

MGIC INVESTMENT CORP

Form 10-Q

May 10, 2007

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**FORM 10-Q  
UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**☐ 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 1-10816  
MGIC INVESTMENT CORPORATION  
(Exact name of registrant as specified in its charter)**

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

**39-1486475**  
(I.R.S. Employer  
Identification No.)

**250 E. KILBOURN AVENUE  
MILWAUKEE, WISCONSIN**  
(Address of principal executive offices)

**53202**  
(Zip Code)

**(414) 347-6480**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

**YES ☐**

**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. (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 ☐**

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| <b>CLASS OF STOCK</b> | <b>PAR VALUE</b> | <b>DATE</b> | <b>NUMBER OF<br/>SHARES</b> |
|-----------------------|------------------|-------------|-----------------------------|
| Common stock          | \$1.00           | 04/30/07    | 83,067,157                  |

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## MGIC INVESTMENT CORPORATION AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

March 31, 2007 (Unaudited) and December 31, 2006

|   | March 31,<br>2007         | December 31,<br>2006 |
|---|---------------------------|----------------------|
|   | (In thousands of dollars) |                      |
| <b>ASSETS</b>   |                           |                      |
| Investment portfolio:   |                           |                      |
| Securities, available-for-sale, at market value:                      |                           |                      |
| Fixed maturities (amortized cost, 2007-\$5,355,893; 2006-\$5,121,074) | \$ 5,267,073              | \$ 5,249,854         |
| Equity securities (cost, 2007-\$2,616; 2006-\$2,594)                  | 2,583                     | 2,568                |
| Collateral held under securities lending (cost, 2007-\$58,215)        | 58,215                    |                      |
| <br>  |                           |                      |
| Total investment portfolio  | 5,327,871                 | 5,252,422            |
| <br>  |                           |                      |
| Cash and cash equivalents   | 255,043                   | 293,738              |
| Accrued investment income   | 65,604                    | 64,646               |
| Reinsurance recoverable on loss reserves                              | 13,621                    | 13,417               |
| Prepaid reinsurance premiums  | 9,122                     | 9,620                |
| Premiums receivable   | 87,870                    | 88,071               |
| Home office and equipment, net  | 32,126                    | 32,603               |
| Deferred insurance policy acquisition costs                           | 11,925                    | 12,769               |
| Investments in joint ventures   | 622,090                   | 655,884              |
| Income taxes recoverable  | 19,012                    |                      |
| Other assets  | 203,406                   | 198,501              |
| <br>  |                           |                      |
| Total assets  | \$ 6,647,690              | \$ 6,621,671         |
| <br>  |                           |                      |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>                            |                           |                      |
| Liabilities:  |                           |                      |
| Loss reserves   | \$ 1,141,566              | \$ 1,125,715         |
| Unearned premiums   | 194,175                   | 189,661              |
| Short- and long-term debt (note 2)                                    | 607,886                   | 781,277              |
| Obligations under securities lending                                  | 58,215                    |                      |
| Income taxes payable  |                           | 34,480               |
| Other liabilities   | 190,432                   | 194,661              |
| <br>  |                           |                      |
| Total liabilities   | 2,192,274                 | 2,325,794            |
| <br>  |                           |                      |
| Contingencies (note 3)  |                           |                      |

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Shareholders' equity:

|   |              |              |
|---|--------------|--------------|
| Common stock, \$1 par value, shares authorized 300,000,000; shares issued,<br>3/31/07 - 123,064,226 12/31/06 - 123,028,976;<br>shares outstanding, 3/31/07 - 83,067,337 12/31/06 - 82,799,919 | 123,064      | 123,029      |
| Paid-in capital   | 305,512      | 310,394      |
| Treasury stock (shares at cost, 3/31/07 - 39,996,889 12/31/06 - 40,229,057)   | (2,190,036)  | (2,201,966)  |
| Accumulated other comprehensive income, net of tax (note 5)   | 61,121       | 65,789       |
| Retained earnings (note 7)  | 6,155,755    | 5,998,631    |
| <br>  |              |              |
| Total shareholders' equity  | 4,455,416    | 4,295,877    |
| <br>  |              |              |
| Total liabilities and shareholders' equity  | \$ 6,647,690 | \$ 6,621,671 |

See accompanying notes to consolidated financial statements.

