

LINCOLN NATIONAL CORP
Form 10-Q
May 10, 2007

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549**

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 31, 2007.

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____.

Commission File Number 1-6028

LINCOLN NATIONAL CORPORATION
(Exact name of registrant as specified in its charter)

Indiana
**(State or other jurisdiction of
incorporation or organization)**

35-1140070
**(I.R.S. Employer
Identification No.)**

1500 Market Street, Suite 3900, Philadelphia,
Pennsylvania
(Address of principal executive offices)

19102-2112
(Zip Code)

(215) 448-1400
Registrant's telephone number, including area code

Not Applicable
Former name, former address and former fiscal year, if changed since last report

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 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 No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

(Check one): Large accelerated filer Accelerated filer "Non- accelerated filer "

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes "No

As of May 1, 2007, there were 270,773,385 shares of the registrant's common stock outstanding.

Item 1. Financial Statements**LINCOLN NATIONAL CORPORATION
CONSOLIDATED BALANCE SHEETS**

	March 31, 2007 (Unaudited)	December 31, 2006
	(in millions)	
ASSETS		
Investments:		
Securities available-for-sale, at fair value:		
Fixed maturity (cost: 2007-\$55,268; 2006-\$54,960)	\$ 56,256	\$ 55,853
Equity (cost: 2007-\$682; 2006-\$681)	714	701
Trading securities	2,910	3,036
Mortgage loans on real estate	7,416	7,384
Real estate	406	421
Policy loans	2,767	2,760
Derivative investments	413	415
Other investments	967	918
Total investments	71,849	71,488
Cash and invested cash	900	1,621
Deferred acquisition costs and value of business acquired	8,535	8,420
Premiums and fees receivable	375	356
Accrued investment income	919	866
Amounts recoverable from reinsurers	8,132	7,939
Goodwill	4,521	4,500
Other assets	2,948	2,770
Assets held in separate accounts	83,147	80,534
Total assets	\$ 181,326	\$ 178,494
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Insurance and investment contract liabilities:		
Insurance policy and claim reserves	\$ 15,014	\$ 14,771
Investment contract and policyholder funds	58,729	58,817
Total insurance and investment contract liabilities	73,743	73,588
Short-term debt	593	658
Long-term debt:		
Senior notes	2,383	2,231
Junior subordinated debentures issued to affiliated trusts	155	155
Capital securities	1,571	1,072
Reinsurance related derivative liability	230	229
Funds withheld reinsurance liabilities	2,121	2,094
Deferred gain on indemnity reinsurance	741	760
Other liabilities	4,610	4,972
Liabilities related to separate accounts	83,147	80,534
Total liabilities	169,294	166,293

Commitments and Contingencies (See Note 9)**Shareholders' Equity**

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

Series A preferred stock-10,000,000 shares authorized (2007 liquidation value-\$1)		1		1
Common stock-800,000,000 shares authorized (shares issued and outstanding: 2007- 270,685,522; 2006- 275,752,668)		7,318		7,449
Retained earnings		4,054		4,138
Accumulated other comprehensive income:				
Net unrealized gain on securities available-for-sale		528		493
Net unrealized gain on derivative instruments		47		39
Foreign currency translation adjustment		168		165
Funded status of employee benefit plans		(84)		(84)
Total accumulated other comprehensive income		659		613
Total shareholders' equity		12,032		12,201
Total liabilities and shareholders' equity	\$	181,326	\$	178,494

See accompanying Notes to Consolidated Financial Statements

LINCOLN NATIONAL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended	
	March 31,	
	2007	2006
	(Unaudited)	
	(in millions, except per share amounts)	
Revenue		
Insurance premiums	\$ 459	\$ 78
Insurance fees	779	475
Investment advisory fees	90	78
Communications revenue (net)	67	-
Net investment income	1,090	678
Realized gain (loss)	26	(1)
Amortization of deferred gain on indemnity reinsurance	19	19
Other revenue and fees	140	95
Total revenue	2,670	1,422
Benefits and Expenses		
Benefits	1,194	582
Underwriting, acquisition, insurance and other expenses	805	503
Communications expense	41	-
Interest and debt expense	61	22
Total benefits and expenses	2,101	1,107
Income before taxes	569	315
Federal income taxes	173	94
Net income	\$ 396	\$ 221
Net Income Per Common Share		
Basic	\$ 1.44	\$ 1.27
Diluted	\$ 1.42	\$ 1.24

See accompanying Notes to Consolidated Financial Statements

LINCOLN NATIONAL CORPORATION
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Three Months Ended March 31,	
	2007	2006
	(Unaudited)	
	(in millions, except for share amounts)	
Series A Preferred Stock		
Balance at beginning-of-year	\$ 1	\$ 1
Balance at end-of-period	1	1
Common Stock		
Balance at beginning-of-year	7,449	1,775
Issued for acquisition	20	-
Stock compensation/issued for benefit plans	41	35
Deferred compensation payable in stock	3	8
Retirement of common stock	(195)	-
Balance at end-of-period	7,318	1,818
Retained Earnings		
Balance at beginning-of-year	4,138	4,082
Cumulative effect of adoption of SOP 05-1	(41)	-
Cumulative effect of adoption of FIN 48	(15)	-
Comprehensive income (loss)	442	(23)
Less other comprehensive income (loss) (net of Federal income tax):		
Net unrealized gain (loss) on securities available-for-sale, net of reclassification adjustment	35	(278)
Net unrealized loss on derivative instruments	8	28
Foreign currency translation adjustment	3	6
Net income	396	221
Retirement of common stock	(317)	-
Dividends declared:		
Common (2007-\$.395; 2006-\$.38)	(107)	(67)
Balance at end-of-period	4,054	4,236
Net Unrealized Gain on Securities Available-for-Sale		
Balance at beginning-of-year	493	497
Change during the period	35	(278)
Balance at end-of-period	528	219
Net Unrealized Gain on Derivative Instruments		
Balance at beginning-of-year	39	7
Change during the period	8	28
Balance at end-of-period	47	35
Foreign Currency Translation Adjustment		
Balance at beginning-of-year	165	83
Change during the period	3	6
Balance at end-of-period	168	89
Minimum Pension Liability Adjustment		
Balance at beginning-of-year	-	(60)
Balance at end-of-period	-	(60)
Funded Status of Employee Benefit Plans		
Balance at beginning-of-year	(84)	-
Balance at end-of-period	(84)	-

Total shareholders' equity at end-of-period	\$	12,032	\$	6,338
---	----	--------	----	-------

See accompanying Notes to Consolidated Financial Statements

LINCOLN NATIONAL CORPORATION
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

-CONTINUED-

	Three Months Ended March 31,	
	2007	2006
	(Unaudited)	
	(Number of Shares)	
Series A Preferred Stock		
Balance at beginning-of-year	12,706	15,515
Conversion into common stock	(180)	(550)
Balance at end-of-period	12,526	14,965
Common Stock		
Balance at beginning-of-year	275,752,668	173,768,078
Conversion of series A preferred stock	2,880	8,800
Stock compensation/issued for benefit plans	2,144,891	2,107,311
Retirement of common stock	(7,214,917)	-
Balance issued and outstanding at end-of-period	270,685,522	175,884,189
Common stock at end-of-period:		
Assuming conversion of preferred stock	270,885,938	176,123,629
Diluted basis	274,004,126	178,468,931

See accompanying Notes to Consolidated Financial Statements

LINCOLN NATIONAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended	
	March 31,	
	2007	2006
	(Unaudited)	
	(in millions)	
Cash Flows from Operating Activities		
Net income	\$ 396	\$ 221
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred acquisition costs and value of business acquired	(206)	(80)
Premiums and fees receivable	(19)	(20)
Accrued investment income	(53)	(6)
Policy liabilities and accruals	243	(9)
Net trading securities purchases, sales and maturities	126	(45)
Gain on reinsurance embedded derivative/trading securities	-	(6)
Contractholder funds	281	201
Pension plan contribution	-	(1)
Amounts recoverable from reinsurers	(193)	27
Federal income taxes	(186)	68
Stock-based compensation expense	15	9
Depreciation	13	14
Increase in funds withheld liability	27	46
Realized loss (gain) on investments and derivative instruments	(26)	7
Amortization of deferred gain	(19)	(19)
Other	70	(82)
Net adjustments	73	104
Net cash provided by operating activities	469	325
Cash Flows from Investing Activities		
Securities-available-for-sale:		
Purchases	(5,017)	(1,836)
Sales	3,705	1,285
Maturities	972	494
Purchase of other investments	(603)	(529)
Sale or maturity of other investments	514	569
Increase in cash collateral on loaned securities	(288)	(35)
Other	(124)	(69)
Net cash used in investing activities	(841)	(121)
Cash Flows from Financing Activities		
Payment of long-term debt	(314)	-
Issuance of long-term debt	749	-
Net increase (decrease) in short-term debt	150	(109)
Universal life and investment contract deposits	2,177	1,179
Universal life and investment contract withdrawals	(1,968)	(1,139)
Investment contract transfers	(574)	(432)
Common stock issued for benefit plans and excess tax benefits	52	26
Retirement of common stock	(512)	-
Dividends paid to shareholders	(109)	(67)

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

Net cash used in financing activities	(349)	(542)
Net decrease in cash and invested cash	(721)	(338)
Cash and invested cash at beginning-of-year	1,621	2,312
Cash and invested cash at end-of-period	\$ 900	\$ 1,974

See accompanying Notes to Consolidated Financial Statements

LINCOLN NATIONAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

Lincoln National Corporation and its majority-owned subsidiaries (“LNC” or the “Company,” which also may be referred to as “we”, “our” or “us”) operate multiple insurance and investment management businesses as well as a broadcasting and sports programming business through seven business segments (see Note 10). The collective group of businesses uses “Lincoln Financial Group” as its marketing identity. Through our business segments, we sell a wide range of wealth protection, accumulation and retirement income products and solutions. These products include institutional and/or retail fixed and indexed annuities, variable annuities, universal life insurance, variable universal life insurance, term life insurance, mutual funds and managed accounts. We report less than majority-owned entities in which we have at least a 20% interest on the equity basis.

The accompanying unaudited consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) for interim financial information and with the instructions for the Securities and Exchange Commission Quarterly Report on Form 10-Q, including Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. Therefore, the information contained in the notes to consolidated financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2006 (“2006 Form 10-K”) should be referred to in connection with the reading of these interim unaudited consolidated financial statements.

On April 3, 2006, we completed our merger with Jefferson-Pilot Corporation (“Jefferson-Pilot”), and have included the results of operations and financial condition of Jefferson-Pilot in our consolidated financial statements beginning on April 3, 2006. The unaudited consolidated financial statements for the three months ended March 31, 2006 exclude the results of operations and financial condition of Jefferson-Pilot.

In the opinion of management, these statements include all normal recurring adjustments necessary for a fair presentation of the results. Operating results for the three month period ended March 31, 2007 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2007. All material intercompany accounts and transactions have been eliminated in consolidation.

