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# Lincoln National Corp. (LNC)

Bank of America Securities Insurance Conference

## CORPORATE PARTICIPANTS

**Dennis R. Glass**

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**Ellen Gail Cooper**

*Executive Vice President & Chief Executive Officer-Elect, Lincoln National Corp.*

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**Joshua Shanker**

*Analyst, BofA Securities, Inc.*

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## MANAGEMENT DISCUSSION SECTION

**Joshua Shanker**

*Analyst, BofA Securities, Inc.*

Hello, everyone. Welcome back. This is Josh Shanker. It's the Bank of America US Insurance Conference. Lincoln Financial is the next presenters on deck. To remind you, if you're watching this, you're probably watching it through a Veracast app. You can ask me questions and I will happily ask them. So, will you please type in?

People tell me that life insurance isn't fun, but I mean this is going to be a little bit of fun because we have Lincoln here, but we have both, Dennis Glass, CEO of Lincoln Financial, and Ellen Cooper, the CEO-Elect. So, we're getting the best of both worlds here. We'll get to hear maybe a little bit about how they take the world and triangulating on what's going on, and I hope that no one's shy. Please ask questions.

Thank you, Dennis. Thank you, Ellen. Congratulations to you both. It's an exciting time at Lincoln. We're going to get to some of the excitement.

## QUESTION AND ANSWER SECTION

**Joshua Shanker**

*Analyst, BofA Securities, Inc.*

Q

But I want to understand exactly what's going on in the transition right now. Where are we? What portfolios Dennis have you given up? Ellen, what portfolios have you given up in the investment capacity and whatnot? And where are we in the process?

**Dennis R. Glass**

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

A

Joshua, first of all, we're so delighted to be invited to the conference. This is one of the outstanding of its type during the year, and we've been regular attendees. So we appreciate it very much and look forward to the next 30 minutes as well as the one-on-ones.

So, specifically to your question, sort of a bright line everyone could think about the fact that I'm closing out 2021 and all the areas and issues in and around closing out a year with the board and things like that. And Ellen is looking at everything that is 2022 and forward, and of course she is getting input from me and I'm getting input from her, so it's been a terrific transition.

Ellen, do you want to talk a little bit more about what's on your mind for the coming year?

**Ellen Gail Cooper**

*Executive Vice President & Chief Executive Officer-Elect, Lincoln National Corp.*

A

Absolutely. And good morning, Josh, and good morning to all of you and I look forward to the meetings today as well. And exactly as Dennis said, we are working extremely closely together and as it relates to 2022, all things related to strategy execution, being fully prepared to run all aspects of the business are really the areas that I am the most focused on with Dennis' input, and working very closely with the senior team.

There are a couple of areas in particular as it relates [audio gap] (00:02:54) the first one, and Josh, you alluded to this in your question, is around the leadership structure. And one of the first things that we did was we announced a couple of months ago a new Chief Investment Officer, and I look forward to all of you getting to know him at some point, an internal candidate, Jayson Bronchetti, and that enabled me to delegate all investment responsibilities away and really focus on the transition.

The second thing as it relates to leadership structure is we also announced a new role that is a direct report of mine and that is the Chief Strategy Officer, and that individual will really – as we continue to execute on all aspects of the strategy that we have talked to you about, we also will be focused on thinking about building the business of tomorrow, and that will be a primary focus of the role of the Chief Strategy Officer.

So the second area is this long-term planning – longer-term planning that we will also be doing. And the third area around the transition for me has really been around building and developing the relationships, and that includes with all of you, with our investor, analyst community, distribution, significant amount of meetings internally to really get to know all aspects of the business, many listening tours, et cetera. So it's been really fun and it's been a really smooth and seamless transition exactly as we had expected.

**Joshua Shanker**

*Analyst, BofA Securities, Inc.*



Well, I know the Chief Strategy Officer, so that – he's really good, so I told that you're in good hands [indiscernible] (00:04:35) and congratulations to everybody all around in terms of that, all the changes.