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MGIC INVESTMENT CORPORATION AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF OPERATIONS  
 Three Months Ended March 31, 2007 and 2006  
 (Unaudited)

|   | Three Months Ended<br>March 31,                  |            |
|---|--|------------|
|   | 2007   | 2006       |
|   | (In thousands of dollars, except per share data) |            |
| Revenues:                               |  |            |
| Premiums written:                       |  |            |
| Direct                                  | \$ 341,838                                       | \$ 333,576 |
| Assumed                                 | 684  | 397        |
| Ceded                                   | (38,488)   | (33,501)   |
| Net premiums written                    | 304,034  | 300,472    |
| Increase in unearned premiums, net      | (5,013)  | (805)      |
| Net premiums earned                     | 299,021  | 299,667    |
| Investment income, net of expenses      | 62,970   | 57,964     |
| Realized investment (losses) gains, net | (3,010)  | 87         |
| Other revenue                           | 10,661   | 11,314     |
| Total revenues                          | 369,642  | 369,032    |
| Losses and expenses:                    |  |            |
| Losses incurred, net                    | 181,758  | 114,885    |
| Underwriting and other expenses, net    | 75,072   | 74,265     |
| Interest expense                        | 10,959   | 9,315      |
| Total losses and expenses               | 267,789  | 198,465    |
| Income before tax and joint ventures    | 101,853  | 170,567    |
| Provision for income tax                | 23,543   | 46,166     |
| Income from joint ventures, net of tax  | 14,053   | 39,052     |
| Net income                              | \$ 92,363  | \$ 163,453 |
| Earnings per share (note 4):            |  |            |
| Basic                                   | \$ 1.13  | \$ 1.89    |

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|  |    |        |    |        |
|--|----|--------|----|--------|
| Diluted  | \$ | 1.12   | \$ | 1.87   |
| Weighted average common shares outstanding diluted (shares in thousands, note 4) |    | 82,354 |    | 87,227 |
| Dividends per share  | \$ | 0.25   | \$ | 0.25   |

See accompanying notes to consolidated financial statements.

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MGIC INVESTMENT CORPORATION AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF CASH FLOWS  
 Three Months Ended March 31, 2007 and 2006  
 (Unaudited)

|   | Three Months Ended<br>March 31, |            |
|---|---------------------------------|------------|
|   | 2007                            | 2006       |
|   | (In thousands of dollars)       |            |
| Cash flows from operating activities:   |                                 |            |
| Net income  | \$ 92,363                       | \$ 163,453 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                 |            |
| Amortization of deferred insurance policy acquisition costs                       | 2,660                           | 3,521      |
| Increase in deferred insurance policy acquisition costs                           | (1,816)                         | (2,039)    |
| Depreciation and amortization   | 4,708                           | 6,854      |
| (Increase) decrease in accrued investment income                                  | (958)                           | 104        |
| (Increase) decrease in reinsurance recoverable on loss reserves                   | (204)                           | 748        |
| Decrease in prepaid reinsurance premiums  | 498                             | 498        |
| Decrease (increase) premium receivable  | 201                             | (1,237)    |
| Increase (decrease) in loss reserves  | 15,851                          | (20,897)   |
| Increase in unearned premiums   | 4,514                           | 307        |
| Increase in income taxes payable  | 32,074                          | 50,006     |
| Equity earnings in joint ventures   | (19,338)                        | (57,251)   |
| Distributions from joint ventures   | 51,512                          | 67,862     |
| Other   | (3,077)                         | (19,910)   |
| <br>  |                                 |            |
| Net cash provided by operating activities   | 178,988                         | 192,019    |
| <br>  |                                 |            |
| Cash flows from investing activities:   |                                 |            |
| Purchase of fixed maturities  | (466,702)                       | (386,062)  |
| Purchase of equity securities   | (22)                            |            |
| Increase in collateral under securities lending                                   | (58,215)                        |            |
| Additional investment in joint ventures   | (210)                           | (984)      |
| Proceeds from sale of fixed maturities  | 294,516                         | 350,525    |
| Proceeds from maturity of fixed maturities  | 142,880                         | 40,125     |
| Other   | 4,087                           | 9,114      |
| <br>  |                                 |            |
| Net cash (used in) provided by investing activities                               | (83,666)                        | 12,718     |
| <br>  |                                 |            |
| Cash flows from financing activities:   |                                 |            |
| Dividends paid to shareholders  | (20,760)                        | (21,954)   |
| Repayment of long-term debt   | (200,000)                       |            |
| Net proceeds from (repayment of) short-term debt                                  | 25,376                          | (89,583)   |
| Increase in obligations under securities lending                                  | 58,215                          |            |
| Reissuance of treasury stock  | 1,255                           | 1,275      |



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|   |            |            |
|---|------------|------------|
| Repurchase of common stock                                |            | (91,534)   |
| Common stock issued                                       | 1,942      | 5,532      |
| Excess tax benefits from share-based payment arrangements | (45)       | 2,866      |
| Net cash used in financing activities                     | (134,017)  | (193,398)  |
| Net (decrease) increase in cash and cash equivalents      | (38,695)   | 11,339     |
| Cash and cash equivalents at beginning of period          | 293,738    | 195,256    |
| Cash and cash equivalents at end of period                | \$ 255,043 | \$ 206,595 |

See accompanying notes to consolidated financial statements.

