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Call Participants

EXECUTIVES

Beth A. Costello
Executive VP & CFO

Christopher Jerome Swift
Chairman & CEO

ANALYSTS

Joshua David Shanker
BofA Securities, Research Division

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Presentation

Joshua David Shanker
BofA Securities, Research Division

Hello, everyone. Welcome back to the Annual Bank of America U.S. insurance conference. If you're joining us now, this is the Hartford presentation. Just on deck is Ohio National for what it's worth. And if you have any questions, you can e-mail them to me on the Veracast website, and I will ask the questions, but try and get them in earlier, so we don't have a time crunch at the end.

I'm really happy to introduce Chris Swift and Beth Costello, the CEO and CFO for the Hartford for giving us their time, and I appreciate it. And so welcome. You guys -- obviously, most people on this call know who you are. So you both come without introduction. I hope that everyone is safe and your families are well, and thanks for joining me today.

Christopher Jerome Swift
Chairman & CEO

Yes. Thank you, Josh. Everyone is good, and...

Joshua David Shanker
BofA Securities, Research Division

Good. Good. Chris, you might want to make some opening remarks before we get to the Q&A. The few things you want to say, and I'll be happy to listen and set the stage.

Christopher Jerome Swift
Chairman & CEO

Yes, happy to. Just briefly, again, thank you for hosting the event, albeit virtually. I look forward to hopefully being together physically next year at this time because I always enjoy Bank of America's views of Manhattan.

So about a year ago at this time, at your conference, we had just finished up reporting '19 results and our outlook for 2020 and really in a matter of weeks, the world had basically completely changed and dealing with COVID and all the factors that every organization and every individual across America had to deal with.

So I said in our prepared remarks on our earnings call, it probably was the most turbulent year of my life from both a personal side and a work side. And I'm glad 2020 is done. But I think heading in 2021 it's realistic to believe that the first half of the year is going to continue to be challenged in a lot of different respects and that there are more hopeful signs for the second half of '20 -- '21, excuse me.

Last week, we did deliver our full year earnings report and our outlook hopefully. I was pleased with both of them. Core earnings for 2020 were over $2.1 billion, $5.78 per diluted share. A strong core earnings margin even in a pandemic of 12.7%. And I thought we gave ambitious guidance, but also realistic and achievable based on our strategies. So I would say on our strategies, nothing has really changed.

I mean, we're focused on execution, improving our competitive advantages in the marketplace and leadership and expect to grow top line, expect to grow margins and continue to produce, I think, very strong ROE, even with the pandemic lingering in 2021. So you heard us talk about the pricing environment. It continues to be robust particularly in P&C. Prices are going up. I think they are going to continue to go up. I think that will generate better risk adjusted returns for the industry over longer period of time making up for low interest rates and we continue specifically to be focused on our efficiency as an organization with our Hartford Next initiatives.

I think the only maybe cloudy area is group benefits. We had a high level of excess mortality in the fourth quarter. We expect that to continue into early '21. But if you look at the core of the franchise and group

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benefits, everything is fine. It's a solid franchise. It's the #2 group benefit business in the industry. We just need to fight our way through this period of elevated mortality.

On the positive side, with our long-term disability trends, they're behaving as we would expect. There is nothing unusual that has happened during 2020 with COVID, with any of the economic pressures that LTD has correlated to. So feel very pleased of where our performance on LTD is, and continue to expect solid, solid performance in 2021. So I think we have a good business mix, Josh, I said that on the earnings call.

We're in the right aspects of the market where I think you could earn good returns over a longer period of time. We have wonderful distribution, and I think we have a fulsome product set that is going to allow us to compete even more holistically than we have in the past. So -- and lastly, our financial results will continue, I think, to be very, very good. We'll earn good ROEs, well in excess of our cost of equity capital. And you put it all together, I believe we're going to create value for shareholders in the years to come.

Joshua David Shanker
BofA Securities, Research Division
Well, great. So Beth, do you want to say some introductory remarks as well? No. Okay.