So change is really what's going on. I mean operation Spark or the Spark Initiative is a huge part of what's going on here. It's interesting the idea of – like the word restructuring, whatever you want to call it, but we've actually had a interesting sort of experience with the pandemic people retiring early and some call it the Great Resignation. And Lincoln had started the Spark Initiative during that period of time. To what extent have Lincoln employees already been voluntarily retiring during the Great Resignation that Spark has an opportunity to find other employees who want that option. How is it proceeding? How has the news been taken by your employees? And sort of where are we in the Spark process?

**Dennis R. Glass**

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



Yeah. Joshua, let me break that question up into two operational activities. The first one is Spark. And just on Spark, it's very much a cost initiative. As we've discussed, we're talking about cost saves of \$260 million to \$300 million as we end 2024. Those numbers are in our financial plans. There's a name behind each one of these numbers and we have a long history of good execution. And so we're pretty excited about that.

With respect to corporate culture, I really would put that into the category of having what we call a long-term employee model that is coming out of our experience with virtual activity in both our manufacturing operations and in distribution.

And to your point, with the Great Resignation, and people looking for more flexible work arrangements in our manufacturing offices, we're going from what used to be about 30% people full time home, 65% full time in the office. The new model, which we'll be testing and learning from as we implement it, as the same 30% full time virtual at home, but the – and 5% permanently in the office, mailmen and people like that. But the middle group, 65% are in what the category is referred to as sort of flex role. And so the long-term employee model is in response to the experiences that we've had in COVID. And candidly, across America it's been quite surprising how well virtual has worked.

I'd also like to say that we have done a similar in-depth study of our distribution activities. And big picture, in the past, all of our distribution organizations led with in-person activities. And so, of the mix between in-person and virtual was probably 70/30. Big picture, moving forward, it'll be probably 40% in-person, 60% virtual. And with that comes a lot of economics. You can just imagine wholesalers who used to get in the car, drive 30 miles to somebody's office, give a presentation, get back in the car and go to another office, much of that is going to be eliminated.

So we think virtual is both on the manufacturing side as well as distribution, something that is going to set us on a very strong path. Our culture is strong already. We get very high engagement scores. We work with McKinsey understanding the way we work as an organization, we get some of the highest marks in America. So [audio gap] (00:09:06) this is another evolution of already a strong culture.

Now coming back to Spark, it's bigger than the Spark \$240 million and \$300 million in savings that I've just mentioned. And actually, Ellen was the co-lead on the development of that strategy. And Ellen, maybe you could just give us a couple of more points beyond cost saves what Spark is going to do for us?

**Ellen Gail Cooper**

*Executive Vice President & Chief Executive Officer-Elect, Lincoln National Corp.*

A

Absolutely. So the Spark Initiative, first of all, is really so much more than expense save program. And we worked for the better part of the year across the entire organization before we concluded the overall financial savings that we committed to. And the way that we really focused on this, we're really asking ourselves questions. And by the way, we had about 1,000 people across the organization that were involved in this. It was widely communicated and it was very much while we were working remotely in this environment. The entire organization was aware and, again, so many were part of it. And we really looked for were ways that we could improve the way that we work, that included being more efficient, thinking about modernization of technology, thinking about ways to improve the overall customer experience. And from there, what we did was we really captured a number of initiatives and ideas. We ran them through a very robust cost-benefit analysis. This was all Lincoln-led, it was supported by McKinsey in a very tight framework.

And then from there we went into a resource prioritization methodology and sequencing to really ensure that we could deliver on what we were committing to. And then from there, as Dennis mentioned, we incorporated this all into our financial plan. So we spent about a year in that process. We're now about six months into the implementation. We have high confidence that we will deliver on the numbers that we communicated to all of you. And again, really significant parts of this are around continuing to accelerate our digital and our overall automation and improvement of processes. And also, there is some significant opportunities in here in terms of talent development and way we work as well.

And so as we think about in particular Spark and just the question around head count, we really expect to be managing the bulk of this through just normal turnover which is typically what we've done with these kinds of programs in the past. So a significant amount of energy across the organization, a lot of buy-in and, as you know, we're also making a pretty sizable investment here to be able to deliver on some of these improvements and enhancements as we work through the Spark Initiative.