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**MGIC INVESTMENT CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**March 31, 2007**

**(Unaudited)**

**Note 1 Basis of presentation and summary of certain significant accounting policies**

The accompanying unaudited consolidated financial statements of MGIC Investment Corporation (the Company) and its wholly-owned subsidiaries have been prepared in accordance with the instructions to Form 10-Q as prescribed by the Securities and Exchange Commission (SEC) for interim reporting and do not include all of the other information and disclosures required by accounting principles generally accepted in the United States of America. These statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2006 included in the Company's Annual Report on Form 10-K.

In the opinion of management such financial statements include all adjustments, consisting primarily of normal recurring accruals, necessary to fairly present the Company's financial position and results of operations for the periods indicated. The results of operations for the three months ended March 31, 2007 may not be indicative of the results that may be expected for the year ending December 31, 2007.

**Business Combination**

On February 6, 2007 the Company and Radian Group Inc. (Radian) announced that they have agreed to merge. The agreement provides for a merger of Radian into the Company in which 0.9658 shares of the Company's common stock will be exchanged for each share of Radian common stock. The shares of the Company's common stock to be issued to effect the merger will be recorded at \$66.41 per share. This stock price is based on an average of the closing prices of the Company's common stock for the two trading days before through the two trading days after the Company and Radian announced their merger. The transaction has been unanimously approved by each company's board of directors and is expected to be completed late in the third quarter or early in the fourth quarter of 2007, subject to regulatory and shareholder approvals.

**Securities Lending**

The Company participates in securities lending, primarily as an investment yield enhancement, through a program administered by the Company's custodian. The program obtains collateral in an amount generally equal to 102% and 105% of the fair market value of domestic and foreign securities, respectively, and monitors the market value of the securities loaned on a daily basis with additional collateral obtained as necessary. The collateral received for securities loaned is included in the investment portfolio, and the offsetting obligation to return the collateral is reported as a liability, on the consolidated balance sheet. At March 31, 2007, the amount of the securities lending collateral and offsetting obligation was \$58.2 million. The fair value of securities on loan at March 31, 2007 was \$57.1 million.

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**New Accounting Standards**

In February 2007, the FASB issued SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities . This statement provides companies with an option to report selected financial assets and liabilities at fair value. The objective of this statement is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. The statement also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The statement is effective for a company s first fiscal year beginning after November 15, 2007. The Company is currently evaluating the provisions of this statement and the impact, if any, this statement will have on the Company s results of operations and financial position.

In September 2006, the FASB issued SFAS No. 157 Fair Value Measurements . This statement provides enhanced guidance for using fair value to measure assets and liabilities. This statement also provides expanded disclosure about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. This statement applies whenever other standards require or permit assets or liabilities to be measured at fair value. The statement does not expand the use of fair value in any new circumstances. The statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company is currently evaluating the provisions of this statement and the impact, if any, this statement will have on the Company s results of operations and financial position.

**Reclassifications**

Certain reclassifications have been made in the accompanying financial statements to 2006 amounts to conform to 2007 presentation.

**Note 2 Short- and long-term debt**

The Company has a \$300 million commercial paper program, which is rated A-1 by Standard and Poors ( S&P ) and P-1 by Moody s. At March 31, 2007, December 31, 2006 and March 31, 2006, the Company had \$110.3 million, \$84.1 million and \$100.0 million in commercial paper outstanding with a weighted average interest rate of 5.34%, 5.35% and 4.74%, respectively.

The Company has a \$300 million, five year revolving credit facility, expiring in 2010. Under the terms of the credit facility, the Company must maintain shareholders equity of at least \$2.25 billion and Mortgage Guaranty Insurance Corporation ( MGIC ) must maintain a risk-to-capital ratio of not more than 22:1 and maintain policyholders position (which includes MGIC s statutory surplus and its contingency reserve) of not less than the amount required by Wisconsin insurance regulation. At March 31, 2007, these requirements were met. The facility will continue to be used as a liquidity back up facility for the outstanding commercial paper. The remaining credit available under the facility after reduction for the amount

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necessary to support the commercial paper was \$189.7 million, \$215.9 million and \$200.0 million at March 31, 2007, December 31, 2006 and March 31, 2006, respectively.

In March 2007 the Company repaid the \$200 million, 6% Senior Notes that came due with funds raised from the September 2006 public debt offering. At March 31, 2007 the Company had \$200 million, 5.625% Senior Notes due in September 2011 and \$300 million, 5.375% Senior Notes due in November 2015. At March 31, 2006 the Company had \$300 million, 5.375% Senior Notes due in November 2015 and \$200 million, 6% Senior Notes due in March 2007. At March 31, 2007, December 31, 2006 and March 31 2006, the market value of the outstanding debt (which also includes commercial paper) was \$609.5 million, \$783.2 million and \$588.4 million, respectively.