Certain amounts reported in prior periods’ unaudited consolidated financial statements have been reclassified to conform to the 2007 presentation. These reclassifications have no effect on net income or shareholders’ equity of the prior periods.

2. Changes in Accounting Principles and Changes in Estimates

Statement of Position 05-1 - Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts. In September 2005, the American Institute of Certified Public Accountants (“AICPA”) issued Statement of Position 05-1, “Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts” (“SOP 05-1”). SOP 05-1 provides guidance on accounting for deferred acquisition costs (“DAC”) on internal replacements of insurance and investment contracts. An internal replacement, defined by SOP 05-1, is a modification in product benefits, features, rights or coverages that occurs by the exchange of a contract for a new contract, or by amendment, endorsement or rider to a contract, or by the election of a feature or coverage within a contract. Contract modifications that result in a substantially unchanged contract will be accounted for as a continuation of the replaced contract. Contract modifications that result in a substantially changed contract should be accounted for as an extinguishment of the replaced contract. Unamortized DAC, unearned revenue and deferred sales inducements from the replaced contract

must be written-off. SOP 05-1 is effective for internal replacements occurring in fiscal years beginning after December 15, 2006.

We adopted SOP 05-1 effective January 1, 2007 by recording decreases to the following categories in our Consolidated Balance Sheets:

(in millions)

Assets

Deferred acquisition costs	\$	31
Value of business acquired		35
Other assets - deferred sales inducements		3
Total assets	\$	69

Liabilities and Shareholders' Equity

Investment contract and policyholder funds - deferred front end loads	\$	2
Insurance policy and claim reserves - guaranteed minimum death benefit annuity reserves		4
Other liabilities - income tax liabilities		22
Total liabilities		28
Retained earnings		41
Total liabilities and shareholders' equity	\$	69

The adoption of this new guidance primarily impacts our Individual Markets Annuities and Employer Markets Group Protection businesses, and our accounting policies regarding the assumptions for lapsation used in the amortization of DAC and value of business acquired (“VOBA”). In addition, the adoption of SOP 05-1 resulted in a \$6 million pre-tax increase to underwriting, acquisition, insurance and other expenses on our Consolidated Statements of Income in the first three months of 2007, which was attributable to changes in DAC and VOBA deferrals and amortization.

FASB Interpretation No. 48 - Accounting for Uncertainty in Income Taxes - an interpretation of FASB

Statement No. 109. In July 2006, the Financial Accounting Standards Board (“FASB”) issued FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109” (“FIN 48”). FIN 48 requires an entity to determine whether it is “more likely than not” that an individual tax position will be sustained upon examination by the appropriate taxing authority prior to any part of the benefit being recognized in the financial statements. The amount recognized would be the largest amount of tax benefit that is greater than fifty percent likely of being realized upon ultimate settlement, along with any related interest and penalties (if applicable). Upon adoption of FIN 48, the guidance will be applied to all tax positions, and only those tax positions meeting the “more likely than not” threshold will be recognized or continue to be recognized in the financial statements. In addition, FIN 48 expands disclosure requirements to include additional information related to unrecognized tax benefits, including accrued interest and penalties, and uncertain tax positions where the estimate of the tax benefit may change significantly in the next twelve months. FIN 48 is effective for fiscal years beginning after December 15, 2006. We adopted FIN 48 effective January 1, 2007 by recording an increase in the liability for unrecognized tax benefits of \$15 million in our Consolidated Balance Sheets, offset by a reduction to the beginning balance of retained earnings. See Note 4 for more information regarding our adoption of FIN 48.

SFAS No. 155 - Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements

No. 133 and 140. In February 2006, the FASB issued Statement of Financial Accounting Standards (“SFAS”) No. 155, “Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140” (“SFAS 155”), which permits fair value remeasurement for a hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. Under SFAS 155, an entity may make an irrevocable election to measure a hybrid financial instrument at fair value, in its entirety, with changes in fair value recognized in earnings. SFAS 155 also: (a) clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities” (“SFAS 133”); (b) eliminates the interim guidance

in SFAS 133 Implementation Issue No. D1, “Application of Statement 133 to Beneficial Interests in Securitized Financial Assets,” and establishes a requirement to evaluate beneficial interests in securitized financial assets to identify interests that are either freestanding derivatives or hybrid financial instruments that contain an embedded derivative requiring bifurcation; (c) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives; and (d) eliminates restrictions on a qualifying special-purpose entity’s ability to hold passive derivative financial instruments that pertain to beneficial interests that are or contain a derivative financial instrument.

In December 2006, the FASB issued Derivative Implementation Group Statement 133 Implementation Issue No. B40,

7

“Embedded Derivatives: Application of Paragraph 13(b) to Securitized Interests in Prepayable Financial Assets” (“DIG B40”). Since SFAS 155 eliminated the interim guidance related to securitized financial assets, DIG B40 provides a narrow scope exception for securitized interests that contain only an embedded derivative related to prepayment risk. Under DIG B40, a securitized interest in prepayable financial assets would not be subject to bifurcation if: (a) the right to accelerate the settlement of the securitized interest cannot be controlled by the investor and (b) the securitized interest itself does not contain an embedded derivative for which bifurcation would be required other than an embedded derivative that results solely from the embedded call options in the underlying financial assets. Any other terms in the securitized financial asset that may affect cash flow in a manner similar to a derivative instrument would be subject to the requirements of paragraph 13(b) of SFAS 133. The guidance in DIG B40 is to be applied upon the adoption of SFAS 155.

We adopted the provisions SFAS 155 and DIG B40 on January 1, 2007. Prior period restatement was not permitted. The adoption of SFAS 155 did not have a material impact on our consolidated financial condition or results of operations.

SFAS No. 157 - Fair Value Measurements. In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements” (“SFAS 157”), which establishes a framework for measuring fair value under current accounting pronouncements that require or permit fair value measurement. SFAS 157 retains the exchange price notion, but clarifies that exchange price is the price in an orderly transaction between market participants to sell the asset or transfer the liability in the most advantageous market for that asset or liability. Fair value measurement is based on assumptions used by market participants in pricing the asset or liability, which may include inherent risk, restrictions on the sale or use of an asset, or nonperformance risk which would include the reporting entity’s own credit risk. SFAS 157 establishes a three-level fair value hierarchy, which prioritizes the inputs to valuation techniques used to measure fair value. The highest priority is given to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs in situations where there is little or no market activity for the asset or liability. In addition, SFAS 157 expands the disclosure requirements for annual and interim reporting to focus on the inputs used to measure fair value, including those measurements using significant unobservable inputs, and the effects of the measurements on earnings. SFAS 157 will be applied prospectively and is effective for fiscal years beginning after November 15, 2007. Retrospective application is required for certain financial instruments as a cumulative effect adjustment to the opening balance of retained earnings. We expect to adopt SFAS 157 effective January 1, 2008, and are currently evaluating the effects of SFAS 157 on our consolidated financial condition and results of operations.

SFAS No. 159 - The Fair Value Option for Financial Assets and Financial Liabilities. In February 2007, the FASB issued SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities” (“SFAS 159”), which allows an entity to make an irrevocable election, on specific election dates, to measure eligible items at fair value. The election to measure an item at fair value may be determined on an instrument by instrument basis, with certain exceptions. If the fair value option is elected, unrealized gains and losses will be recognized in earnings at each subsequent reporting date, and any upfront costs and fees related to the item will be recognized in earnings as incurred. In addition, the presentation and disclosure requirements of SFAS 159 are designed to assist in the comparison between entities that select different measurement attributes for similar types of assets and liabilities. SFAS 159 applies to fiscal years beginning after November 15, 2007, with early adoption permitted for an entity that has also elected to apply the provisions of SFAS 157. At the effective date, the fair value option may be elected for eligible items that exist on that date. The effect of the first remeasurement to fair value shall be reported as a cumulative effect adjustment to the opening balance of retained earnings. We expect to adopt SFAS 159 effective January 1, 2008, and are currently evaluating the items to which we may apply the fair value option and the effect on our consolidated financial condition and results of operations.

3. Business Combination

On April 3, 2006, we completed our merger with Jefferson-Pilot by acquiring 100% of the outstanding shares of Jefferson-Pilot in a transaction accounted for under the purchase method of accounting prescribed by SFAS No. 141, "Business Combinations" ("SFAS 141"). Jefferson-Pilot's results of operations are included in our results of operations beginning April 3, 2006. As a result of the merger, our product portfolio was expanded, and we now offer fixed and variable universal life, fixed annuities, including indexed annuities, variable annuities, mutual funds and institutional accounts, 401(k) and 403(b) offerings, and group life, disability and dental insurance products. We also own and operate television and radio stations in selected markets in the Southeastern and Western United States and produce and distribute sports programming.

SFAS 141 requires that the total purchase price be allocated to the assets acquired and liabilities assumed based on their fair values at the merger date.

The aggregate consideration paid for the merger was as follows:

(in millions, except share data)	Share Amounts	
LNC common shares issued	112,301,906	
Purchase price per share of LNC common share ⁽¹⁾	\$ 48.98	
Fair value of common shares issued		\$ 5,501
Cash paid to Jefferson-Pilot shareholders		1,800
Fair value of Jefferson-Pilot stock options ⁽²⁾		151
Transaction costs		66
Total purchase price		\$ 7,518

⁽¹⁾ The value of the shares of LNC common stock exchanged with Jefferson-Pilot shareholders was based upon the average of the closing prices of LNC common stock for the five day trading period ranging from two days before, to two days after, October 10, 2005, the date the merger was announced.

⁽²⁾ Includes certain stock options that vested immediately upon the consummation of the merger. Any future income tax deduction related to these vested stock options will be recognized on the option exercise date as an adjustment to the purchase price and recorded to goodwill.

The fair value of Jefferson-Pilot's net assets assumed in the merger was \$4.2 billion. Goodwill of \$3.3 billion resulted from the excess of purchase price over the fair value of Jefferson-Pilot's net assets. The amount of goodwill that is expected to be deductible for tax purposes is approximately \$24 million. We paid a premium over the fair value of Jefferson-Pilot's net assets for a number of potential strategic and financial benefits that are expected to be realized as a result of the merger including, but not limited to, the following:

- Greater size and scale with improved earnings diversification and strong financial flexibility;
- Broader, more balanced product portfolio;
- Larger distribution organization; and
- Value creation opportunities through expense savings and revenue enhancements across business units.

The following table summarizes the fair values of the net assets acquired as of the acquisition date:

(in millions)	Fair Value	
Investments	\$	27,910
Due from reinsurers		1,296
Value of business acquired		2,486
Goodwill		3,324
Other assets		1,693
Assets held in separate accounts		2,574
Insurance and investment contract liabilities		(26,641)
Long-term debt		(905)
Income tax liabilities		(782)
Accounts payable, accruals and other liabilities		(863)
Liabilities related to separate accounts		(2,574)
Total purchase price	\$	7,518

The goodwill resulting from the merger was allocated to the following segments:

(in millions)

Individual Markets:		
Life Insurance	\$	1,318
Annuities		997
Total Individual Markets		2,315
Employer Markets: Group Protection		268
Lincoln Financial Media		741
Total goodwill	\$	3,324

The following table summarizes the fair value of identifiable intangible assets acquired in the merger and reported in other assets.