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Question and Answer

Joshua David Shanker
BofA Securities, Research Division

So you talk about the pricing environment. And I think that when people look at Hartford's numbers, they look at these Small Commercial pricing and say, "Okay, your pricing is up 1% to 2%, and everyone else's pricing is up 15% to 20%." Why [indiscernible] say, "Well, I did something that you made -- I blended the numbers together." And I got your pricing was up around 7% for what it's worth, given the disclosures that you give.

But when we think about pricing for, on the one extreme, the global specialty business being up 20%. And we think about the pricing in the Small Commercial business being up 1% to 2%, and we certainly think about the factors driving both those things. I guess, where are loss cost trends for each of those areas in aggregate? Are both those areas pushing margin as it is right now? At 2% in Small Commercial, can you get extra margin on the business? And at 20% in global specialty can you get extra margin out of the business? And are you merely doing a responsible price above the loss cost trend in both? How should we think about how -- why there's different outcomes there and what that means for your loss ratios?

Christopher Jerome Swift
Chairman & CEO

Yes. So a lot to unpack there as usual. So I appreciate the detailed question. So first, I'm glad that you are talking about segmentation of the market because our book is obviously concentrated more in the Small to Middle side with our recent acquisition of Navigators who are more of a specialty player. And there's dynamics in each of those markets that are impacting price and loss cost trends. I hear an echo, Josh. So I hope -- can you hear me okay?

Joshua David Shanker
BofA Securities, Research Division

You sound fantastic.

Christopher Jerome Swift
Chairman & CEO

Okay. Great. I'll just -- if I look like I'm listening to myself -- I hear myself in my ear. So going back to the segmentation, you really got to look at it on that type of granular level, where I think all our trends are right in line with the marketplace broadly. If you look at global specialty, up 20% domestically, it's probably up 30% in London. We're right in line with the best-in-class competitors in that area. And I think we're competing well with our product set and capabilities.

And clearly, loss cost trends, our pricing is exceeding loss cost trends there. I think with the Navigators book that we acquired, it was a self-help opportunity, and I give Doug and Vince Tizzio, a lot of credit for improving it. We did improve it greater than the combined ratio margin improvement that we talked about in 2021. There's still pockets where more rate is needed in that book to get to sort of targeted ROEs on that book over long term, particularly in London and certain excess lines.

So -- but as we sit here today, we feel really good about what we've been able to execute. The rate increases that we have been able to deliver and giving ourselves the opportunity, as we said in our guidance, to continue to expand margin in all of commercial, but the largest margin contributor is going to continue to be Global Specialty in 2021.

Middle market, same story, to a lesser degree. Same story, Mo Tooker, in that business, and Doug have been reshaping that portfolio a little bit, particularly in comp. We had elements of that book that just weren't performing to our standards. We took on that initiative basically 18 months ago. And obviously, we're getting the rate that we can in the book in a competitive environment. But ex comp, middle market

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has been up 10%-ish the last 2 quarters, and feel really good about that. And that is in excess of loss trend also.

So have the ability there to continue to grow margins and expand margins in '21. Not all product lines at the same rate. I would still say that certain aspects of the commercial auto liability product set probably needs more rate to expand even margins even greater. But we'll see what the market bears. But we know what we're trying to achieve.

And Small is on the other end of the spectrum. But I always like to say, Josh, just look at where they're starting from. I mean, 2 years in a row of sub 90 combined ratios, with workers' comp being 60%, 65% of that overall book of business. So I mean, it's performing at a high level. Frequency trends, the last couple of years, have been coming down. They came down even more this year. So you got to put things into context. If Doug were here, he would say, "Yes, it's probably less negative rate environment in '21 than '20, but it's still going to be negative, just given the overall trends, particularly on frequency."

Workers' comp is our largest line of business. I think we have deep, deep expertise on it. And we know how to manage that line well during different cycles. We're focused on severity, particularly indemnity. And with low or higher unemployment, or people staying on comp longer, you always got to be sensitive to long-term medical inflation trends, which we take a prudent approach in pricing. So you put it all together, that's where we come out with our 3 points of margin improvement for commercial, but there's different contributors by our subsegment of the book of business.

Josh, you're on mute.

