as of today, and we undertake no obligation to update or revise any of them to reflect events or circumstances that occur after this date.

Today's call may include a discussion of certain historical non-GAAP financial measures, full reconciliation of such non-GAAP measures, including adjusted return on equity and adjusted income from operations or adjusted operating income to the most comparable GAAP measures can be found in the statistical supplement posted on the investor relations section of Lincoln's website, www.lincolnfinancial.com.

Presenting on today's call are Dennis Glass, President and Chief Executive Officer and Randy Freitag, Chief Financial Officer and Head of Individual Life. After their prepared remarks, we will move to the question-and-answer portion of the call.

I would now like to turn the call over to Dennis.

Dennis R. Glass

President, Chief Executive Officer & Director, Lincoln National Corp.

Thank you, Al. Good morning, everyone and thank you for joining us on short notice. This morning we are pleased to announce we've entered into an agreement to reinsure a block of our in-force life insurance business to Resolution Life. This transaction will generate approximately \$1.2 billion of capital.

In a moment, Randy will discuss the details, including the blocks to be reinsured, planned use of proceeds, timing and the expected impact on our financials. As we've long discussed, it is our core strategy that continues to drive our 8% to 10% growth expectations. We view block deals as an opportunistic way to generate additional shareholder value by freeing up capital to buy back shares at attractive prices. This is precisely what we plan to do via this transaction, which is expected to be highly accretive to our adjusted operating earnings per share and expand ROE. We have been creative in our use of these reinsurance tools over the years and we remain open to additional block deals as well as flow reinsurance agreements as we continue to focus on maximizing shareholder value.

It is important to note that this transaction will not have any impact on our relationships with our policyholders as we will continue to administer the policies covered under this transaction nor does it have any impact on our distribution partners who will continue selling Lincoln's high-quality life insurance products. Going forward, we remain committed to growing our life insurance business and each of our businesses, and we'll continue to focus on executing our core strategy, bolstered by our distribution strength and product breadth, which again drives our 8% to 10% growth expectations.

Once again, I want to say how pleased we are about completing the sizable transaction and I will turn the call over to Randy.

Randal J. Freitag

Executive Vice President, Chief Financial Officer & Head-Individual Life, Lincoln National Corp.

Thank you, Dennis. This morning we are excited to announce that we have entered into an agreement with Resolution Life to reinsure approximately \$9.4 billion of life insurance reserves, which will generate significant capital. The deal will have an effective date of October 1, 2021. Closing of the deal is subject to usual customary closing conditions, but there are no regulatory approvals required to close. The \$9.4 billion of reserves we are seeing includes \$5 billion of general account and \$4.4 billion of separate account reserves. \$8.1 billion of ceded reserves come from our executive benefits business with the balance coming from our universal life business. This represents approximately one-eighth of total life insurance reserves.

Resolution Life will reinsure 90% of the ceded blocks and Lincoln will retain the remaining 10%. Additionally, Lincoln will provide administration for the ceded business and will remain an active issuer of both executive benefits and universal life business. This transaction will generate approximately \$1.2 billion of capital or about 16 times expected earnings on the block, which will fund about \$900 million of incremental share buybacks. We'd expect that the buybacks will be complete by the end of the first quarter of 2022 with \$500 million accomplished through an accelerated share repurchase program that will begin shortly after closing. The remaining proceeds will be used for general corporate purposes primarily paying down debt, which will keep our debt to capital ratio consistent with recent periods. Looking forward, life insurance segment operating earnings will be negatively impacted by about \$40 million per year after tax, net of a benefit from amortization of a deferred gain related to the transaction. Additionally, any debt reduction would lower interest expense in the other operations segment.

When factoring the subsequent share repurchases, we expect the deal to be approximately 5% accretive to Lincoln's 2022 adjusted operating EPS. We expect the impact on book value per share excluding AOCI to be de minimis.

As Dennis said, we remain committed to our core strategy that continues to drive our 8% to 10% growth expectations. This includes continuing to grow our life insurance business and the executive benefits in universal life product lines. Lastly, this transaction is only possible because of the high quality of our book of business that we created through the strength of our distribution, product strategy, and industry leadership.

With that, let me turn the call back over to AI to begin Q&A.

Albert S. Copersino

Vice President & Head-Investor Relations, Lincoln National Corp.