Interest payments on all long-term and short-term debt were \$12.5 million and \$8.3 million for the three months ended March 31, 2007 and 2006, respectively.

During 2006, an outstanding interest rate swap contract was terminated. This swap was placed into service to coincide with the committed credit facility, used as a backup for the commercial paper program. Under the terms of the swap contract, the Company paid a fixed rate of 5.07% and received a variable interest rate based on the London Inter Bank Offering Rate ( LIBOR ). The swap had an expiration date coinciding with the maturity of the credit facility and was designated as a cash flow hedge for accounting purposes. At March 31, 2007 the Company had no interest rate swaps outstanding.

(Income) expense on the interest rate swaps for the three months ended March 31, 2006 of approximately (\$0.1) million was included in interest expense. Gains or losses arising from the amendment or termination of interest rate swaps are deferred and amortized to interest expense over the life of the hedged items.

**Note 3 Litigation and contingencies**

The Company is involved in litigation in the ordinary course of business. In the opinion of management, the ultimate resolution of this pending litigation will not have a material adverse effect on the financial position or results of operations of the Company.

Consumers are bringing a growing number of lawsuits against home mortgage lenders and settlement service providers. In recent years, seven mortgage insurers, including MGIC, have been involved in litigation alleging violations of the anti-referral fee provisions of the Real Estate Settlement Procedures Act, which is commonly known as RESPA, and the notice provisions of the Fair Credit Reporting Act, which is commonly known as FCRA. MGIC's settlement of class action litigation against it under RESPA became final in October 2003. MGIC settled the named plaintiffs' claims in litigation against it under FCRA in late December 2004 following denial of class certification in June 2004. In December 2006, class action litigation was separately brought against three large lenders alleging that their captive mortgage reinsurance arrangements violated RESPA. While we are not a defendant in any of these cases, there can be no assurance that MGIC will not be subject to future litigation under RESPA or FCRA or that the outcome of any such litigation would not have a material adverse effect on us. In 2005, the United States Court of Appeals for the Ninth Circuit decided a case under FCRA to which we were not a party that may make it more likely that we will be subject

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to litigation regarding when notices to borrowers are required by FCRA. The Supreme Court of the United States is reviewing this case, with a decision expected in the second quarter of 2007.

In June 2005, in response to a letter from the New York Insurance Department (the NYID), we provided information regarding captive mortgage reinsurance arrangements and other types of arrangements in which lenders receive compensation. In February 2006, the NYID requested MGIC to review its premium rates in New York and to file adjusted rates based on recent years' experience or to explain why such experience would not alter rates. In March 2006, MGIC advised the NYID that it believes its premium rates are reasonable and that, given the nature of mortgage insurance risk, premium rates should not be determined only by the experience of recent years. In February 2006, in response to an administrative subpoena from the Minnesota Department of Commerce (the MDC), which regulates insurance, we provided the MDC with information about captive mortgage reinsurance and certain other matters. We subsequently provided additional information to the MDC. Other insurance departments or other officials, including attorneys general, may also seek information about or investigate captive mortgage reinsurance. The anti-referral fee provisions of RESPA provide that the Department of Housing and Urban Development (HUD) as well as the insurance commissioner or attorney general of any state may bring an action to enjoin violations of these provisions of RESPA. The insurance law provisions of many states prohibit paying for the referral of insurance business and provide various mechanisms to enforce this prohibition. While we believe our captive reinsurance arrangements are in conformity with applicable laws and regulations, it is not possible to predict the outcome of any such reviews or investigations nor is it possible to predict their effect on us or the mortgage insurance industry. Under its contract underwriting agreements, the Company may be required to provide certain remedies to its customers if certain standards relating to the quality of the Company's underwriting work are not met. The cost of remedies provided by the Company to customers for failing to meet these standards has not been material to the Company's financial position or results of operations for the three months ended March 31, 2007 and 2006. See note 7 for a description of federal income tax contingencies.

**Note 4 Earnings per share**

The Company's basic and diluted earnings per share (EPS) have been calculated in accordance with SFAS No. 128, Earnings Per Share. The Company's net income is the same for both basic and diluted EPS. Basic EPS is based on the weighted average number of common shares outstanding. Diluted EPS is based on the weighted average number of common shares outstanding plus common stock equivalents which include stock awards and stock options. The following is a reconciliation of the weighted average number of shares used for basic EPS and diluted EPS.