**Joshua Shanker**

*Analyst, BofA Securities, Inc.*

Q

Let's shift focus to the production side of things, and when – if you can talk a little about the VA market, for the past half-decade, a lot of competitors have been pulling out of the market. We've just had in the past few months the first material increase in interest rates in a very long time. What does a higher interest environment mean for the VA market? And can your competitors who exited the market for various reasons, is there any frictional costs to them change their mind and getting back in? How do you view the next five years, I suppose, of VA sales and Lincoln's role in it?

**Ellen Gail Cooper**

*Executive Vice President & Chief Executive Officer-Elect, Lincoln National Corp.*

A

Yeah. It's a great question, Josh. And I want to start by just taking a step back and saying that we have communicated with all of you and we are very much committed as it relates to our overall annuity portfolio and really across all of our product portfolios around broad product portfolio diversification. In annuity that is particularly focused on guaranteed living benefits. And so we shared with you that in the fourth quarter, the – when we look at the overall annuity account value, just to give you a sense of that diversification, the account value associated with guaranteed living benefit is now less than half – less than 50% of the overall account value. And when we look at sales in annuities in 2021, guaranteed living benefits represented about 25% which gets to broad overall diversification.

We know that a number of our competitors have exited and entered in and out of the market and one of the things and you all know that that I've been responsible also for running the annuity business, as I've talked to producers, one of the things that they value for – with us is around our consistency of really staying in the market. And additionally, when we look at our overall variable annuity guaranteed living benefit portfolio and we go a decade, we go even longer, we have always priced appropriately. We have always had strong risk management. We have hedged from the very beginning. We have always had strong ROEs. We've always had significant cash flow generation that comes from this business. We have never had a surprise as it relates to policyholder behavior, any kind of unlocking assumptions.

So, we feel really good about this business. And as a matter of fact when we think about our VA business, we actually think about the fact that the majority of our revenue is associated with fees on assets under management, which really suggest to us that we should think about our VA revenue stream effectively like an asset manager, and we've recognized that the business isn't valued that way, but that is the way that we think about it.

So, yes, interest rates are up from where they were before, and we think that that creates an opportunity here because the customer value proposition can be a little bit stronger than it's been. We will continue to offer really – achieve really solid returns on the business, mid-teens or even a little bit higher. And at the same time, we're going to continue to focus on this theme of diversity and we – we are really expecting to be targeting our guaranteed sales at about the level that you saw in 2021.

So, additionally as it relates to carriers that exit the market and reenter, one of the things as we talk to our distribution partners, we know that distribution firms have really become much more focused on prioritizing shelf space. It's just become a much bigger deal and a much bigger deal in terms of product offerings, and much of that has to do with the changing regulatory environment. And so, reentering and exiting the market and really getting back on the shelf is a difficult thing to do. It's not that it can't be done, but again it just gets to the point that we – we've heard over and over again that we're a market leader and that we get significant really credit from our distribution partners around the consistency and staying in the market.

And so, Josh, on the question about five-plus years from now, it's really hard to say what this market is going to look like five-plus years from now. As I reflect on the question, part of what I've thought about is what would we have said five years ago. Because I think the most important thing here is that we are extremely close to our distribution partners. We have all kinds of focus groups with advisors, with our overall wholesale distribution network, and we're constantly understanding and getting feedback around the customer value proposition and ensuring that we are developing solutions from a product manufacturing perspective that meet the needs of consumers. Five years ago, we didn't envision the IBA market, as an example, the buffered annuity and that is now a substantial part of our overall business, and we think that that's going to continue to grow. That's an example of something where principal protection with some level of downside while also having some ability to participate on equity market upside has really resonated with customers and also a younger age demographic. So it's really expanded the annuity playing field in terms of customer. So we're going to continue to stay in front of that and look for those opportunities as we think about annuities in the future and build the business for tomorrow.

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**Dennis R. Glass**

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

A

And let me just underscore a couple of key points that Ellen made, Josh, and that is, one, we've been in the VA business with living benefits for a long time. We have the most – one of the best risk-adjusted portfolios because we've been in the market consistently. And as Ellen said, there's no [indiscernible] (00:18:34). We've managed the hedge program well. This liability – guaranteed living benefit liability has all the characteristics of the type of

products that should drive high valuations, high cash flow conversion, high ROEs, good growth. So it's a good business. But to Ellen's point, it's a good business to about 25% of new sales.