(in millions)			Weighted Average Amortization Period
Lincoln Financial Media:			
FCC licenses	\$	638	N/A
Sports production rights		11	5 years
Network affiliation agreements		10	21 years
Other		11	16 years
Total Lincoln Financial Media		670	
Individual Markets - Life Insurance:			
Sales force		100	25 years
Total indentifiable intangibles	\$	770	
Identifiable intangibles not subject to amortization	\$	638	N/A
Identifiable intangibles subject to amortization		132	22 years
Total identifiable intangibles	\$	770	

4. Federal Income Taxes

The effective tax rate was 30.4% and 29.7% for the first quarter of 2007 and 2006, respectively. Differences in the effective rates and the U.S. statutory rate of 35% are the result of certain tax preferred investment income, foreign tax credits and other tax preference items.

We are required to establish a valuation allowance for any gross deferred tax assets that are unlikely to reduce taxes payable in future years' tax returns. At March 31, 2007, we believe that it is more likely than not that all gross deferred tax assets will reduce taxes payable in future years.

As discussed in Note 2, we adopted FIN 48 on January 1, 2007, and as of this date we had unrecognized tax benefits of \$349 million of which \$143 million, if recognized, would impact the effective tax rate. Also, as of the adoption date, we had accrued interest expense related to the unrecognized tax benefits of \$51 million. We recognize interest and penalties, if any, accrued related to unrecognized tax benefits as a component of tax expense.

In the normal course of business we are subject to examination by taxing authorities throughout the United States and the United Kingdom. At any given time, we may be under examination by state, local or non-U.S. income tax authorities.

We are currently under audit by the Internal Revenue Service ("IRS"). LNC is currently under audit by the IRS for years 2003 and 2004. For the former Jefferson-Pilot Corporation and its subsidiaries, the IRS is examining the years 2004 and 2005. During the first quarter of 2006, the IRS completed its examination for the tax years 1999 through 2002 with assessments resulting in a payment that was not material to our consolidated results of operations. In addition to taxes assessed and interest, the payment included a deposit relating to a portion of the assessment, which we continue to challenge. We believe that this portion of the assessment is inconsistent with existing law and are protesting it through the established IRS appeals process. We do not anticipate that any adjustments that might result from such audits would be material to our consolidated results of operations or financial condition. It is likely that the IRS appeals process for the tax years 1996 to 1998 will conclude within the next twelve months. It is reasonably possible that a reduction in the unrecognized tax benefits may occur; however, quantification of an estimated range cannot be made at this time.

5. Supplemental Financial Data

A rollforward of DAC is as follows:

(in millions)	Three Months Ended	
	2007	2006
Balance at beginning-of-year	\$ 5,116	\$ 4,164
Cumulative effect of adoption of SOP 05-1	(31)	-
Deferral	473	245
Amortization	(194)	(148)
Adjustment related to realized gains on securities available-for-sale and derivatives	(13)	(11)
Adjustment related to unrealized (gains) losses on securities available-for-sale and derivatives	(15)	194
Foreign currency translation adjustment	2	5
Balance at end-of-period	\$ 5,338	\$ 4,449

A rollforward of VOBA is as follows:

(in millions)	Three Months Ended			
	March 31,			
	2007		2006	
Balance at beginning-of-year	\$	3,304	\$	999
Cumulative effect of adoption of SOP 05-1		(35)		-
Business acquired		14		-
Deferral of commissions and accretion of interest		15		-
Amortization		(88)		(17)
Adjustment related to realized gains on securities available-for-sale and derivatives		(5)		-
Adjustment related to unrealized gains on securities available-for-sale and derivatives		(10)		-
Foreign currency translation adjustment		2		2
Balance at end-of-period	\$	3,197	\$	984

Realized gains and losses on investments and derivative instruments on the Consolidated Statements of Income for the three months ended March 31, 2007 and 2006 are net of amounts amortized against DAC and VOBA of \$18 million and \$11 million, respectively. In addition, realized gains and losses for both the three months ended March 31, 2007 and 2006, are net of adjustments made to policyholder reserves of \$(2) million. We have either a contractual obligation or a consistent historical practice of making allocations of investment gains or losses to certain policyholders and to certain reinsurance arrangements.

A rollforward of deferred sales inducements, which is included in other assets on the Consolidated Balance Sheets, is as follows:

(in millions)	Three Months Ended			
	March 31,			
	2007		2006	
Balance at beginning-of-year	\$	194	\$	129
Cumulative effect of adoption of SOP 05-1		(3)		-
Deferral		23		16
Amortization		(8)		(5)
Balance at end-of-period	\$	206	\$	140

Details underlying underwriting, acquisition, insurance and other expenses on the Consolidated Statements of Income are as follows:

(in millions)	Three Months Ended			
	March 31,			
	2007		2006	
Commissions	\$	515	\$	242
General and administrative expenses		422		305
DAC and VOBA deferrals, net of amortization		(206)		(80)
Other intangibles amortization		4		2
Taxes, licenses and fees		66		34
Restructuring charges		4		-
Total	\$	805	\$	503

As discussed in Note 3, the excess of the purchase price for the Jefferson-Pilot merger over the fair value of net assets acquired totaled \$3.3 billion.

The following summarizes the changes in the carrying amount of goodwill by reportable segment for the three months ended March 31, 2007:

(in millions)	Balance at December 31, 2006	Purchase Accounting and Other Adjustments	Balance at March 31, 2007
Individual Markets:			
Life Insurance	\$ 2,181	\$ (9)	\$ 2,172
Annuities	1,032	9	1,041
Employer Markets:			
Retirement Products	20	-	20
Group Protection	281	(13)	268
Investment Management	262	-	262
Lincoln Financial Media	707	34	741
Lincoln UK	17	-	17
Total	\$ 4,500	\$ 21	\$ 4,521

Details of investment contract and policyholder funds on the Consolidated Balance Sheets are as follows:

(in millions)	March 31, 2007	December 31, 2006
Premium deposit funds	\$ 20,116	\$ 20,541
Other policyholder funds	37,492	37,197
Deferred front end loads	1,018	977
Undistributed earnings on participating business	103	102
Total	\$ 58,729	\$ 58,817

6. Insurance Benefit Reserves

We issue variable contracts through our separate accounts for which investment income and investment gains and losses accrue directly to, and investment risk is borne by, the contractholder (traditional variable annuities). We also issue variable annuity and life contracts through separate accounts that include various types of guaranteed minimum death benefit (“GMDB”), guaranteed minimum withdrawal benefit and guaranteed income benefit features. The GMDB features include those where we contractually guarantee to the contractholder either (a) return of no less than total deposits made to the contract less any partial withdrawals, (b) total deposits made to the contract less any partial withdrawals plus a minimum return, or (c) the highest contract value on any contract anniversary date through age 80 minus any payments or withdrawals following the contract anniversary.

The following table provides information on the GMDB features outstanding at March 31, 2007 and December 31, 2006. (Note that our variable contracts with guarantees may offer more than one type of guarantee in each contract; therefore, the amounts listed are not mutually exclusive). The net amount at risk is defined as the current guaranteed minimum death benefit in excess of the current account balance at the balance sheet date.

(dollars in billions)	In Event of Death	
	March 31, 2007	December 31, 2006
Return of Net Deposit		
Account value	\$ 39.6	\$ 38.3
Net amount at risk	0.1	0.1
Average attained age of contractholders	54	54
Return of Net Deposits Plus a Minimum Return		
Account value	\$ 0.4	\$ 0.4
Net amount at risk	-	-
Average attained age of contractholders	67	67
Guaranteed minimum return	5%	5%
Highest Specified Anniversary Account Value Minus Withdrawals Post Anniversary		
Account value	\$ 23.1	\$ 22.5
Net amount at risk	0.2	0.2
Average attained age of contractholders	64	64

The determination of the GMDB liabilities is based on models that involve a range of scenarios and assumptions, including those regarding expected market rates of return and volatility, contract surrender rates and mortality experience.

The following summarizes the liabilities for GMDB, which is recorded in insurance policy and claim reserves on our Consolidated Balance Sheets:

(in millions)	March 31, 2007	March 31, 2006
Balance at beginning of year	\$ 23	\$ 15
Cumulative effect of adoption of SOP 05-1	(4)	-
Changes in reserves	6	4
Benefits paid	(2)	(2)
Balance at end-of-period	\$ 23	\$ 17

The changes to the benefit reserves amounts above are reflected in benefits in the Consolidated Statements of Income.

Also included in benefits are the results of the hedging program, which included losses of less than \$1 million for GMDB for the three months ended March 31, 2007 and \$2 million for the same period in 2006.

Separate account balances attributable to variable annuity contracts with guarantees are as follows:

(in billions)	March 31, 2007	December 31, 2006
Asset Type		
Domestic equity	\$ 40.3	\$ 39.3
International equity	6.3	5.9
Bonds	6.8	6.4
Total	53.4	51.6
Money market	5.9	5.6
Total	\$ 59.3	\$ 57.2
Percent of total variable annuity separate account values	87%	87%

7. Employee Benefit Plans

Pension and Other Postretirement Benefit Plans

As a result of our merger with Jefferson-Pilot, we maintain funded defined benefit pension plans for the former U.S. employees and agents of Jefferson-Pilot. The components of net defined benefit pension plan and postretirement benefit plan expense are as follows:

(in millions)	Pension Benefits Three Months Ended March 31,		Other Postretirement Benefits Three Months Ended March 31,	
	2007	2006	2007	2006
U.S. Plans				
Service cost	\$ 9	\$ 5	\$ 1	\$ 1
Interest cost	16	9	2	1
Expected return on plan assets	(20)	(11)	(1)	-
Recognized net actuarial (gains) losses	-	1	-	-
Net periodic benefit expense	\$ 5	\$ 4	\$ 2	\$ 2
Non-U.S. Plans				
Interest cost	5	4		
Expected return on plan assets	(5)	(4)		
Recognized net actuarial losses	1	1		
Net periodic benefit expense	\$ 1	\$ 1		

See Note 13 for information on a change to our retirement benefits.

See Note 8 to the consolidated financial statements in our 2006 Form 10-K for a detailed discussion of our other benefit plans.

8. Stock-Based Incentive Compensation Plans

See Note 9 to the consolidated financial statements in our 2006 Form 10-K for a detailed discussion of stock and incentive compensation.

We have various incentive plans for our employees, agents and directors and our subsidiaries that provide for the issuance of stock options, stock incentive awards, stock appreciation rights, restricted stock awards, restricted stock

units (“performance shares”), and deferred stock units. Delaware Investments U.S., Inc. (“DIUS”) has a separate stock option incentive plan.