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|                                 | Three Months Ended<br>March 31, |        |
|---------------------------------|---------------------------------|--------|
|                                 | 2007                            | 2006   |
|                                 | (in thousands)                  |        |
| Weighted-average shares Basic   | 81,890                          | 86,577 |
| Common stock equivalents        | 464                             | 650    |
| <br>                            |                                 |        |
| Weighted-average shares Diluted | 82,354                          | 87,227 |

**Note 5 Comprehensive income**

The Company's total comprehensive income, as calculated per SFAS No. 130, Reporting Comprehensive Income, was as follows:

|  | Three Months Ended<br>March 31, |             |
|--|---------------------------------|-------------|
|  | 2007                            | 2006        |
|  | (In thousands of dollars)       |             |
| Net income   | \$ 92,363                       | \$ 163,453  |
| Other comprehensive loss                             | (4,668)                         | (31,523)    |
| <br>   |                                 |             |
| Total comprehensive income                           | \$ 87,695                       | \$ 131,930  |
| <br>   |                                 |             |
| Other comprehensive income (loss) (net of tax):      |                                 |             |
| Change in unrealized net derivative gains and losses | \$                              | \$ 777      |
| Change in unrealized gains and losses on investments | (5,914)                         | (32,336)    |
| Other  | 1,246                           | 36          |
| <br>   |                                 |             |
| Other comprehensive loss                             | \$ (4,668)                      | \$ (31,523) |

At March 31, 2007, accumulated other comprehensive income of \$61.1 million included \$77.8 million of net unrealized gains on investments, \$2.4 million relating to a foreign currency translation adjustment, (\$17.8) million relating to defined benefit plans and (\$1.3) million relating to the accumulated other comprehensive loss of the Company's joint venture investments, all net of tax. At December 31, 2006, accumulated other comprehensive income of \$65.8 million included \$83.7 million of net unrealized gains on investments, (\$17.8) million relating to defined benefit plans and (\$0.1) million relating to the accumulated other comprehensive loss of the Company's joint venture investments.

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The following table provides the components of net periodic benefit cost for the pension, supplemental executive retirement and other postretirement benefit plans:

|                                       | Three Months Ended<br>March 31,                              |          |                                  |          |
|---------------------------------------|--|----------|----------------------------------|----------|
|                                       | Pension and<br>Supplemental<br>Executive Retirement<br>Plans |          | Other Postretirement<br>Benefits |          |
|                                       | 2007   | 2006     | 2007                             | 2006     |
|                                       | (In thousands of dollars)                                    |          |                                  |          |
| Service cost                          | \$ 2,504   | \$ 2,463 | \$ 890                           | \$ 898   |
| Interest cost                         | 3,016  | 2,741    | 1,112                            | 1,024    |
| Expected return on plan assets        | (4,370)  | (3,709)  | (804)                            | (649)    |
| Recognized net actuarial loss (gain)  | 63   | 98       | 26                               | 111      |
| Amortization of transition obligation |  |          | 71                               | 71       |
| Amortization of prior service cost    | 141  | 141      |                                  |          |
| <br>                                  |  |          |                                  |          |
| Net periodic benefit cost             | \$ 1,354   | \$ 1,734 | \$ 1,295                         | \$ 1,455 |

The Company previously disclosed in its financial statements for the year ended December 31, 2006 that it expected to contribute approximately \$10.7 million and \$3.5 million, respectively, to its pension and postretirement plans in 2007. As of March 31, 2007, no contributions have been made.

**Note 7 Income Taxes**

Effective January 1, 2007, the Company has adopted FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes. The Interpretation seeks to reduce the significant diversity in practice associated with recognition and measurement in the accounting for income taxes. The interpretation applies to all tax positions accounted for in accordance with SFAS No. 109, Accounting for Income Taxes. When evaluating a tax position for recognition and measurement, an entity shall presume that the tax position will be examined by the relevant taxing authority that has full knowledge of all relevant information. The interpretation adopts a benefit recognition model with a two-step approach, a more-likely-than-not threshold for recognition and derecognition, and a measurement attribute that is the greatest amount of benefit that is cumulatively greater than 50% likely of being realized. The Company as a result of the adoption recognized a decrease of \$85.5 million in the liability for unrecognized tax benefits, which was accounted for as an increase to the January 1, 2007 balance of retained earnings.

The total amount of unrecognized tax benefits as of January 1, 2007 was \$81.0 million. Included in that total are \$71.3 million in benefits that would affect the Company's effective tax rate. The Company recognizes interest accrued and penalties related to unrecognized tax benefits in income taxes. The Company has \$16.5 million for the payment of interest accrued as of January 1, 2007. It is reasonably possible that the

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Company could make a deposit of taxes during the next twelve months to eliminate the further accrual of interest. The occurrence, amount and timing of any deposit are discretionary and cannot be determined at this time.

The establishment of this liability requires estimates of potential outcomes of various issues and requires significant judgment. Although the resolutions of these issues are uncertain, the Company believes that sufficient provisions for income taxes have been made for potential liabilities that may result. If the resolutions of these matters differ materially from the Company's estimates, it could have a material impact on the Company's effective tax rate, results of operations and cash flows.