Right now, the market is affording us returns on the living benefit business in the mid-20s, and we're not trying to build more volume. We're taking advantage of the opportunity of the competitive environment. So, just to add to that.

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**Joshua Shanker**

*Analyst, BofA Securities, Inc.*

Q

Saying with annuities a little bit during, you know, go back 12, 18 months ago, a lot of your more well-regarded competitors like you recall, back from the Fixed Annuity markets, but we did see a lot of activity and multiyear guarantees in fixed indexed annuities by lower-rated carriers who are filling the void with returns that I think might be called as hard to generate given where the interest rate environment is.

To what extent is that a persistent problem that as they'll always be offering rates that a company like Lincoln will just refuse to participate in and thinking about your producers, when they see these options of getting a better return for very plain vanilla Fixed Annuity product with a lower rated carrier, what's the conversation they have with their – with their customer in trying to say, look, you really want to take a low-rated carrier when you could be with Lincoln? How does that – how does that sort of conversation work?

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**Ellen Gail Cooper**

*Executive Vice President & Chief Executive Officer-Elect, Lincoln National Corp.*

A

Yeah, so, so, Josh we've been in the Fixed Annuity business for a long time, and we have strong conviction over the fact that we have disciplined risk management. So, for us that means we don't take excess credit risk, we are diligent around our asset liability management, around our liquidity stress testing, and all of that is the basis of the crediting rates that we ultimately provide and we also feel strongly about maintaining our financial strength as well. Our focus in the Fixed Annuity business has really been primarily in the brokerage channel and there, it's really much less about price sensitivity and it's more about providing a proprietary product, customized index options, and so, those are really the places that we have focused.

So, our producers are not – are not necessarily coming into play with some of the – the times where we were seeing more aggressive peers that are out there because those aren't the same distribution channels that we are playing in. So, we do think that overall, the fact that we know that our industry is highly regulated, we know that all are subject to the same capital rules et cetera, that even though there is some level of additional credit risk that we might be seeing from some of the players, if they're holding the appropriate capital, doing all the appropriate testing et cetera, that's important in terms of recognizing that potentially, there is a reasonable approach to risk for them as well.

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**Joshua Shanker**

*Analyst, BofA Securities, Inc.*

Q

Okay. Thank you. And I want just point out to everyone – they probably know, but you can always ask me questions to ask. Just type into Veracast and shoot me a question. Let's move on to credit a little bit and this is – I think that over the past decade, and there have been some credit scares here and there, but it does seem to me that you can never pick which is the next area to be of concern and credit and you learn from mistakes and you [ph] target those holes (00:22:42).

What is Lincoln doing right now to prepare itself for the next credit scare, whatever that may be? What did we learn from the past and how to best prepare for that which you don't know what's coming?

**Ellen Gail Cooper**

*Executive Vice President & Chief Executive Officer-Elect, Lincoln National Corp.*

A

Yes. So, as it relates to credit risk, we have a very deliberate, diligent credit risk management process. And the first thing is that we have a unique model here at Lincoln, and the investment team is responsible for overall portfolio construction and defining the investment strategy. And that is subject to understanding our liabilities or liability profiles in – at a credit risk that we are comfortable with et cetera. We then go out and we find the best managers and managers are responsible for selecting the individual securities subject to all of our risk limits, et cetera.

And what we find with that process is that in addition to managers selecting securities, managers also partner with us to do all types of individual credit scenario analysis to really look at when potentially an investment could deteriorate and either be downgraded, so therefore, we'd have to put more capital or even potentially default. And when we see that, we start to de-risk. And so, we have shared with all of you that over a period of the last five years, we have de-risked more than about \$6 billion of the portfolio and in particular, in the beginning of COVID, we did very focused individual de-risking analysis that was really around the most directly impacted sectors. And from there, we did an additional about \$1 billion plus de-risking, and we had shared all of that with you.