Joshua David Shanker
BofA Securities, Research Division

I guess somebody muted me maybe to take care of the echo, I don't know. But we'll bear that in mind. So if I think about comp a little bit, [on one hand,] frequency has been great. You never know what the future brings, but there's probably no admitted line of business that is more governed by interest rates than workers' comp. And there might be some other [captive] lines, but it's really one-to-one in some ways when we think about the relationship.

Can you talk about discussions with regulators how they see the profitability right now and how they might see the profitability in the future? And what is that conversation? So look, interest rates are the most important ingredient. Interest rates are down. Yes, we understand it is very wonderful short period of low frequency, but that can change on a dime, and we're stuck with the low interest rates over the long term. How does that conversation take place?

Christopher Jerome Swift
Chairman & CEO

Well, you're pointing out sort of the inherent challenge with the model of regulation. It's on a lag basis. And a lot of times, it can't be forward-looking, right? I mean there's not an expected concept in pricing. So look, I don't have detailed discussions with the regulators on pricing as you would expect. But knowing and observing and sitting in dialogues with our team, it's a challenge. Most of the loss data is backward-looking, 12 to 18 months, depending on your filing dates.

Interest rates are a component. So the lower interest rate environment, the declining interest rate environment that we experienced in 2020 will be -- start to be baked into trend, into the pricing trends. But again, as I said, frequencies continue to be very stable to improving, particularly this year. Different states -- and California is basically saying right now, we don't want to consider anything COVID in your filing. So all the presumption in rules right now, at least in California, they want to take a wait and see attitude and approach and are basically asking the impacts of COVID on the benefit side to be excluded.

Now the frequency benefits are flowing through. So it's a little bit of a mismatch in California, but those are some of the vagaries of state-based regulation that we just have to live with and deal with. But look, over a longer period of time, I think we've managed these lags in cycles and time frames very

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well. But we're still in a period of declining frequency that's going to continue to overwhelm the pricing environment, at least through '21.

Doug would say, and Doug said on the call that I expect it to be less negative, but still negative. And if you put it then in the context of that contributing to overall margin contraction in Small. Our next-gen spectrum product or our BOP product, commercial auto, those lines of business need to make up for it, to get us into that flattish slightly down margin perspectives. But it's clearly a challenge. And you're right. Our calculations are for every 100 basis point decline in interest rates. You probably need 3 points of improvement on your loss ratio to maintain the same ROE.

Joshua David Shanker
BofA Securities, Research Division

This is -- while, we're on the topic of workers' comp, this is a sight from one of the investors of the 90 people who are on the line right now. How much favorable workers' comp benefit did Hartford take in the quarter, which was part of a net $14 million COVID charge from workers' comp? Was there a -- I guess, they are asking, what were the gross claims versus the net favorable is what the investors...

Christopher Jerome Swift
Chairman & CEO

I'm going to ask Beth to comment upon it. But again, I think we've been transparent on what our gross COVID losses are primarily due to presumption and then the frequency benefit that we get. We think it was important to net those 2 down. So Beth is going to give you a fourth quarter, but I would also ask her to give you year-to-date numbers so that you could see the impact. Beth?

Beth A. Costello
Executive VP & CFO

Yes. Sure. And as Chris said, we were very transparent in all of this. It's included right in our earnings slides for those that want to look at that. But in the fourth quarter, the $14 million charge we took for comp was offset by $26 million of favorable frequency. And then from a full year perspective, the $66 million that we had was offset -- that was net of $114 million of favorable frequency. And again, all these numbers are clearly laid out in our disclosures. I think we've been extremely transparent through this whole year in quantifying both sides of that equation.

Joshua David Shanker
BofA Securities, Research Division

Okay. And one more question, I guess, this is really [indiscernible] everything. Can Hartford achieve a 12% ROE in a 2021 with notable COVID headwinds?

Christopher Jerome Swift
Chairman & CEO

I've talked about ROE in the past. I've said and we'll continue to believe a good anchor point for the Hartford is a 12% ROE, it was 12.7% last year. But I think what we guided to with the COVID headwinds being 1.5 points in commercial. And then roughly the $177 million in group life and disability. Never say never, but a lot of things have to go right, particularly with catastrophes, market performance, views on how reserves are going to develop for us to come close to earning a 12% ROE.