Thank you, Dennis, and Randy. We will now begin the question-and-answer portion of the call. As a reminder, we ask that you please limit yourself to one question and one follow-up and then re-queue if you have additional questions. Given the short duration of this call, we ask that questions be focused on today's release and that you save questions on other topics for our upcoming third quarter earnings conference call.

With that, let me turn the call over to Shannon to begin Q&A.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Please stand by while we compile the Q&A roster. Our first question comes from Erik Bass with Autonomous Research. Your line is open.

Erik Bass

Analyst, Autonomous Research

Q

Hi. Thank you. I was hoping you could provide more detail on the breakdown of the \$1.2 billion capital benefit, what was the ceding commission received and what came from releasing excess capital?

Dennis R. Glass

President, Chief Executive Officer & Director, Lincoln National Corp.

A

Erik, as you can tell it was a very attractive amount of capital generation. There are three components to the capital generation. There's a ceding commission and then taxes, which we will pay and then the capital release. What I would tell you is that the capital we will release and the taxes about offset each other, so the ceding commission was pretty much in line with the capital generation we talked about.

Erik Bass

Analyst, Autonomous Research

Q

Great. Thank you. And then maybe if you could talk about a little bit how this transaction changes some of the risk metrics for your block going forward, and I guess specifically how does the transaction change your sensitivity to interest rates both in terms of spread compression risk, but also exposure to potential changes in long-term assumptions?

Dennis R. Glass

President, Chief Executive Officer & Director, Lincoln National Corp.

A

We really don't see this changing our risk profile at all. We expect to continue to have, for instance, mortality/morbidity represent about 30% of our overall earnings. I'd point out with this business, Erik, I had noted that these reserves represented roughly an eighth of our life insurance business reserves, and I'd point out that the earnings represent a very similar percentage. So, we don't see this as having any material impact on the overall risk profile, Erik.

Erik Bass

Analyst, Autonomous Research

Q

Got it. Thank you.

Operator: Our next question comes from Thomas Gallagher of Evercore. Your line is open.

Thomas Gallagher

Analyst, Evercore Group LLC

Q

Thanks. So, first question, you got a 16 times PE multiple on this, obviously, very attractive relative to where your stock trades. Would you consider doing more of these in the future on the life insurance side or other businesses if you have that sort of extremely high spread over your current PE? Like, is this just something that we could

expect you to continue to evaluate and potentially execute, or should we view this more as a one-off and now less likely to do something like it going forward?

Dennis R. Glass

President, Chief Executive Officer & Director, Lincoln National Corp.

A

Tom, as – [ph] and I'll certainly (11:32) say that we're going to continue to evaluate opportunities as we move forward to add to our core strategy, which is going to again drive and we're very confident of this [indiscernible] (11:52) saying on calls an 8% to 10% EPS growth over time. As you know, I think it's maybe the third or fourth transaction, including block sales, flow reinsurance transactions. And so, we have a history of executing when appropriate on right terms to improve shareholder value. So, we've done it, we're open to doing more, but again I want to come back to our core strategy remains our primary focus. But we are very, very open to opportunities to add value on top of that core strategy.

Thomas Gallagher

Analyst, Evercore Group LLC

Q

Okay. Thanks, Dennis. And then, just a follow-up; Randy, does this change the GAAP to free cash flow conversion ratio at all or is that still expected to run around the 50% to 55% level?

Randal J. Freitag

Executive Vice President, Chief Financial Officer & Head-Individual Life, Lincoln National Corp.

A

Yeah. The way I think about it, Tom, is, I don't expect that this is going to change at all our \$850 million to \$950 million capital return to shareholders over the course of the year. Of course, we're giving up some small amount of earnings, which I referenced in my script. But when you think about the fact that we continue to issue profitable new business and when you're factoring growth and you're factoring the strength of our balance sheet, I don't expect any change to our previous expectations for capital or return to shareholders over the course of the year.

Thomas Gallagher

Analyst, Evercore Group LLC

Q

Okay. Thanks.

Operator: Our next question comes from Humphrey Lee, Dowling & Partners. Your line is open.