So, as we look at the portfolio today, we don't know when the next credit risk event will be. What we know is that the broad diversification and the discipline that we have around our stress testing and credit risk analysis is very important. The overall credit quality stands at 97% investment grade. That's the highest that I believe it's ever been historically, and we're just going to continue to remain diligent in any type of environment.

**Joshua Shanker**

*Analyst, BofA Securities, Inc.*

Q

Okay. I guess, I'm going to send this to Dennis. Let's talk about COVID and endemic COVID and the mortality. Now, there's a lot of talk that the population who survived COVID is healthier than the population who obviously, unfortunately, has passed in the past couple of years. What does that mean with mortality tables and for the profitability of the life of the business at Lincoln pricing? How should we think about all those things in terms of a post-COVID or endemic COVID reality?

**Dennis R. Glass**

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

A

Yeah. Great question, Joshua, and let's hope that we're seeing the end of this pandemic. It's caused so much heartbreak for so many families around the world. So, it will be great if it's behind us. Let me divide your question into the Individual Life business and then the Group Protection business in terms of the ongoing effects and pricing related to those two businesses.

So, in Individual Life, what we've been saying is that we think the significant incremental claims that we've experienced over the last 24 months related to COVID was really a pull-forward of mortality events that would have happened over the next 20 to 30 years and we're not changing our annual estimates of aggregate mortality claims in the Life business because of that. But essentially, it's a pull forward.

We don't think that we have to do anything specific with respect to pricing or our Individual Life business because I think [indiscernible] (00:26:58) going away. So, on the Individual Life, it's been a pull-forward, if [indiscernible]

(00:27:04) otherwise occurred, and we haven't made any pricing changes specifically related to COVID, again, because we think it's going to fade away hopefully. A little bit of a different story in Group Protection, everybody remembers that in the early stages of COVID, the age cohorts most affected by it were 60, 70 and older, and the working age cohorts sort of missed the first wave of this. Unfortunately, the second wave hit the working age cohorts. And so, in our Group Life business, we saw increases in our loss ratios both on the Life and on the Group Disability benefit ratios.

So, from a pricing perspective, because we expect – even though expect COVID to lessen over the next several years, we think it will still be a factor. So, to some extent, we're pricing for a little bit of ongoing COVID losses in the Group business. And so, a little bit of pricing change for COVID, but, again, from the company's perspective, hopefully, this is behind us by the end of 2022.

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**Joshua Shanker**

*Analyst, BofA Securities, Inc.*

Q

And so – and then, one other question, so, in terms of endemic COVID, we talk about we hope it's behind us. Do we – do we think that there is a – if the flu is 50,000 American lives per year, do we think it's reasonable to expect that COVID is a – is an additional factor on that that stays with us?

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**Dennis R. Glass**

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

A

Yeah, Josh, in the near – none of us – and I know that you know this, but none of us know what's going to happen with pandemic versus pandemic. We've unfortunately been surprised on the negative. Hopefully, we'll be surprised on the positive. Most importantly, in the Group area where we can reprice for the expectation there'll be lingering COVID impact on that business, we're doing that again on the Individual Life side, but we haven't changed pricing for COVID.

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**Joshua Shanker**

*Analyst, BofA Securities, Inc.*

Q

Let's shift to Group Retirement. And look, there's been a lot of transaction activity in Group Retirement among you and your competitors. It does feel, certainly there is a sense that it's an economies of scale business and some of your competitors are scaling up in a very big way. Do you think that this is a business that's dominated by very few competitors in a 5- or 10-year timeline? And when you think about Lincoln in the Group Retirement business, what makes Lincoln the right owner for that business that give it staying power and competitive edge?

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**Dennis R. Glass**

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

A

Yeah, Joshua, in our overall strategic thinking across our businesses we picked as well as distribution. So, in RPS, we concentrated on the following fastest growth – growing markets, small and mid-case 401K, healthcare, government and not-for-profit. And we have very good success in those segments. We don't try to go beyond those segments, we'll get some business, but we have a pretty good market position in each of those segments of the overall Retirement business.