So I'm not saying it's impossible. It's just highly unlikely. I would say, on the other hand, if we didn't include those charges in our guidance for 2021, I think we could have anchored around a 12.5% ROE for the year. So yes, it's still a year of transition, as I said, with COVID. And as I said even more granularly, I think the first half is going to be dramatically different than the second half of '21.

But we'll see how things play out. But I'd like you and most investors think in terms of you can anchor around 12% ROE for us. And some years, we might outperform. But this particular year coming up, given COVID headwinds, it might fall a little shy of that.

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Joshua David Shanker
BofA Securities, Research Division

It's not necessarily the Hartford, although many of your competitors talk about social inflation as a driver of why pricing is up. But given the majority of the past 12 months have had a COVID overlay where claims frequency is lower, what sort of tools or confidence do you have that this is a blip in a larger social inflationary trend and that we should expect social inflation to revert back to the -- some of the reasons why pricing has been increased as we get through the vaccination period?

Christopher Jerome Swift
Chairman & CEO

Well, I mean our litigious environment is not going to change overnight. I mean, there's deep-seated views on a lot of different aspects regarding litigation in America. And I just don't see it changing, Josh. So it can take a temporary reprieve during a COVID pandemic. But once we're out of the pandemic throws, I just don't -- I don't see any reason and there's no impetus I could feel for a changing litigation environment. We see it annually, specifically with our A&E study.

Severity continues to go up as much as frequency is coming down on people with [indiscernible] exposure, frequency goes up. We're seeing it in mass torts during the year with different mass tort litigation that we get involved with. So I just think it's going to be a pattern of -- that's going to continue for the future. We did get a reprieve this year, primarily in what I would call the slip and fall categories and less of the mass tort environment. But I think the industry just needs to continue to be diligent about thinking about social inflation and making sure that we never fall behind trend again, the way we did over the last, say, 4 or 5 years.

Joshua David Shanker
BofA Securities, Research Division

And would you expect in a recovering economy, regardless of the level of social inflation, we should be seeing claims begin to spike year-over-year in workers' comp and commercial auto due to recovery?

Christopher Jerome Swift
Chairman & CEO

I would say not necessarily, Josh. I don't expect a spike in claims. Because I don't think there's any spike in economic activity that's going to come. I think we're going to slowly grind back to normal. And as more people get hired, there's opportunities, obviously, for more frequency events in workers' comp. But hopefully, safety programs still remain robust when people get back there. Hopefully, there's an element of [mature] worker contributing to safety. So I don't see a spike in frequency and comp at this point in time, but we just got to be eyes wide open of just how negative frequency can be?

And plan for maybe a reversion to a longer-term mean of favorable frequency, but not as favorable as it been this past year. Same in personal auto and commercial auto. Driving patterns are down, miles driven are down everywhere. Claims are down roughly 20% year-over-year. But again, as people get vaccinated and feel more comfortable, traveling and economic activity picks up? Yes, there is going to be, again, a reversion to the mean there. But I don't see any shocks or spikes in the systems in the near term, Josh.

Joshua David Shanker
BofA Securities, Research Division

Change in focus. You renegotiated your relation with AARP, and you're now going to be nonrenewed performing drivers, which is something that you had a hard time doing in the past. To what extent does that let you widen the net to get more drivers? When should we see it in the policy count? And even if we don't see, does that mean margins will begin to improve? They're already good right now, so there's a question there.

Christopher Jerome Swift
Chairman & CEO

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Yes. Well, as I said, there's going to be a reversion to the mean, right? So we did talk about seeing a normalization of driving patterns in 2021. So yes, I would say -- and I think I've chatted with you before on this on prior earnings call. We were really pleased to renew a 30-plus year standing relationship with AARP, one of the largest affinities in the world. I think we've had mutual success over the years. But on the other hand, the program did need to be modernized because what was valued 20 years ago by AARP members isn't necessarily valued today, evidenced by the fact that you referenced lifetime continuity is not part of a policy form going forward because there is ample availability of product even for seniors.