On April 30, 2007, as a result of an examination by the Internal Revenue Service ( IRS ) for taxable years 2000 through 2004, the Company received several Notices of Proposed Adjustment. The notices would greatly increase reported taxable income for those years and, if upheld, would require the Company to pay a total of \$188 million in taxes and accuracy related penalties, plus applicable interest. The IRS disagrees with the Company's treatment of the flow through income and loss from an investment in a portfolio of the residual interests of Real Estate Mortgage Investment Conduits ( REMICS ). The IRS has indicated that it does not believe that, for various reasons, the Company has established sufficient tax basis in the REMIC residual interests to deduct the losses from taxable income. The Company disagrees with this conclusion and believes that the flow through income and loss from these investments was properly reported on its federal income tax returns in accordance with applicable tax laws and regulations in effect during the periods involved and intends to use appropriate means to appeal these adjustments. Radian holds an interest in a substantially similar portfolio of REMICs that was purchased from the same seller in a transaction that closed at the same time.

**Note 8 Condensed consolidating financial statements**

The following condensed financial information sets forth, on a consolidating basis, the balance sheet, statement of operations, and statement of cash flows for MGIC Investment Corporation ( Parent Company ), which represents the Parent Company's investments in all of its subsidiaries under the equity method, Mortgage Guaranty Insurance Corporation and Subsidiaries ( MGIC Consolidated ), and all other subsidiaries of the Company ( Other ) on a combined basis. The eliminations column represents entries eliminating investments in subsidiaries, intercompany balances, and intercompany revenues and expenses.



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**Condensed Consolidating Balance Sheets**  
**At March 31, 2007**  
(in thousands of dollars)

|   | Parent<br>Company | MGIC<br>Consolidated | Other      | Eliminations   | Total        |
|---|-------------------|----------------------|------------|----------------|--------------|
| <b>ASSETS</b>                               |                   |                      |            |                |              |
| Total investments                           | \$ 2,331          | \$ 5,023,278         | \$ 302,262 | \$             | \$ 5,327,871 |
| Cash and cash equivalents                   | 11,279            | 208,426              | 35,338     |                | 255,043      |
| Reinsurance recoverable on loss reserves    |                   | 84,089               | 19         | (70,487)       | 13,621       |
| Prepaid reinsurance premiums                |                   | 24,088               | 3          | (14,969)       | 9,122        |
| Deferred insurance policy acquisition costs |                   | 11,925               |            |                | 11,925       |
| Investments in subsidiaries/joint ventures  | 5,007,564         | 619,273              | 2,817      | (5,007,564)    | 622,090      |
| Other assets                                | 49,279            | 397,205              | 27,064     | (65,530)       | 408,018      |
| <br>  |                   |                      |            |                |              |
| Total assets                                | \$ 5,070,453      | \$ 6,368,284         | \$ 367,503 | \$ (5,158,550) | \$ 6,647,690 |
| <br>  |                   |                      |            |                |              |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>  |                   |                      |            |                |              |
| Liabilities:                                |                   |                      |            |                |              |
| Loss reserves                               | \$                | \$ 1,141,565         | \$ 70,488  | \$ (70,487)    | \$ 1,141,566 |
| Unearned premiums                           |                   | 194,175              | 14,969     | (14,969)       | 194,175      |
| Short- and long-term debt                   | 607,847           | 9,364                |            | (9,325)        | 607,886      |
| Other liabilities                           | 7,190             | 250,784              | 39,467     | (48,794)       | 248,647      |
| <br>  |                   |                      |            |                |              |
| Total liabilities                           | 615,037           | 1,595,888            | 124,924    | (143,575)      | 2,192,274    |
| <br>  |                   |                      |            |                |              |
| Total shareholders equity                   | 4,455,416         | 4,772,396            | 242,579    | (5,014,975)    | 4,455,416    |
| <br>  |                   |                      |            |                |              |
| Total liabilities and shareholders equity   | \$ 5,070,453      | \$ 6,368,284         | \$ 367,503 | \$ (5,158,550) | \$ 6,647,690 |

**Condensed Consolidating Balance Sheets**  
**At December 31, 2006**  
(in thousands of dollars)

|                           | Parent<br>Company | MGIC<br>Consolidated | Other      | Eliminations | Total        |
|---------------------------|-------------------|----------------------|------------|--------------|--------------|
| <b>ASSETS</b>             |                   |                      |            |              |              |
| Total investments         | \$ 27,374         | \$ 4,935,881         | \$ 289,167 | \$           | \$ 5,252,422 |
| Cash and cash equivalents | 162,198           | 99,286               | 32,254     |              | 293,738      |