In the first quarter of 2007, a performance period from 2007-2009 was approved for our executive officers by the Compensation Committee. Executive officers participating in this performance period received one-half of their award in 10-year

15

LNC or DIUS stock options, with the remainder of the award in a combination of either: 100% performance shares or 75% performance shares and 25% cash. LNC stock options granted for this performance period vest ratably over the three-year period, based solely on a service condition. DIUS stock options granted for this performance period vest ratably over a four-year period, based solely on a service condition and were granted only to employees of DIUS. Depending on the performance, the actual amount of performance shares could range from zero to 200% of the granted amount. Under the 2007-2009 plan, a total of 725,161 LNC stock options were granted; 12,237 DIUS stock options were granted; and 126,879 LNC performance shares were granted.

In addition to the stock-based grants noted above, various other LNC stock-based awards were granted in the first quarter of 2007, which are summarized in the table below:

	Three Months Ended March 31, 2007
Awards	
10-year LNC stock options	348,888
Non-employee agent stock options	158,075
Restricted stock units	222,656
Stock appreciation rights	187,750

9. Restrictions, Commitments and Contingencies

See “Restrictions, Commitments and Contingencies” in Note 10 to the consolidated financial statements in our 2006 Form 10-K for a discussion of restrictions, commitments and contingencies, which information is incorporated herein by reference.

Guaranteed Investment Contracts

In December 2006, we invested \$400 million in a secured limited recourse note issued by a third-party segregated portfolio company. In April 2007, we invested \$200 million in a secured limited recourse note issued by the same portfolio company and \$250 million in a secured limited recourse note issued by a second portfolio company. These companies entered into a credit default swap with a third party providing credit protection in exchange for a fee. Defaults in the underlying reference portfolio will only affect the note if cumulative losses of a synthetic reference portfolio exceed the loss attachment point on the portfolio. We have determined that we are not the primary beneficiary, as we do not hold the majority of the risk of loss. Our maximum exposure to loss as a result of our involvement with these entities is our recorded investment of \$400 million as of March 31, 2007, and \$850 million as of April 2007.

10. Segment Information

In the quarter ended June 30, 2006, we completed our merger with Jefferson-Pilot and changed our management organization. We also realigned our reporting segments to reflect the current manner by which our chief operating decision makers view and manage the business. All segment data for reporting periods have been adjusted to reflect the current segment reporting. As a result of these changes, we provide products and services in five operating businesses: (1) Individual Markets, (2) Employer Markets, (3) Investment Management, (4) Lincoln UK and (5) Lincoln Financial Media, and report results through seven business segments.

We also have “Other Operations,” which includes the financial data for operations that are not directly related to the business segments, unallocated corporate items (such as investment income on investments related to the amount of statutory surplus in our insurance subsidiaries that is not allocated to our business units and other corporate investments, interest expense on short-term and long-term borrowings, and certain expenses, including restructuring and merger-related expenses), along with the ongoing amortization of deferred gain on the indemnity reinsurance portion of the transaction with Swiss Re. Other Operations also includes the eliminations of intercompany transactions and the inter-segment elimination of the investment advisory fees for asset management services the Investment Management segment provides to Individual Markets and Employer Markets.

Segment operating revenue and income (loss) from operations are internal measures used by our management and Board of Directors to evaluate and assess the results of our segments. Operating revenue is GAAP revenue excluding realized gains and losses on investments and derivative instruments, gains and losses on reinsurance embedded derivative/trading securities, gains and losses on sale of subsidiaries/businesses and the amortization of deferred gain arising from reserve development on business sold through reinsurance. Income (loss) from operations is GAAP net income excluding net realized investment gains and losses, losses on early retirement of debt, reserve development net of related amortization on business sold through reinsurance and

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

cumulative effect of accounting changes. Our management and Board of Directors believe that operating revenue and income (loss) from operations explain the results of our ongoing businesses in a manner that allows for a better understanding of the underlying trends in our current businesses because net realized investment gains and losses, reserve development net of related amortization on business sold through reinsurance and cumulative effect of accounting changes are unpredictable and not necessarily indicative of current operating fundamentals or future performance of the business segments, and in many instances, decisions regarding these items do not necessarily relate to the operations of the individual segments. Operating revenue and income (loss) from operations do not replace revenues and net income as the GAAP measures of our consolidated results of operations.

The following table shows financial data by segment:

(in millions)	Three Months Ended	
	March 31,	
	2007	2006
Revenue		
Segment operating revenue		
Individual Markets:		
Annuities	\$ 605	\$ 375
Life Insurance	971	500
Total Individual Markets	1,576	875
Employer Markets:		
Retirement Products	359	306
Group Protection	361	-
Total Employer Markets	720	306
Investment Management ⁽¹⁾	150	140
Lincoln UK	91	70
Lincoln Financial Media ⁽²⁾	67	-
Other Operations	75	61
Consolidating adjustments	(35)	(29)
Net realized investment results ⁽³⁾	26	(1)
Revenue	\$ 2,670	\$ 1,422
Net Income		
Segment operating income		
Individual Markets:		
Annuities	\$ 121	\$ 66
Life Insurance	167	69
Total Individual Markets	288	135
Employer Markets:		
Retirement Products	64	60
Group Protection	23	-
Total Employer Markets	87	60
Investment Management	16	15
Lincoln UK	11	11
Lincoln Financial Media	12	-
Other Operations	(35)	-
Net realized investment results ⁽⁴⁾	17	-
Net income	\$ 396	\$ 221

- (1) Revenues for the Investment Management segment include inter-segment revenues for asset management services provided to our other segments. These inter-segment revenues totaled \$25 million for both the three months ended March 31, 2007 and 2006.
- (2) Lincoln Financial Media revenues are net of \$8 million of commissions paid to agencies for the three months ended March 31, 2007.
- (3) Includes realized gains (losses) on investments of \$26 million and \$(11) million for the three months ended March 31, 2007 and 2006, respectively; realized gains on derivative instruments of \$4 million for the three months ended March 31, 2006; and gains on reinsurance embedded derivative/trading securities of \$6 million for the three months ended March 31, 2006.
- (4) Includes realized gains (losses) on investments of \$17 million and \$(6) million for the three months ended March 31, 2007 and 2006; realized gains on derivative instruments of \$2 million for the three months ended March 31, 2006; and gains on reinsurance embedded derivative/trading securities of \$4 million for the three months ended March 31, 2006.

11. Earnings Per Share

The income used in the calculation of our diluted earnings per share is our income before cumulative effect of accounting change and net income, reduced by minority interest adjustments related to outstanding stock options under the DIUS stock option incentive plan of less than \$1 million for all periods presented.

A reconciliation of the denominator in the calculations of basic and diluted net income and income before cumulative effect of accounting change per share is as follows:

	Three Months Ended	
	March 31,	
	2007	2006
Denominator: [number of shares]		
Weighted-average shares, as used in basic calculation	274,889,645	174,577,421
Shares to cover conversion of preferred stock	200,960	243,371
Shares to cover non-vested stock	1,148,067	1,560,646
Average stock options outstanding during the period	14,322,952	8,850,988
Assumed acquisition of shares with assumed proceeds and benefits from exercising stock options (at average market price for the year).	(12,137,623)	(7,778,439)
Shares repurchaseable from measured but unrecognized stock option expense	(255,647)	(824,764)
Average deferred compensation shares	1,308,460	1,300,430
Weighted-average shares, as used in diluted calculation	279,476,814	177,929,653

In the event the average market price of LNC common stock exceeds the issue price of stock options, such options would be dilutive to our earnings per share and will be shown in the table above. Participants in our deferred compensation plans that select LNC stock for measuring the investment return attributable to their deferral amounts will be paid out in LNC stock. The obligation to satisfy these deferred compensation plan liabilities is dilutive and is shown in the table above.

12. Restructuring Charges

2006 Restructuring Plan

Upon completion of the merger with Jefferson-Pilot, we implemented a restructuring plan relating to the integration of our legacy operations with those of Jefferson-Pilot. The realignment will enhance productivity, efficiency and scalability while positioning us for future growth.

The following is the detail of the reserve for restructuring charges:

(in millions)	Total
Restructuring reserve at December 31, 2006	\$ 8
Amounts incurred in the first three months of 2007	
Employee severance and termination benefits	1
Other	3
Total 2007 restructuring charges	4
Amounts expended in the first three months of 2007	(6)
Restructuring reserve at March 31, 2007	\$ 6
Additional amounts expended in the first three months of 2007 that do not qualify as restructuring charges	\$ 10
Total expected costs	180
	4th Quarter 2009
Expected completion date	

The total expected costs include both restructuring charges and additional expenses that do not qualify as restructuring charges that are associated with the integration activities. In addition, involuntary employee termination benefits were recorded in goodwill as part of the purchase price allocation (see Note 3). Merger integration costs relating to employee severance and termination benefits of \$13 million were included in other liabilities in the purchase price allocation in 2006. The remaining liability balance at December 31, 2006 was \$3 million. In the first quarter of 2007, an additional \$8 million was recorded to goodwill and other liabilities as part of the final adjustment to the purchase price allocation related to employee severance and termination benefits. Through March 31, 2007 approximately \$13 million of these costs were incurred and the remaining liability balance at March 31, 2007 was \$8 million.

Restructuring charges for this plan in the first three months of 2007 were included in underwriting, acquisition, insurance and other expenses within Other Operations on the Consolidated Statements of Income.

13. Subsequent Event

On May 1, 2007, we announced plans to change the retirement benefits provided to employees, which include replacing traditional pension retirement benefits with a new defined contribution plan beginning January 1, 2008. This prospective change in benefits will not impact any of the pension retirement benefits that have already accrued to employees. On January 1, 2008, retirement benefits for employees will begin accruing through the new defined contribution plan. This change is not expected to be material to our future earnings, but will result in a one-time curtailment gain of \$9 million (\$6 million after-tax) in the second quarter of 2007, which will be reported within Other Operations.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following is a discussion of the financial condition of Lincoln National Corporation and its consolidated subsidiaries ("LNC" or the "Company" which also may be referred to as "we" or "us") as of March 31, 2007, compared with December 31, 2006, and the results of operations of LNC for the three months ended March 31, 2007 and 2006. On April 3, 2006, LNC completed its merger with Jefferson-Pilot Corporation (Jefferson-Pilot). Beginning on April 3, 2006, the results of operations and financial condition of Jefferson-Pilot, after being adjusted for the effects of purchase accounting, were consolidated with LNC's. As part of the merger, we realigned our businesses to conform to the way we intend to manage and assess our business going forward. Accordingly, all prior period segment results have been adjusted to reflect the new segmentation. The financial information presented herein for the three months ended March 31, 2006, reflects only the accounts of LNC. The balance sheet information presented below is as of March 31, 2007 and December 31, 2006. The statement of operations information is for the three months ended March 31 for each respective year.

For more information regarding the completion of the merger, including the calculation and allocation of the purchase price, see Note 3 to the consolidated financial statements in this Form 10-Q.