That wasn't the case 20 years ago, and again, it was a constraint that we managed through. But again, in the negotiations, which were cordial, friendly, professional with AARP, they had some points of view, we had some points of view, and we ended where we did. But lifetime continuity isn't required for their membership, and that allows us to be bluntly a little more aggressive on new business opportunities. Because then we have the opportunity to season the book faster through rate increases or other means to ensure that we're retaining the most profitable customers going forward.

I think equally important for Josh and our development is both of us, including AARP, wants to be more relevant in that 50- to 65-year old space. So that requires us to have more of an orientation for youthful drivers associated with that 50- to 65-year old demographic because they probably have teenagers or young adults still living at home. So that's another reason, again, to modernize our product. And besides the contract, a modern auto and home product, we view that we needed some new technology to help us administer, to have a better digital experience with the AARP members.

So we've invested in a new platform administered by Duck Creek, customizing it obviously for our needs, but we'll have that up and running when we launch, I think, 2 auto states later in March here. So -- and then we'll have a home in those same states by middle of the year. And I think our plan calls for basically at 7 or 8 states in total here by the end of '21.

So and the rollout will continue into '22, so I do expect new business to be better. I think our conversion rates and placement rates will improve. But I would caution you, there's going to be a little bit of a timing difference from going from 12-month policies to 6-month policies. So you shouldn't necessarily expect a big spike in net written premiums. But again, over time, I think our growth rates will improve compared to the -- where they have been over the last 5 years.

Joshua David Shanker
BofA Securities, Research Division

As time is running down, I want to talk about Group, but I'll ask an investor question to make sure we get it out. What industry groups are you exposed to in group life that have particularly COVID vulnerable employees, I guess, frontline workers' health. And there's a second part of the question, what magnitude of long-term disability impact are you expecting as mortality transitions to morbidity?

Christopher Jerome Swift
Chairman & CEO

Yes. I would say our book of business is roughly $5.6 billion of premium, $5.7 billion, split almost 50-50 between LTD and disability in life, maybe just a smidge more of disability. But it's a highly diversified book of business. And we don't have any industry concentrations in any way, shape or form, either on the mortality or the morbidity side. Obviously, certain aspects of the book, I think, in terms of like airlines, they have reduced their workforce or furloughed people and/or unfortunately, had more permanent displacement employees. That has hurt revenues.

Not necessarily losses given that many people are flying, and they don't have a lot of people on the workforce these days. So I don't see any -- again, any extraordinary amounts of concentration in any aspects of our book because it's a big national, diversified book. We got small accounts. We got middle accounts. We do have a lot of national accounts, but it's highly diversified.

Your impact -- your question on what is the COVID impact on LTD? We haven't seen any. We only have -- I could count them on one hand, the number of cases that have migrated from STD to LTD. STD on average

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is a 2 to 3-week benefit. I mean, it's a volume game. We've had a significant spike in volume in STD and leave claims. But we've only had, as I said, a handful migrate to LTD. And we watch it closely.

We watch the employment-centric correlation happening in LTD, but there is no emerging trend here that causes us concern as we sit here today, and we'll continue to monitor it. I think we've been thoughtful in pricing new business as we look forward, particularly on mortality and what we've experienced in certain aspects. So I feel good about where that overall book of business is and once we get through COVID, how it will continue to perform at a high level.

Joshua David Shanker
BofA Securities, Research Division

I have a very specific and nontypical question from an investor. Just -- now that you've committed -- commented that real estate might be a source of savings as you rationalize real estate, I'm curious if that includes potential selling of properties that are held in stat entities at carried values. If you sold properties, would that in turn create potentially significant excess capital?

Beth A. Costello
Executive VP & CFO

So I'll take that one. So first of all, we really don't own a lot of properties, a lot of our properties are leased. We have really 2 facilities that we own that are in Hartford and Windsor. So I would not look to the sale of real estate property that we use for operations as a source of significant change in our capitalization of our subsidiaries.