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|   |              |              |            |                |              |
|---|--------------|--------------|------------|----------------|--------------|
| Reinsurance recoverable on loss reserves    |              | 78,114       | 21         | (64,718)       | 13,417       |
| Prepaid reinsurance premiums                |              | 24,779       | 4          | (15,163)       | 9,620        |
| Deferred insurance policy acquisition costs |              | 12,769       |            |                | 12,769       |
| Investments in subsidiaries/joint ventures  | 4,882,408    | 652,910      | 2,974      | (4,882,408)    | 655,884      |
| Other assets                                | 15,228       | 391,247      | 27,598     | (50,252)       | 383,821      |
| <br>  |              |              |            |                |              |
| Total assets                                | \$ 5,087,208 | \$ 6,194,986 | \$ 352,018 | \$ (5,012,541) | \$ 6,621,671 |
| <br>  |              |              |            |                |              |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>  |              |              |            |                |              |
| Liabilities:                                |              |              |            |                |              |
| Loss reserves                               | \$           | \$ 1,125,715 | \$ 64,718  | \$ (64,718)    | \$ 1,125,715 |
| Unearned premiums                           |              | 189,661      | 15,163     | (15,163)       | 189,661      |
| Short- and long-term debt                   | 781,238      | 9,364        |            | (9,325)        | 781,277      |
| Other liabilities                           | 10,093       | 219,105      | 31,651     | (31,708)       | 229,141      |
| <br>  |              |              |            |                |              |
| Total liabilities                           | 791,331      | 1,543,845    | 111,532    | (120,914)      | 2,325,794    |
| <br>  |              |              |            |                |              |
| Total shareholders equity                   | 4,295,877    | 4,651,141    | 240,486    | (4,891,627)    | 4,295,877    |
| <br>  |              |              |            |                |              |
| Total liabilities and shareholders equity   | \$ 5,087,208 | \$ 6,194,986 | \$ 352,018 | \$ (5,012,541) | \$ 6,621,671 |

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**Condensed Consolidating Statements of Operations**  
**Three Months Ended March 31, 2007**  
(in thousands of dollars)

|  | Parent<br>Company | MGIC<br>Consolidated | Other      | Eliminations | Total      |
|--|-------------------|----------------------|------------|--------------|------------|
| Revenues:  |                   |                      |            |              |            |
| Net premiums written                               | \$                | \$ 285,998           | \$ 18,074  | \$ (38)      | \$ 304,034 |
| Net premiums earned                                |                   | 280,792              | 18,267     | (38)         | 299,021    |
| Equity in undistributed net income of subsidiaries | 42,623            |                      |            | (42,623)     |            |
| Dividends received from subsidiaries               | 55,000            |                      |            | (55,000)     |            |
| Investment income, net of expenses                 | 2,368             | 56,328               | 4,274      |              | 62,970     |
| Realized investment losses, net                    |                   | (377)                | (2,633)    |              | (3,010)    |
| Other revenue                                      |                   | 2,598                | 8,063      |              | 10,661     |
| Total revenues                                     | 99,991            | 339,341              | 27,971     | (97,661)     | 369,642    |
| Losses and expenses:                               |                   |                      |            |              |            |
| Losses incurred, net                               |                   | 166,787              | 14,971     |              | 181,758    |
| Underwriting and other expenses                    | 70                | 54,756               | 20,295     | (49)         | 75,072     |
| Interest expense                                   | 10,959            |                      |            |              | 10,959     |
| Total losses and expenses                          | 11,029            | 221,543              | 35,266     | (49)         | 267,789    |
| Income before tax and joint ventures               | 88,962            | 117,798              | (7,295)    | (97,612)     | 101,853    |
| Provision (credit) for income tax                  | (3,401)           | 29,742               | (2,241)    | (557)        | 23,543     |
| Income from joint ventures, net of tax             |                   | 14,049               | 4          |              | 14,053     |
| Net income   | \$ 92,363         | \$ 102,105           | \$ (5,050) | \$ (97,055)  | \$ 92,363  |

**Condensed Consolidating Statements of Operations**  
**Three Months Ended March 31, 2006**  
(in thousands of dollars)

|                      | Parent<br>Company | MGIC<br>Consolidated | Other     | Eliminations | Total      |
|----------------------|-------------------|----------------------|-----------|--------------|------------|
| Revenues:            |                   |                      |           |              |            |
| Net premiums written | \$                | \$ 282,653           | \$ 17,841 | \$ (22)      | \$ 300,472 |