This discussion and analysis should be read in conjunction with our consolidated financial statements and notes thereto presented in "Item 1" ("consolidated financial statements") and "Item 7 Management's Discussion and Analysis of Financial Condition, Results of Operations" ("MD&A"), "Item 1A Risk Factors" and "Item 8 Consolidated Financial Statements" in our latest annual report on Form 10-K for the year ended December 31, 2006 ("2006 Form 10-K").

This report contains certain financial information determined by methods other than in conformity with accounting principles generally accepted in the United States of America ("GAAP"). In addition to providing consolidated revenues and net income (loss), we also provide segment operating revenue and income (loss) from operations because we believe they are meaningful measures of revenues and the profit or loss generated by our operating segments. Operating revenue is GAAP revenue excluding realized gains and losses on investments and derivative instruments, gains and losses on reinsurance embedded derivative/trading securities, gains and losses on sale of subsidiaries/businesses and the amortization of deferred gain arising from reserve development on business sold through reinsurance. Income (loss) from operations is GAAP net income excluding net realized investment gains and losses, losses on early retirement of debt, reserve development net of related amortization on business sold through reinsurance and cumulative effect of accounting changes. Operating revenue and income (loss) from operations are the financial performance measures we use to evaluate and assess the results of our segments. Accordingly, we report operating revenue and income (loss) from operations by segment in Note 10 to our unaudited consolidated financial statements. Our management and Board of Directors believe that operating revenue and income (loss) from operations explain the results of our ongoing businesses in a manner that allows for a better understanding of the underlying trends in our current businesses because net realized investment gains and losses, reserve development net of related amortization on business sold through reinsurance and cumulative effect of accounting changes are unpredictable and not necessarily indicative of current operating fundamentals or future performance of the business segments, and in many instances, decisions regarding these items do not necessarily relate to the operations of the individual segments. Operating revenue and income (loss) from operations do not replace revenues and net income as the GAAP measures of our consolidated results of operations.

Certain reclassifications have been made to prior periods' financial information to conform to the 2007 presentation.

Forward-Looking Statements—Cautionary Language

Certain statements made in this report and in other written or oral statements made by LNC or on LNC's behalf are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 ("PSLRA"). A forward-looking statement is a statement that is not a historical fact and, without limitation, includes any statement

that may predict, forecast, indicate or imply future results, performance or achievements, and may contain words like: “believe”, “anticipate”, “expect”, “estimate”, “project”, “will”, “shall” and other words or phrases with similar meaning in connection with a discussion of future operating or financial performance. In particular, these include statements relating to future actions, prospective services or products, future performance or results of current and anticipated services or products, sales efforts, expenses, the outcome of contingencies such as legal proceedings, operations, trends or financial results. LNC claims the protection afforded by the safe harbor for forward-looking statements provided by the PSLRA.

Forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from the results contained in the forward-looking statements. Risks and uncertainties that may cause actual results to vary materially, some of which are described within the forward-looking statements include, among others:

- . Problems arising with the ability to successfully integrate our and Jefferson-Pilot’s businesses, which may affect our

ability to operate as effectively and efficiently as expected or to achieve the expected synergies from the merger or to achieve such synergies within our expected timeframe;

- Legislative, regulatory or tax changes, both domestic and foreign, that affect the cost of, or demand for, LNC's products, the required amount of reserves and/or surplus, or otherwise affect our ability to conduct business, including changes to statutory reserves and/or risk-based capital requirements related to secondary guarantees under universal life and variable annuity products such as Actuarial Guideline VACARVM; restrictions on revenue sharing and 12b-1 payments; and the potential for U.S. Federal tax reform;
- The initiation of legal or regulatory proceedings against LNC or its subsidiaries and the outcome of any legal or regulatory proceedings, such as: (a) adverse actions related to present or past business practices common in businesses in which LNC and its subsidiaries compete; (b) adverse decisions in significant actions including, but not limited to, actions brought by federal and state authorities, and extra-contractual and class action damage cases; (c) new decisions that result in changes in law; and (d) unexpected trial court rulings;
- Changes in interest rates causing a reduction of investment income, the margins of LNC's fixed annuity and life insurance businesses and demand for LNC's products;
- A decline in the equity markets causing a reduction in the sales of LNC's products, a reduction of asset fees that LNC charges on various investment and insurance products, an acceleration of amortization of deferred acquisition costs ("DAC"), value of business acquired ("VOBA"), deferred sales inducements ("DSI") and deferred front-end loads ("DFEL") and an increase in liabilities related to guaranteed benefit features of LNC's variable annuity products;
- Ineffectiveness of LNC's various hedging strategies used to offset the impact of declines in and volatility of the equity markets;
- A deviation in actual experience regarding future persistency, mortality, morbidity, interest rates or equity market returns from LNC's assumptions used in pricing its products, in establishing related insurance reserves, and in the amortization of intangibles that may result in an increase in reserves and a decrease in net income, including as a result of investor-owned life insurance business;
- Changes in accounting principles generally accepted in the United States ("GAAP") that may result in unanticipated changes to LNC's net income, including the impact of adopting Statements of Financial Accounting Standard 157 and 159;
- Lowering of one or more of LNC's debt ratings issued by nationally recognized statistical rating organizations, and the adverse impact such action may have on LNC's ability to raise capital and on its liquidity and financial condition;
- Lowering of one or more of the insurer financial strength ratings of LNC's insurance subsidiaries and the adverse impact such action may have on the premium writings, policy retention, and profitability of its insurance subsidiaries;
- Significant credit, accounting, fraud or corporate governance issues that may adversely affect the value of certain investments in the portfolios of LNC's companies requiring that LNC realize losses on such investments;

- The impact of acquisitions and divestitures, restructurings, product withdrawals and other unusual items, including LNC's ability to integrate acquisitions and to obtain the anticipated results and synergies from acquisitions;
- The adequacy and collectibility of reinsurance that LNC has purchased;
- Acts of terrorism, war, or other man-made and natural catastrophes that may adversely affect LNC's businesses and the cost and availability of reinsurance;
- Competitive conditions, including pricing pressures, new product offerings and the emergence of new competitors, that may affect the level of premiums and fees that LNC can charge for its products;
- The unknown impact on LNC's business resulting from changes in the demographics of LNC's client base, as aging baby-boomers move from the asset-accumulation stage to the asset-distribution stage of life;
- Loss of key management, portfolio managers in the Investment Management segment, financial planners or wholesalers; and
- Changes in general economic or business conditions, both domestic and foreign, that may be less favorable than expected and may affect foreign exchange rates, premium levels, claims experience, the level of pension benefit costs and funding, and investment results.

The risks included here are not exhaustive. Other sections of this report and LNC's annual report on Form 10-K, current reports on Form 8-K and other documents filed with the SEC include additional factors which could impact LNC's business and financial performance. Moreover, LNC operates in a rapidly changing and competitive environment. New risk factors emerge from time to time and it is not possible for management to predict all such risk factors.

Further, it is not possible to assess the impact of all risk factors on LNC's business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results. In addition, LNC disclaims any obligation to update any forward-looking statements to reflect events or circumstances that occur after the date of this report.

INTRODUCTION

Executive Summary

We are a holding company that operates multiple insurance and investment management businesses as well as broadcasting and sports programming business through subsidiary companies. Through our business segments, we sell a wide range of wealth protection, accumulation and retirement income products and solutions. These products include institutional and/or retail fixed and indexed annuities, variable annuities, universal life insurance, variable universal life insurance, linked-benefit universal life, term life insurance, mutual funds and managed accounts.

We provide products and services in five operating businesses: (1) Individual Markets, (2) Employer Markets, (3) Investment Management, (4) Lincoln UK and (5) Lincoln Financial Media, and are reporting results through seven business segments. These operating businesses and their segments are described in "Part I--Item 1--Business" of the 2006 Form 10-K.

Our strategic intent is to be "The Retirement Income Security Company". Retirement income security represents all of the risks at various stages of the wealth management cycle, not just the risk of outliving income during retirement. We believe that the baby-boomer generation reaching retirement age will present an emerging opportunity for companies like ours that offer products allowing baby-boomers to better manage their wealth accumulation, retirement income and wealth transfer needs.

In 2007, we are launching a larger, unified product suite available to our distribution force. To this end and as discussed further below under "Recent Developments," we reorganized our insurance subsidiaries by merging several insurance subsidiaries.

During 2007 we expect our major challenges to include:

- The continued, successful integration of the Jefferson-Pilot businesses and the success of our new unified product portfolio.
- While recent increases in long-term rates have eased pressure on spreads, a continuation of the low interest rate environment creates a challenge for our products that generate investment margin profits, such as fixed annuities and universal life insurance.
- The ability to generate tangible results from Retirement Income Security Ventures ("RISV").
- The continued, successful expansion of our wholesale distribution businesses.

- The ability to improve financial results and sales growth in Employer Markets.
- The continuation of competitive pressures in the life insurance marketplace, increased regulatory scrutiny of the life and annuity industry, which may lead to higher product costs and negative perceptions about the industry.
- Continued focus by the government on tax reform, which may impact our products.

In the face of these challenges, there are three key themes that will influence our actions and decisions throughout 2007:

- Taking market share. We are making sizeable investments in distribution throughout the organization, recognizing that sales growth is driven by our ability to maintain a strong presence in our key accounts and distribution channels.
- Jumpstarting our RISV. The focus of this cadre of insurance professionals is to rethink the products, delivery systems and customer servicing that will address the emerging needs of the baby boomers.

Embedding financial and execution discipline in our operations. We are making significant investments in operating efficiencies while integrating and consolidating systems and processes across the organization. Investment decisions will be evaluated based on a comprehensive metrics-based approach.

Recent Developments

On March 8, 2007, we sold \$500 million aggregate principal amount of our 6.05% Capital Securities due April 20, 2067. Additionally, we sold \$250 million aggregate principal amount of our Floating Rate Senior Notes due March 12, 2010.

On March 14, 2007, we entered into an agreement to purchase shares of our common stock for an aggregate purchase price of \$350 million under an accelerated stock buyback program. Pursuant to the agreement, the minimum number of shares to be purchased has been set at approximately 4.8 million while the maximum is approximately 5.9 million. On March 19, 2007, approximately 4.8 million shares were delivered to us. Additional shares may be delivered to us at the end of the program, depending on the price of our shares during the remainder of the program, which is expected to conclude in the third quarter of 2007.

As part of our continuing merger integration, on April 2, 2007, we completed the merger of one of our wholly owned insurance subsidiaries, Jefferson-Pilot Life Insurance Company, a North Carolina domiciled insurer, with and into The Lincoln National Life Insurance Company ("LNL"), an Indiana domiciled insurer. LNL remains an Indiana domiciled insurer. We also completed the merger of Jefferson Pilot LifeAmerica Insurance Company ("JPLA"), a New Jersey domiciled insurer, and Lincoln Life & Annuity Company of New York, a New York domiciled insurer. JPLA has been redomiciled to New York and renamed Lincoln Life & Annuity Company of New York ("LLANY").