With respect to scale and why we're a good owner, we're very good at managing cost. Our average cost per participant competes very well with the larger retirement companies that try to be all things to all segments. So, we're not at a disadvantage from a cost perspective. In the mid – small and mid-case 401K distribution channel, because of our significant participation in channels where these plans are sold, we sort of have an advantage because we do a lot of cross-selling. So, at Merrill Lynch, our Annuity wholesalers, cross-selling with our RPS

wholesalers and not only is that good for Lincoln, but it's good for Merrill because they get more business because of the presence that we have overall.

So, we choose our markets. We've had excellent results. We have very competitive ROAs and ROEs as compared to people who want to be across all businesses, but we think we're a great owner of this business and it's been one of our best – best performing businesses. Recently, I think we now have had seven consecutive years of positive net flows. So, everything about the business is positive and we expect it to continue to grow and be a big part of Lincoln's story.

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**Joshua Shanker**

*Analyst, BofA Securities, Inc.*

Q

Shifting gears a little, this is off-the-wall question, it's a question I talk about a lot. I think that the life insurance sector is very well prepared for inflation and higher rates should occur. I think that the higher rates problem this is a story people tend to understand, but when I try and find someone smarter than me to explain what inflation might be doing to a balance sheet of a strong life insurance company, I can't find a lot of takers who want to support my hypothesis, which is made with my half-baked knowledge of macroeconomics. I was hoping that maybe, maybe Ellen might have a view on inflation and what it means for Lincoln, should that [ph] VA versus (00:33:17) reality?

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**Ellen Gail Cooper**

*Executive Vice President & Chief Executive Officer-Elect, Lincoln National Corp.*

A

Well, Josh, my response is that higher inflation, in fact, can be beneficial for insurance companies. Of course, it depends on the level of inflation and the persistency of that inflation and what else is going on. But if we look at where we are right now in terms of, yes, we're having higher inflation, but yes, there's also a view that some of that inflation is still temporary and will work its way through the system.

We can look at some of the benefits that we really expect to be able to see as it relates to our opportunity set. So, the first one is that obviously we are seeing higher – we know an expectation of rate hikes on the shorter end and those expectations, coupled with higher inflation expectations, are leading to higher rates on the long end of the curve. So that means a couple of things for us. One is that the spread compression that we have talked about in the past, where we know it's been about a negative 2% to 3% headwind for us, and Randy mentioned in our earnings call that we would have an update shortly.

Well, with rates at these levels, you can expect that that headwind will reduce to about a minus 1% to 2% – minus 2% headwind. So that's an improvement just from the rate move that we have seen and what we expect going forward.

The second thing is that with rates at these levels when rates had fallen in early 2020 and we embarked on our product strategy that we've talked about around the reprice shift in add new, there were a number of our traditional product or long-duration product that just don't work well from a customer value proposition perspective in that interest rate environment. So, with rates at these levels, a number of those products will work well and also hit our target return. So that's another advantage.

And then the other thing that we also are seeing, and we expect to see more of is that we know that there's some level of wage inflation right now. That means that there are more dollars in the customer's pocket and we're already seeing evidence of higher deposits in our RPS business and higher dollars in people's pockets also mean coupled by the way with the fact that we are still unfortunately living through COVID, and there is a real need for

more financial protection and security. More dollars in people's pockets may lead to more opportunities in terms of sales and people recognizing that they need financial protection from a life insurance company.

So, we actually think that there is a fair amount of opportunity out there for us and we plan to capture on that.

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## Joshua Shanker

*Analyst, BofA Securities, Inc.*

Well, I have more questions, but I don't have more time. So, that's going to be it. I really appreciate you two spending time from your day. I hope you have a good day talking to investors and all the best. We'll be in touch and everybody online, stay tuned, we have Willis Towers, Watson, WTW coming up next. And Dennis, Ellen, thank you very much.

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## Dennis R. Glass

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

Josh, thanks very much.

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## Ellen Gail Cooper

*Executive Vice President & Chief Executive Officer-Elect, Lincoln National Corp.*

Thank you, Josh.

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## Joshua Shanker

*Analyst, BofA Securities, Inc.*

Bye-bye.

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