Joshua David Shanker
BofA Securities, Research Division

Okay. That was easy enough. So turning back to the Group section. One thing that I'm curious about, so there are a lot of people who want to go back to work. I want to go back to work. I'm in the office today for the first time since I joined Bank of America. It's very exciting. A lot of people don't want to go back to work. They've adapted this lifestyle and the flexibilities they really enjoy. And I'm not -- I don't -- I'm cautious about using the F word for fraud. But are there people who are going to bristle at the prospect of going back to work that could evolve into a spike in disability claims. The things that they might have been willing to live with in a prior environment suddenly become debilitating in a circumstance where they have to go back to work.

Christopher Jerome Swift
Chairman & CEO

The honest answer is, I don't know, Josh. I mean, it's feasible, but I think a little unlikely. Remember, disability usually does involve some type of mental -- excuse me, mental and/or medical condition. And I'm sure people are working at home and those even in the office with maybe minor medical conditions that might be eligible for STD today. So yes. Anything's possible, but I think the probability is low. And the other reason for saying that, is -- I do think there will be a level of increased flexibility employers offer to their people to avoid that dispute or that argument that as you allege might create another claim.

So I think we're all learning a lot during this point in time. And that's why we've been pushing our digital agenda so hard, not because we saw a pandemic coming because it was an easier way to connect with customers and agents and allow people to directly have a relationship with us, and we're kind of going to continue to accelerate all aspects of digital in all our businesses going forward. So that's what I would say, Josh.

Joshua David Shanker
BofA Securities, Research Division

One last question. I think maybe it's more for Beth, but you can both answer it. So you recently announced a $1.5 billion share repurchase authorization across the next 2 years. In the 4 years, 2014 - 2017, you repurchased $5.4 billion worth of stock. That's $1.35 billion, annually. I would argue that $1.5 billion over 2 years gets a little light to me. Maybe it doesn't to you, but it does to me. How much

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cash flow are you guys generating annually to pay for dividends repurchases? And how do you rank the priorities given where your stock price is for the best use of cash right now?

Beth A. Costello
Executive VP & CFO

Yes. I'll start with Chris and you can add. But when I look at it, $1.5 billion over 2 years, we talked about the fact that we'd probably use that roughly half and half, which would be $750 million and $750 million. I'd remind you, when we entered 2020, we had an $800 million share repurchase authorization, and that was before the pandemic. So the fact that this is what we're projecting in the near term, given the fact that we're still in a pandemic, I think, is very strong. I'll also remind you that when you look back at some of those numbers that you quoted, we were also divesting things as well in some of the early days.

So I think all in all, it's a very good program. We were also very pleased to be able to raise our dividend again that we announced last week as well. And the cash flows that we get from our subsidiaries, we've, again, laid out very clearly in our disclosures. Very robust and provides excess capital for the holding company to -- for us to be able to deploy it for the share repurchase program that we have.

And as Chris said in the past, obviously, we want to continue to find ways to invest in our businesses, invest for growth, and we do have ambitious growth plans as we look out over the next several years and feel that we have the right balance as we think about capitalization of our subsidiaries, holding company needs. And as I said, returning capital to shareholders.

Christopher Jerome Swift
Chairman & CEO

I think I commented, Josh. You were, I think, on our earnings call. As Beth said, I mean, we want to grow. We think it's a great time to grow right now. We think we have all the capabilities inside the organization today to capture more market share. Really pleased with the overall team's performance in all our businesses and we got our leverage ratio down. Beth's worked that down over the years.

And if we can't find growth opportunities organically, we're prepared to return excess capital to shareholders. M&A is a lower priority right now, just given where we're at as an organization, where we're at in the cycle, pricing cycle. So again, we're going to invest in our capabilities to grow and have a healthy increasing dividend over time like we have and we're pleased to buy back shares, particularly at what I think is a very strong or weak valuation, depending on how you want to look at it, but a great time to buy a Hartford stock.

Joshua David Shanker
BofA Securities, Research Division

I appreciate all your time, and thank you for coming today, and safety of your families and all your employees. And 1-year from today, we'll be doing this in person.

Christopher Jerome Swift
Chairman & CEO

Excellent. Thank you for having us.

Joshua David Shanker
BofA Securities, Research Division

Great. Thank you.

Beth A. Costello
Executive VP & CFO

Thank you.

Joshua David Shanker
BofA Securities, Research Division

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Take care. Bye-bye.

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