On April 2, 2007 we announced the introduction of our new Unified Product Portfolio (UPP), a wide array of life insurance, annuity and linked benefit products. We expect to phase in UPP over the next few months, with fixed products being the first to market. These include universal life products and fixed and indexed annuities. We expect to launch variable products, including variable annuities and variable universal life, and term products during this summer. Our new product portfolio will offer solutions to baby boomers no matter where they may be in the wealth management cycle.

On May 1, 2007 we announced plans to change the retirement benefits provided to employees, which include replacing traditional pension retirement benefits with a new defined contribution plan beginning January 1, 2008. For additional details, see Note 13 of our consolidated financial statements.

During the first quarter of 2007, we called for redemption \$312 million in long-term debt with interest rates ranging from 8.14% to 8.285%.

For a description of the sales and redemptions, see "Review of Consolidated Financial Condition - Liquidity and Capital Resources" below.

Critical Accounting Policies

The MD&A included in our 2006 Form 10-K contains a detailed discussion of our critical accounting policies. The following information updates the critical accounting policies provided in the 2006 Form 10-K.

Deferred Acquisition Costs, Value of Business Acquired, Deferred Sales Inducements and Deferred Front-End Loads

In September 2005, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants (“AICPA”) issued Statement of Position (“SOP”) 05-1, “Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts” (“SOP 05-1”). SOP 05-1 addresses the accounting for DAC on internal replacements other than those described in SFAS No. 97, “Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments.” An internal replacement is defined by SOP 05-1 as a modification in product benefits, features, rights or coverages that occurs by (a) exchanging the contract for a new contract, (b) amending, endorsing or attaching a rider to the contract, or (c) electing a feature or coverage within a contract. Contract modifications that result in a substantially unchanged contract will be accounted for as a continuation of the replaced contract. Contract modifications that result in a substantially changed contract should be accounted for as an extinguishment of the replaced contract, and any unamortized DAC, unearned revenue and deferred sales charges must be written-off. SOP 05-1 is to be applied prospectively and is effective for internal replacements occurring in fiscal years beginning

after December 15, 2006.

For a detailed discussion of the cumulative effect of adoption of SOP 05-1 recorded to our January 1, 2007 Consolidated Balance Sheets, see Note 2 of our consolidated financial statements. The adoption of this new guidance primarily impacts our Individual Markets Annuities and Employer Markets Group Protection businesses, and our accounting policies regarding the assumptions for lapsation used in the amortization of DAC and VOBA. In addition, the adoption of SOP 05-1 resulted in a \$6 million, pre-tax, increase to underwriting, acquisition, insurance and other expenses in the first three months of 2007, which was attributable to changes in DAC and VOBA deferrals and amortization. The impact is expected to be approximately \$14 million, pre-tax, for the remainder of 2007. In addition, due to the changes in our GMDB annuity reserves and DSI, we expect benefits to increase by approximately \$2 million, pre-tax, for the twelve months ended December 31, 2007. The impact on amortization of DFEL is expected to be less than \$1 million.

As equity markets do not move in a systematic manner, we use a “reversion to the mean” (“RTM”) process to compute our best estimate long-term gross growth rate assumption. Under our current RTM process, on each valuation date, future EGPs are projected using stochastic modeling of a large number of future equity market scenarios in conjunction with best estimates of lapse rates, interest rate spreads and mortality to develop a statistical distribution of the present value of future EGPs for each of the blocks of business. Because future equity market returns are impossible to predict, the underlying premise of this process is that best estimate projections of future EGPs, as required by Statement of Financial Accounting Standards (“SFAS”) No. 97, “Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments”, need not be affected by random short-term and insignificant deviations from expectations in equity market returns. However, long-term or significant deviations from expected equity market returns require a change to best estimate projections of EGPs and prospective unlocking of DAC, VOBA, DSI and DFEL. The statistical distribution is designed to identify when the equity market return deviations from expected returns have become significant enough to warrant a change of the future equity return EGP assumption. For more information about the implications of declines and advances in equity markets and our RTM process, see “Part II - Item 7 - Critical Accounting Policies” in our 2006 Form 10-K.

The table below presents the balances by business segment as of March 31, 2007.

March 31, 2007 (in millions)	Individual Markets		Employer Markets			Total
	Life Annuities	Life Insurance	Retirement Products	Group Protection	Lincoln UK	
DAC and VOBA	\$ 2,082	\$ 4,796	\$ 750	\$ 104	\$ 803	\$ 8,535
DSI	206	-	-	-	-	206
Total DAC, VOBA and DSI	2,288	4,796	750	104	803	8,741
DFEL	105	491	22	-	400	1,018
Net DAC, VOBA, DSI and DFEL	\$ 2,183	\$ 4,305	\$ 728	\$ 104	\$ 403	\$ 7,723

Derivatives

Guaranteed Minimum Withdrawal and Guaranteed Income Benefits

The Individual Markets Annuity segment has a hedging strategy designed to mitigate the risk and income statement volatility caused by changes in the equity markets, interest rates, and volatility associated with the Lincoln Smart SecuritySM Advantage GMWB feature and our i4LIFE[®] Advantage GIB feature that is available in our variable annuity products. The hedging strategy is designed such that changes in the value of the hedge contracts move in the opposite direction of changes in the value of the embedded derivative of the GMWB and GIB. This dynamic hedging

strategy utilizes U.S.-based and international equity futures and options as well as interest rate futures and swaps. The notional amounts of the underlying hedge instruments are such that the magnitude of the change in the value of the hedge instruments due to changes in equity markets, interest rates, and implied volatilities is designed to offset the magnitude of the change in the fair value of the GMWB and GIB guarantees caused by those same factors. At March 31, 2007, the embedded derivative for GMWB was an asset valued at \$63 million and the embedded derivative for i4LIFE® Advantage GIB was an asset valued at \$16 million.

Income Taxes

Management uses certain assumptions and estimates in determining income taxes payable or refundable for the current year, deferred income tax liabilities and assets for events recognized differently in its financial statements and income tax returns, and federal income tax expense. Determining these amounts requires analysis of certain transactions and interpretation of tax laws and regulations. Management exercises considerable judgment in evaluating the amount and timing of recognition of the resulting

income tax liabilities and assets. These judgments and estimates are re-evaluated on a continual basis as regulatory and business factors change.

We adopted FASB Interpretation No. 48, - "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement 109" ("FIN 48") effective January 1, 2007 and recorded an increase in the liability for unrecognized tax benefits of \$15 million in our Consolidated Balance Sheets, offset by a reduction to the beginning balance of retained earnings with no impact on net income. FIN 48 established criteria for recognizing or continuing to recognize only more-likely-than tax positions, which may result in federal income tax expense volatility in future periods. While we believe we have adequately provided for all tax positions, amounts asserted by taxing authorities could be greater than our accrued position. Accordingly, additional provisions on federal and foreign tax-related matters could be recorded in the future as revised estimates are made or the underlying matters are settled or otherwise resolved. For a detailed discussion of FIN 48, see Note 2 and Note 4 of our consolidated financial statements.

RESULTS OF CONSOLIDATED OPERATIONS

(in millions)	Three Months Ended		Increase (Decrease)
	2007	March 31, 2006	
Insurance premiums	\$ 459	\$ 78	NM
Insurance fees	779	475	64%
Investment advisory fees	90	78	15%
Communications revenue (net)	67	-	NM
Net investment income	1,090	678	61%
Amortization of deferred gain on indemnity reinsurance	19	19	0%
Other revenues and fees	140	95	47%
Realized gain (loss)	26	(1)	NM
Total revenue	2,670	1,422	88%
Benefits	1,194	582	105%
Underwriting, acquisition, insurance and other expenses	805	503	60%
Communications expenses	41	-	NM
Interest and debt expenses	61	22	177%
Total benefits and expenses	2,101	1,107	90%
Income before taxes	569	315	81%
Federal income taxes	173	94	84%
Net income	\$ 396	\$ 221	79%
Items included in net income (after-tax):			
Realized gain (loss) on investments and derivative instruments	\$ 17	\$ (4)	
Net gain on reinsurance embedded derivative/trading securities	-	4	
Restructuring charges	(3)	-	

The table below provides a detailed comparison of items included within net realized investment gains (losses).

(in millions)	Three Months Ended		Improvement (Worsening)
	2007	March 31, 2006	
Realized gains on investments	\$ 66	\$ 25	164%
Realized losses on investments	(20)	(21)	5%
Realized gain (loss) on derivative instruments	-	4	-100%
Amounts amortized to balance sheet accounts	(18)	(11)	-64%
Gain on reinsurance embedded derivative/trading securities	-	6	-100%
Investment expenses	(2)	(4)	50%
Net gains (losses) on investments and derivative instruments	\$ 26	\$ (1)	NM
Write-downs for other-than-temporary impairments included in realized losses on investments above	\$ (4)	\$ (2)	-100%

Following are deposits and net flows by business segment. For additional detail of deposit and net flow information, see the discussion in "Results of Operations by Segment" below.

(in millions)	Three Months Ended		Improvement (Worsening)
	2007	March 31, 2006	
Deposits			
Individual Markets:			
Annuities	\$ 2,821	\$ 2,136	32%
Life Insurance	1,039	488	113%
Employer Markets:			
Retirement Products - Defined Contributions	1,487	1,240	20%
Retirement Products - Executive Benefits	65	47	38%
Investment Management	6,033	9,064	-33%
Consolidating adjustments ⁽¹⁾	(909)	(739)	-23%
Total Deposits	\$ 10,536	\$ 12,236	-14%
Net Flows			
Individual Markets:			
Annuities	\$ 754	\$ 770	-2%
Life Insurance	698	257	172%
Employer Markets:			
Retirement Products - Defined Contributions	221	180	23%
Retirement Products - Executive Benefits	(75)	40	NM
Investment Management	(89)	4,899	NM
Consolidating adjustments ⁽¹⁾	45	42	7%
Total Net Flows	\$ 1,554	\$ 6,188	-75%

(in millions)	As of March 31,		As of December 31,	Increase over	Increase over Prior quarter
	2007	2006	2006	Prior year	
Assets Under Management by Advisor ⁽²⁾					
Investment Management:					
External Assets	\$ 98,146	\$ 86,428	\$ 97,306	14%	1%
Insurance-related Assets	67,292	41,995	67,067	60%	0%
Lincoln UK	10,255	8,986	10,108	14%	1%
Within Business Units (Policy Loans)	2,767	1,860	2,760	49%	0%
By Non-LNC Entities	58,571	43,726	56,282	34%	4%
	\$ 237,031	\$ 182,995	\$ 233,523	30%	2%

(1) Consolidating adjustments represent the elimination of deposits and net flows on products affecting more than one segment.

(2) Assets under management by advisor provides a breakdown of assets that we manage or administer either directly or through unaffiliated third parties. These assets represent our investments, assets held in separate accounts and assets that we manage or administer for individuals or other companies. We earn insurance fees, investment advisory fees or investment income on these assets.