Humphrey Lee

Analyst, Dowling & Partners Securities LLC

Q

Good morning and thank you for taking my questions. Just related to, I guess, using some of the proceeds for debt reduction, but in your prepared remarks, Randy, you talked about the impact to book value is de minimis. So, I guess, what is the thinking between using some of the proceeds for debt reduction as opposed to using more on the share repurchases?

Randal J. Freitag

Executive Vice President, Chief Financial Officer & Head-Individual Life, Lincoln National Corp.

A

Yeah. I think, Humphrey – as we said we're selling away some small amount of overall Lincoln earnings. And so, I think when you're doing that it's prudent to think about what you might do with those proceeds. And I think some level of debt reduction as we mentioned, we expect our ratios to largely remain consistent with recent periods with this mix. I think the percentage we're allocating to buyback is 75%. I think that's a strong indication of being very proactive in how we're using the capital. But some level of debt reduction I think is just prudent.

Humphrey Lee

Analyst, Dowling & Partners Securities LLC

Q

Got it. And then in terms of kind of being open to additional transactions, so are you still going to be proactively looking or you are just going to be more kind of, you cut down that a little bit from the asset that you've been putting on kind of since the beginning of the year? So, like how should we think about how proactive Lincoln will be following this transaction?

Dennis R. Glass

President, Chief Executive Officer & Director, Lincoln National Corp.

A

Humphrey, again, at this moment in time it's kind of interesting because a lot of the business that we're putting on the books is at much higher returns on capital that we're deploying than what buyers are required. So, we're putting new business on the books at high IRRs and going forward if the market stays the way it is, we could sell some of that new business into the private market and create value for the shareholders.

So, when we do another deal, it is just up to market conditions and [indiscernible] (16:03) we'll continue to follow it. And again, we're looking both at block opportunities as well as flow transactions. And we're going to keep attentive to the opportunities to create additional shareholder value that go beyond our core strategy.

Humphrey Lee

Analyst, Dowling & Partners Securities LLC

Q

Got it.

Randal J. Freitag

Executive Vice President, Chief Financial Officer & Head-Individual Life, Lincoln National Corp.

A

Just to add, Humphrey. Just to add, we're never not looking at these things, right. And we have people whose job is to keep in touch with the marketplace. So, this is something that's going on continuously in the company focused around the exact [indiscernible] (16:49) that Dennis noted.

Humphrey Lee

Analyst, Dowling & Partners Securities LLC

Q

Understood. Fair point. Thanks.

Operator: Our next question comes from Joshua Shanker with Bank of America. Your line is open.

Joshua Shanker

Analyst, BofA Securities, Inc.

Q

Well, [indiscernible] (17:04) answered my question at the end. I was just wondering about the process a little bit in terms of this deal. This is, COLI and BOLI it's not something that there's lot of strain and stress from investors looking at it as a high-risk segment of your portfolio. When you're out there looking at blocks to sell, are you being approached? Are you approaching parties? Is anything on the table, obviously, people looking for VAs as the thing to be converted into earnings, I guess, like can you talk about the rest of the book and how the process goes with you looking to sell blocks and whatnot?

Dennis R. Glass

President, Chief Executive Officer & Director, Lincoln National Corp.

A

Josh, as you might imagine it goes both ways. I mean, we're out and we're talking to people and people are coming into our offices in this world virtually and talking with us. So, it isn't any one or the other [indiscernible] (17:59). Specifically, when you decide you want to move forward, typically you will create a process that you'll run, that will include multiple bidders, which this process that includes multiple bidders who are all very interested in this business, and it's reflected in the price, which is very attractive.

Joshua Shanker

Analyst, BofA Securities, Inc.

Q

All right. Well, I mean, Humphrey, kind of asked my question. So, I'll defer. Thank you very much.

Operator: Our next question comes from Tracy Benguigui with Barclays. Your line is open.

Q

Hi. Good morning. This is [ph] Alex Rafael (18:40) on for Tracy. I just had one question, what type of general account assets will be part of the coinsurance treaty? And what I'm getting at here is just the pro forma asset allocation of your general account look different. Thank you.

Randal J. Freitag

Executive Vice President, Chief Financial Officer & Head-Individual Life, Lincoln National Corp.

A

So, [ph] Alex (18:59), the way these things work we will transfer assets to resolutions that are equal to the reserves minus the ceding commission. And then as part of the deal, there will be an investment strategy, which I'm not going to get into details of which we've reviewed and approved with Resolution. So, they have an allowed investment strategy and the day-to-day decisions they make will be up to them, but they will be done inside the context of the investment strategy that was agreed to as part of the transaction.