NM - Not Meaningful

Comparison of the Three Months Ended March 31, 2007 to 2006

Revenues

The merger with Jefferson-Pilot was the primary driver for the increase in insurance premiums and fees for the three months ended March 31, 2007 compared to the same period in 2006. In addition to the merger, the increase in insurance fees and investment advisory fees during the first quarter of 2007 reflects growth in assets under management, as well as, the effects of favorable equity market performance during the last twelve months. Assets under management increased 30% as a result of the Jefferson-Pilot merger, positive net flows and equity market gains. The average level of the equity markets was higher for the three months ended March 31, 2007 compared to the same period in 2006, resulting in higher fee income. Excluding the impact of dividends, the S&P 500 Index[®] at March 31, 2007 was 9.7% higher than at March 31, 2006 and the average daily S&P 500 Index[®] for the first quarter of 2007 was 11.1% higher than the first quarter of 2006.

The increase in net investment income for the first quarter of 2007 compared to the same period in 2006 primarily reflects the addition of Jefferson-Pilot investment assets, higher portfolio yields and higher invested assets due to the favorable effect of asset growth from net flows. Negative fixed (including the fixed portion of variable annuity) net flows partially offset growth in our indexed and variable annuity net flows. Fixed annuity net flows in the first quarter of 2007 were unfavorably impacted by higher withdrawals driven by the expiration of multi-year crediting rate guarantees on certain products we sold three to five years ago.

Included in revenues were net realized gains on investments of \$26 million for the first quarter of 2007 compared to losses of \$1 million for the first quarter of 2006. See "Consolidated Investments" below for additional information on our investment performance.

Benefits and Expenses

Consolidated benefits and expenses increased \$994 million, or 90%, for the first quarter of 2007 compared to the same period in 2006, primarily due to the merger with Jefferson-Pilot. See "Results of Operations by Segment" below for further discussion by segment. Expenses related to growth in our business were partially offset by the effect of spread management through lower crediting rates on interest sensitive business, the lower interest credited from lower fixed annuity account values resulting from net outflows on fixed annuities and movements from fixed to variable annuity products.

Consolidated expenses for the first quarter of 2007 include \$14 million for integration costs, including restructuring charges that were the result of actions undertaken by us to eliminate duplicate operations and functions as a result of the Jefferson-Pilot merger. These actions will be ongoing and are expected to be substantially complete by late 2008, with a total estimated cost of \$180 million pre-tax. In addition, the adoption of SOP 05-1 resulted in a \$6 million, pre-tax, increase to underwriting, acquisition, insurance and other expenses in the first three months of 2007, which was attributable to changes in DAC and VOBA deferrals

and amortization.

We expect to record a one-time curtailment gain of \$9 million (\$6 million after-tax) in the second quarter of 2007 related to a change in our employee benefit plans, for additional information on this change, see "Recent Developments", "Other Operations" and Note 13 to our consolidated financial statements.

For additional information on restructuring charges, see Note 12 to our consolidated financial statements.

RESULTS OF OPERATIONS BY SEGMENT

Following is a reconciliation of our income from operations to our consolidated net income:

(in millions)	Three Months Ended March 31,	
	2007	2006
Revenue		
Segment operating revenue		
Individual Markets:		
Annuities	\$ 605	\$ 375
Life Insurance	971	500
Total Individual Markets	1,576	875
Employer Markets:		
Retirement Products	359	306
Group Protection	361	-
Total Employer Markets	720	306
Investment Management ⁽¹⁾	150	140
Lincoln UK	91	70
Lincoln Financial Media ⁽²⁾	67	-
Other Operations	75	61
Consolidating adjustments	(35)	(29)
Net realized investment results ⁽³⁾	26	(1)
Revenue	\$ 2,670	\$ 1,422
Net Income		
Segment operating income		
Individual Markets:		
Annuities	\$ 121	\$ 66
Life Insurance	167	69
Total Individual Markets	288	135
Employer Markets:		
Retirement Products	64	60
Group Protection	23	-
Total Employer Markets	87	60
Investment Management	16	15
Lincoln UK	11	11
Lincoln Financial Media	12	-
Other Operations	(35)	-
Net realized investment results ⁽⁴⁾	17	-
Net income	\$ 396	\$ 221

- (1) Revenues for the Investment Management segment include inter-segment revenues for asset management services provided to our other segments. These inter-segment revenues totaled \$25 million for both the three months ended March 31, 2007 and 2006.
- (2) Lincoln Financial Media revenues are net of \$8 million of commissions paid to agencies for the three months ended March 31, 2007.
- (3) Includes realized gains (losses) on investments of \$26 million and \$(11) million for the three months ended March 31, 2007 and 2006, respectively; realized gains on derivative instruments of \$4 million for the three months ended March 31, 2006; and gains on reinsurance embedded derivative/trading securities of \$6 million for the three months ended March 31, 2006.
- (4) Includes realized gains (losses) on investments of \$17 million and \$(6) million for the three months ended March 31, 2007 and 2006; realized gains on derivative instruments of \$2 million for the three months ended March 31, 2006; and gains on reinsurance embedded derivative/trading securities of \$4 million for the three months ended March 31, 2006.

RESULTS OF INDIVIDUAL MARKETS

The Individual Markets business provides its products through two segments - Individual Annuities and Individual Life Insurance. Through its Individual Annuities segment, Individual Markets provides tax-deferred investment growth and lifetime income opportunities for its clients by offering individual fixed annuities, including indexed annuities, and variable annuities. The Individual Life Insurance segment offers wealth protection and transfer opportunities through term insurance, a linked-benefit product, which is a universal life insurance policy linked with riders that provide for long-term care costs, and both single and survivorship versions of universal life and variable universal life.

For factors that could cause actual results to differ materially from those set forth in this section, see “Part I - Item 1 - Risk Factors” in our 2006 Form 10-K and “Forward-looking Statements - Cautionary Language” in this report.

Individual Markets - Annuities

Operating Summary (in millions)	Three Months Ended		Increase (Decrease)
	2007	March 31, 2006	
Operating Revenues			
Insurance premiums	\$ 13	\$ 9	44%
Insurance fees	236	174	36%
Net investment income	266	148	80%
Other revenues and fees	90	44	105%
Total operating revenues	605	375	61%
Operating Expenses			
Insurance benefits	188	115	63%
Underwriting, acquisition, insurance and other expenses	256	173	48%
Total operating expenses	444	288	54%
Income from operations before taxes	161	87	85%
Federal income taxes	40	21	90%
Income from operations	\$ 121	\$ 66	83%

Net Flows (in millions)	Three Months Ended March 31,		Improvement (Worsening)
	2007	2006	
Variable portion of variable annuity deposits	\$ 2,000	\$ 1,666	20%
Variable portion of variable annuity withdrawals	(1,179)	(959)	-23%
Variable portion of variable annuity net flows	821	707	16%
Fixed portion of variable annuity deposits	535	449	19%
Fixed portion of variable annuity withdrawals	(151)	(164)	8%
Fixed portion of variable annuity net flows	384	285	35%
Total variable annuity deposits	2,535	2,115	20%
Total variable annuity withdrawals	(1,330)	(1,123)	-18%
Total variable annuity net flows	1,205	992	21%
Indexed annuity deposits	160	-	NM
Indexed annuity withdrawals	(63)	-	NM
Indexed annuity net flows	97	-	NM
Fixed annuity deposits	126	21	NM
Fixed annuity withdrawals	(674)	(243)	NM
Fixed annuity net flows	(548)	(222)	NM
Total annuity deposits	2,821	2,136	32%
Total annuity withdrawals	(2,067)	(1,366)	-51%
Total annuity net flows	\$ 754	\$ 770	-2%
Annuities incremental deposits	\$ 2,794	\$ 2,111	32%
Account Values (in millions)	As of March 31,		Increase (Decrease)
	2007	2006	
Variable annuities	\$ 53,776	\$ 44,314	21%
Fixed annuities (including indexed annuities)	14,663	6,745	117%
Fixed annuities ceded to reinsurers	(1,689)	(2,202)	23%
Total fixed annuities	12,974	4,543	186%
Total annuities	\$ 66,750	\$ 48,857	37%
Fixed portion of variable annuities	\$ 3,476	\$ 3,819	-9%

Interest Rate Spreads	Three Months Ended March 31,		Basis Points Increase (Decrease)
	2007	2006	
Net investment income yield	5.87%	5.84%	3
Interest rate credited to policyholders	3.75%	3.93%	(18)
Interest rate spread	2.12%	1.91%	21
Effect on yield and interest rate spread:			
Commercial mortgage loan prepayment and bond makewhole premiums	0.05%	0.09%	(4)
Interest rate spread, excluding the above items	2.07%	1.82%	25
Average fixed annuity account values (in millions)	\$ 17,738	\$ 9,695	
Effect on income from operations (after-DAC, after-tax) (in millions):			
Commercial mortgage loan prepayment and bond makewhole premiums	\$ 1	\$ 1	

March 31, (in millions)	Three Months Ended March 31,		Increase (Decrease)
	2007	2006	
Average Daily Variable Account Values	\$ 49,284	\$ 39,947	23%

Comparison of the Three Months Ended March 31, 2007 to 2006

Income from operations for this segment increased \$55 million, or 83%, for the first quarter of 2007 compared to the same period in 2006. The increase is due primarily to growth in account values from positive net flows and favorable market conditions, and the merger with Jefferson-Pilot. The adoption of SOP 05-1 resulted in a cumulative effect reduction of \$28 million in the segment's DAC and VOBA balances. The adoption of SOP 05-1 also increased DAC and VOBA amortization by \$4 million for the first quarter of 2007. The impact is expected to be approximately \$6 million, pre-tax, for the remainder of 2007.

Revenues

Insurance fees increased 36% for the first quarter of 2007 compared to the same period in 2006, due to increases in average daily variable annuity account values and an increase in expense assessment rates resulting primarily from increase in account values with elective riders. The increase in account values reflects cumulative positive net flows and improvement in the equity markets between periods. Excluding the impact of dividends, the S&P 500 Index® at March 31, 2007 was 9.7% higher than at March 31, 2006 and the average daily S&P 500 Index® for the first quarter of 2007 was 11.1% higher than the first quarter of 2006.

New deposits are an important component of our effort to grow the annuity business. Although deposits do not significantly impact current period income from operations, they are an important indicator of future profitability. In the past several years, we have concentrated our efforts on both product and distribution breadth. Annuity deposits increased 32% for the first quarter of 2007 compared to the same period in 2006, primarily due to growth in the variable annuity business. The increase in fixed annuity deposits from the previous year includes \$160 million of deposits into indexed annuity products, which were added to our product portfolio as a result of the merger with Jefferson-Pilot.

The growth in individual variable annuity deposits was primarily a result of continued strong sales of products with the Lincoln SmartSecuritySM Advantage and i4Life[®] Advantage features and the expansion of the wholesaling force in LFD. Variable annuity gross deposits in our Lincoln ChoicePlusSM and American Legacy products were up 20% for the first quarter of 2007 compared to the same period in 2006.

The other component of net flows relates to the retention of the business. One of the key assumptions in pricing a product is the account persistency, which we refer to as the lapse rate. The lapse rate compares the amount of withdrawals to the retained account values. One way to measure a company's success in retaining assets is to look at the overall level of withdrawals from period to period. Additionally, by comparing actual lapse rates to the rates assumed in designing the annuity product, it is possible

to gauge the impact of persistency on profitability. The overall lapse rate for the first quarter of 2007 was 10.4%, compared to 9.2% for the same period in 2006. See the discussion below for the drivers of the increased lapse rates.

Included in our suite of fixed annuity products are several multi-year guarantee products. Our Step Five Fixed Annuity products have a 60-day window period following each five-year fixed guarantee period during which there is no surrender charge and where crediting rates are reset at the beginning of the window period. Account values for these products were \$1.9 billion at March 31, 2007, with approximately \$0.7 billion of account values entering the window period throughout the remainder of 2007. Amounts after 2007 are not significant. During the first quarter of 2007, approximately \$0.2 billion of account values entered the window period of which 38% lapsed. The after-DAC, after-tax effect to the earnings of the segment is mitigated in part by a 50% coinsurance arrangement on 89% of the account values. See "Reinsurance" for additional information on this arrangement. Account values for our other multi-year guaranteed products were \$1.7 billion at March 31, 2007, with approximately \$0.3 billion of the account value entering the window period throughout the remainder of 2007. During the first quarter of 2007, approximately \$89 million of these multi-year guarantee products reset with approximately 77% lapsing where the holder did not select another of our products. As multi-year guarantees expire, policyholders have the opportunity to renew their annuities at rates in effect at that time.

Our fixed annuity business also includes products with crediting rates that are reset on an annual basis and are not subject to surrender charges. Account values for these products were \$3.7 billion at March 31, 2007 with 40% already at their minimum guaranteed rates. The average crediting rates for these products were approximately 41 basis points in excess of average minimum guaranteed rates. Our ability to retain the multi-year guarantee and annual reset annuities will be subject to current competitive conditions at the time interest rates for these products reset.

Net investment income increased \$118 million, or 80%, for the first quarter of 2007 compared to the same period in 2006. The increase in net investment income is due to the increase in fixed account values which were acquired in the Jefferson-Pilot merger. Overall growth in net investment income has been constrained due primarily to lower investment portfolio yields, lower average fixed annuity account values and net outflows. Net investment income included \$2 million (5 basis points) and \$3 million (9 basis points), pre-DAC, pre-tax, from commercial mortgage loan prepayment and bond makewhole premiums for the periods ended March 31, 2007 and 2006, respectively. Net investment income for the first quarter of 2007 also includes an increase of \$1 million (pre-DAC, pre-tax) from the mark-to-market adjustment for S&P 500 Index® call options supporting the hedge program for the indexed annuity business. This adjustment, which is largely offset by a \$4 million (\$1 million after-DAC, after-tax) related adjustment in interest credited is included within insurance benefits expense but is excluded from spread calculations.

When analyzing the impact of net investment income, it is important to understand that a portion of the investment income earned is credited to the policyholders of our fixed annuity products. The interest credited to policyholders is included in the segment's insurance benefits. The annuity product interest rate spread represents the excess of the yield on earning assets over the average crediting rate. The yield on earning assets is calculated as net investment income on fixed product investment portfolios divided by average earning assets. The average crediting rate is calculated using interest credited on annuity products less the mark-to-market adjustment on the indexed annuity business, bonus credits and excess interest on policies with the dollar cost averaging feature, divided by the average fixed account values net of coinsured account values. Fixed account values reinsured under modified coinsurance agreements are included in account values for this calculation. Interest credited to policyholder balances increased for the first quarter of 2007 compared to the same period in 2006 as a result of the Jefferson-Pilot merger, partially offset by lower average fixed account values and lower average crediting rates. Interest credited for the first quarter of 2007 was also reduced by \$4 million (\$3 million after-tax) related to adjustments to the opening balance sheet of Jefferson-Pilot finalized in the first quarter of 2007. These adjustments increased our interest rate spread by 9 basis points.

The interest rate spread table above summarizes the effect of changes in the portfolio yield and the rate credited to policyholders, as well as the impact of prepayment premiums on results on an after-DAC, after-tax basis. The adjusted

interest rate spread was 2.07% and 1.82% for the first quarter of 2007 and 2006, respectively. The improvement is primarily due to a reduction in crediting rates year over year and the 9 basis point increase attributable to the opening balance sheet adjustment.

We expect to manage the effect of spreads for near-term operating income through a combination of rate actions and portfolio management. Our expectation includes the assumption that there are no significant changes in net flows in or out of our fixed accounts or other changes that may cause interest rate spreads to differ from our expectation. For information on interest rate spreads and the interest rate risk due to falling interest rates, see "Item 3 - Quantitative and Qualitative Disclosures About Market Risk" of this Form 10-Q.

Benefits and Expenses

Insurance benefits include interest credited to policyholders of \$182 million and \$106 million for the first quarter of 2007 and 2006, respectively. Increases from the merger with Jefferson-Pilot were partially offset by past actions taken to lower crediting

rates commensurate with the reduction in the overall investment yield over the last several years and lower fixed account values. See the table above for the interest rate credited to policyholders. Interest credited decreased \$1 million from the unfavorable fair value adjustment on our indexed annuity product liabilities, as discussed above. This fair value adjustment, which is influenced by equity markets and interest rates used for discounting the calculation, can be volatile from period to period affecting the comparability of interest credited.

Also included in insurance benefits are the costs associated with guaranteed benefits included within variable annuities with the GMDB, GMWB or GIB riders. For first quarter of 2007, favorable market conditions resulted in decreased insurance benefits for the GMDB, GMWB and GIB riders, which were offset by unfavorable hedge results compared to 2006. The effect of changes in net reserve and benefit payments and results of the hedge program attributable to these guaranteed benefits was such that the period over period variances was a decrease to benefits and expenses of \$3 million (\$1 million after-DAC, after-tax).

At March 31, 2007, the segment's net amount at risk ("NAR") related to contracts with a GMDB feature was \$0.3 billion. The related GAAP and statutory reserves were \$22 million and \$42 million, respectively. The comparable amounts at December 31, 2006, were a NAR of \$0.3 billion, GAAP reserves of \$23 million and statutory reserves of \$42 million. At any point in time, the NAR is the difference between the potential death benefit payable and the total account value, with a floor of zero (when account values exceed the potential death benefit there is no amount at risk). Accordingly, the NAR represents the maximum amount we would have to pay if all policyholders died. In evaluating the GMDB exposures that exist within our variable annuity business relative to industry peers, it is important to distinguish between the various types of GMDB features, and consider other factors such as average account values, average amounts of NAR, and the age of contractholders. The following table and discussion provides this information for our variable annuity business as of March 31, 2007:

	Type of GMDB Feature				
	Return of Premium	High Water Mark	Roll-up	No GMDB	Total
Variable Annuity Account Value (billions)	\$ 25.3	\$ 23.1	\$ 0.4	\$ 5.0	\$ 53.8
% of Total Annuity Account Value	47.0%	42.9%	0.7%	9.4%	100.0%
Average Account Value (thousands)	\$ 109.0	\$ 108.3	\$ 82.5	\$ 75.8	\$ 104.3
Average NAR (thousands)	5.0	6.4	12.3	N/A	6.4
NAR (billions)	0.1	0.2	-	-	0.3
Average Age of Contract Holder	64	64	67	62	57
% of Contract Holders > 70 Years of Age	14.7%	31.1%	41.6%	31.7%	20.0%

We have variable annuity contracts containing GMDBs that have a dollar-for-dollar withdrawal feature. Under such a feature, withdrawals reduce both current account value and the GMDB amount on a dollar-for-dollar basis. For contracts containing this dollar-for-dollar feature, the account holder could withdraw a substantial portion of their account value resulting in a GMDB that is multiples of the current account value. Our exposure to this dollar-for-dollar risk is somewhat mitigated by the fact that we do not allow for partial 1035 exchanges on non-qualified contracts. To take advantage of the dollar-for-dollar feature, the contractholder must take constructive receipt of the withdrawal and pay any applicable surrender charges. We report the appropriate amount of the withdrawal that is taxable to the Internal Revenue Service, as well as indicating whether or not tax penalties apply under the premature distribution tax rules. We closely monitor the dollar-for-dollar withdrawal GMDB exposure. Beginning in 2003, the GMDB feature offered on new contract sales is a pro-rata GMDB feature whereby each dollar of withdrawal reduces the GMDB benefit in proportion to the current GMDB to account value ratio. As of March 31, 2007, there were 814 contracts for which the death benefit to account value ratio was greater than ten to one. The

NAR on these contracts was \$52 million.

Underwriting, acquisition, insurance and other expenses increased \$83 million, or 48%, for the first quarter of 2007 compared to the same period in 2006. The increases were driven by the merger with Jefferson-Pilot and account value growth from sales and favorable equity markets, which resulted in higher commission expenses, net of deferrals and higher DAC amortization. Underwriting, acquisition, insurance and other expenses for the first quarter of 2007 were increased by \$2 million (\$1 million after-tax) related to adjustments to the opening balance sheet of Jefferson-Pilot finalized in the first quarter of 2007.

Individual Markets - Life Insurance

Operating Summary (in millions)	Three Months Ended		Increase (Decrease)
	2007	March 31, 2006	
Operating Revenues			
Insurance premiums	\$ 88	\$ 51	73%
Insurance fees	419	200	110%
Net investment income	454	239	90%
Other revenues and fees	10	10	0%
Total operating revenues	971	500	94%
Operating Expenses			
Insurance benefits	498	262	90%
Underwriting, acquisition, insurance and other expenses	221	133	66%
Total operating expenses	719	395	82%
Income from operations before taxes	252	105	140%
Federal income taxes	85	36	136%
Income from operations	\$ 167	\$ 69	142%

Interest Rate Spreads Interest-Sensitive Products	Three Months Ended		Basis Points Increase (Decrease)
	2007	March 31, 2006	
Net investment income yield	6.48%	6.48%	-
Interest rate credited to policyholders	4.46%	4.60%	(14)
Interest rate spread	2.02%	1.88%	14
Effect on yield and interest rate spreads: Commercial mortgage loan prepayment and bond makewhole premiums	0.21%	0.07%	14
Interest rate spread, excluding the above items	1.81%	1.81%	-
Effect on income from operations (after-DAC, after-tax) (in millions):			
Commercial mortgage loan prepayment and bond makewhole premiums	\$ 4	\$ 2	
Traditional Products			
Net investment income yield	6.41%	6.72%	(31)
Effect on yield: Commercial mortgage loan prepayment and bond makewhole premiums	0.02%	0.15%	(13)
Net investment income yield, excluding the above items	6.39%	6.57%	(18)
Effect on income from operations (after-tax) (in millions)			
Commercial mortgage loan prepayment and bond makewhole premiums	\$ -	\$ 1	

**Three Months Ended
March 31,**