Q

Thank you.

Operator: Our next question comes from Ryan Krueger with KBW. Your line is open.

Ryan Krueger

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Hi. Good morning. A couple of quick ones, one just am I doing the math correct, if the block earns \$75 million a year, but then net of the benefit of the deferred gain of the ceding commissions, that's what gets you to the \$40 million?

Randal J. Freitag

Executive Vice President, Chief Financial Officer & Head-Individual Life, Lincoln National Corp.

A

Yeah. Ryan, I think you've got the math, it's between \$70 million and \$75 million of earnings. I mean, you can do 1.2 divided by 16 and you'll get a number that's pretty close to the earnings. And then there is the benefit I noted, which means that the life earnings will be reduced by roughly \$40 million when you factor in and that will be amortizing in this gain. And additionally, the [indiscernible] (20:27) pointed out was that to the extent we do some

debt paydown that will benefit other operations, earnings with lower interest expense and size that probably \$8 million to \$10 million.

Ryan Krueger

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Got it. And then buyback, I'm assuming you'll continue your normal buyback each quarter and then we should just layer in the \$900 million on top of those through 1Q 2022?

Randal J. Freitag

Executive Vice President, Chief Financial Officer & Head-Individual Life, Lincoln National Corp.

A

Yeah. Ryan, as I mentioned we don't expect any change to that \$850 million to \$950 million guidance. So, there should be no change in our ongoing buyback program from what we've noted before. And back on our last call we talked about how we were going to be back at pre-pandemic levels of roughly \$150 million a quarter. Now, we'll have to factor in, Ryan, how many buybacks can be done of Lincoln stock in the quarter. So, that may influence the timing of those. But over the course of the next 15 months to 18 months, we'll be on track and these will be incremental to the normal program.

Ryan Krueger

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Thanks. Last quick one was just, can you give any more detail on the UL reserves that were ceded in terms of with a ULSG or current term assumptions and anything on like the vintage of when that business was written?

Randal J. Freitag

Executive Vice President, Chief Financial Officer & Head-Individual Life, Lincoln National Corp.

A

On when this business is written, we've been in these businesses for decades and this business has been written over the entirety of those decades on the UL reserves. They are our current assumption of UL that's been written over the decades.

Ryan Krueger

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Got it. Thank you.

Operator: Thank you. [Operator Instructions] Our next question comes from Mike Ward with UBS. Your line is open.

Michael Ward

Analyst, UBS

Q

Thanks guys. Good morning. I was just wondering does this deal change at all the potential impact from LDTI or could you quantify that at all? And then maybe was that part of the motivation for this particular deal.

Dennis R. Glass

President, Chief Executive Officer & Director, Lincoln National Corp.

A

No, we don't expect any change to our expected LDTI impact.

Michael Ward

Analyst, UBS

Okay. And then...

Q

Randal J. Freitag

Executive Vice President, Chief Financial Officer & Head-Individual Life, Lincoln National Corp.

...any material change.

A

Michael Ward

Analyst, UBS

Okay. And then, so I understand this deal doesn't require regulatory approval. But I guess just wanted to confirm that you don't anticipate any holdups in Denver or anything similar to what happened [ph] with the (22:56) delays in an earlier deal with Resolution Life as one of your peers?

Q

Dennis R. Glass

President, Chief Executive Officer & Director, Lincoln National Corp.

We do not and that's covered by the phrase that you repeated, which there are no additional regulatory approvals needed.

A

Michael Ward

Analyst, UBS

Great. Thanks guys.

Q

Operator: Thank you. And I'm showing no further questions at this time. I'd like to turn the call back over to Al Copersino for closing remarks.

Dennis R. Glass

President, Chief Executive Officer & Director, Lincoln National Corp.

Al, you are on mute.

Albert S. Copersino

Vice President & Head-Investor Relations, Lincoln National Corp.

Apologies. Thank you all for joining us this morning. As always, we are happy to take any follow-up questions that you have. You can email us at investorrelations@lfg.com. Thank you all, and have a great day.

Operator: This concludes today's conference call. Thank you for participating. You may now disconnect.

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