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|  |            |            |          |              |            |
|--|------------|------------|----------|--------------|------------|
| Net premiums earned                                |            | 283,202    | 16,487   | (22)         | 299,667    |
| Equity in undistributed net income of subsidiaries | (35,515)   |            |          | 35,515       |            |
| Dividends received from subsidiaries               | 205,000    |            |          | (205,000)    |            |
| Investment income, net of expenses                 | 99         | 55,072     | 2,793    |              | 57,964     |
| Realized investment gains, net                     |            | 57         | 30       |              | 87         |
| Other revenue                                      |            | 2,665      | 8,649    |              | 11,314     |
| <br>   |            |            |          |              |            |
| Total revenues                                     | 169,584    | 340,996    | 27,959   | (169,507)    | 369,032    |
| <br>   |            |            |          |              |            |
| Losses and expenses:                               |            |            |          |              |            |
| Losses incurred, net                               |            | 110,599    | 4,286    |              | 114,885    |
| Underwriting and other expenses                    | 64         | 54,108     | 20,126   | (33)         | 74,265     |
| Interest expense                                   | 9,315      |            |          |              | 9,315      |
| <br>   |            |            |          |              |            |
| Total losses and expenses                          | 9,379      | 164,707    | 24,412   | (33)         | 198,465    |
| <br>   |            |            |          |              |            |
| Income before tax and joint ventures               | 160,205    | 176,289    | 3,547    | (169,474)    | 170,567    |
| Provision (credit) for income tax                  | (3,248)    | 48,738     | 659      | 17           | 46,166     |
| Income from joint ventures, net of tax             |            | 39,052     |          |              | 39,052     |
| <br>   |            |            |          |              |            |
| Net income   | \$ 163,453 | \$ 166,603 | \$ 2,888 | \$ (169,491) | \$ 163,453 |

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**Condensed Consolidating Statements of Cash Flows**  
**For the Three Months Ended March 31, 2007**  
(in thousands of dollars)

|   | Parent<br>Company   | MGIC<br>Consolidated | Other           | Eliminations | Total              |
|---|---------------------|----------------------|-----------------|--------------|--------------------|
| Net cash from operating activities:           | \$ 23,725(1)        | \$ 204,214           | \$ 13,504       | \$ (62,455)  | \$ 178,988         |
| Net cash from (used in) investing activities: | 17,543              | (98,289)             | (10,420)        | 7,500        | (83,666)           |
| Net cash (used in) financing activities:      | (192,187)           | 3,215                |                 | 54,955       | (134,017)          |
| <b>Net (decrease) increase in Cash</b>        | <b>\$ (150,919)</b> | <b>\$ 109,140</b>    | <b>\$ 3,084</b> | <b>\$</b>    | <b>\$ (38,695)</b> |

(1) Includes dividends received from subsidiaries of \$55,000.

**Condensed Consolidating Statements of Cash Flows**  
**For the Three Months Ended March 31, 2006**  
(in thousands of dollars)

|   | Parent<br>Company | MGIC<br>Consolidated | Other              | Eliminations | Total            |
|---|-------------------|----------------------|--------------------|--------------|------------------|
| Net cash from operating activities:           | \$ 199,443(1)     | \$ 194,629           | \$ 5,813           | \$ (207,866) | \$ 192,019       |
| Net cash from (used in) investing activities: | 44                | 30,188               | (17,514)           |              | 12,718           |
| Net cash (used in) financing activities:      | (196,264)         | (205,000)            |                    | 207,866      | (193,398)        |
| <b>Net increase (decrease) in Cash</b>        | <b>\$ 3,223</b>   | <b>\$ 19,817</b>     | <b>\$ (11,701)</b> | <b>\$</b>    | <b>\$ 11,339</b> |

(1) Includes dividends received from subsidiaries of \$205,000.

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

MGIC Investment Corporation and Radian Group Inc. have filed a joint proxy statement/prospectus and other relevant documents concerning the MGIC/Radian merger transaction with the United States Securities and Exchange Commission (the SEC). STOCKHOLDERS ARE URGED TO READ THE JOINT PROXY STATEMENT/PROSPECTUS AND ANY OTHER DOCUMENTS FILED WITH THE SEC IN CONNECTION WITH THE MERGER TRANSACTION OR INCORPORATED BY REFERENCE IN THE PROXY STATEMENT/PROSPECTUS BECAUSE THEY CONTAIN IMPORTANT INFORMATION. Investors may obtain these documents free of charge at the SEC's website (<http://www.sec.gov>). In addition, documents filed with the SEC by MGIC are available free of charge by contacting Investor Relations at MGIC Investment Corporation, 250 East Kilbourn Avenue, Milwaukee, WI 53202. Documents filed with the SEC by Radian are available free of charge by calling Investor Relations at (215) 231-1486.

Radian and MGIC and their respective directors and executive officers, certain members of management and other employees may be deemed to be participants in the solicitation of proxies from Radian stockholders and MGIC stockholders with respect to the proposed merger transaction. Information regarding the directors and executive officers of Radian and MGIC and the interests of such participants are included in the joint proxy statement/prospectus filed with the SEC (which relates to the merger transaction, Radian's 2007 annual meeting of stockholders and MGIC's 2007 annual meeting of stockholders) and in the other relevant documents filed with the SEC.

**Overview**

*Proposed Merger with Radian Group*

In early February 2007 we announced that we agreed to merge (the Merger) with Radian Group Inc. (Radian). The agreement provides for a merger of Radian into us in which 0.9658 shares of our common stock will be exchanged for each share of Radian common stock. Radian has publicly reported that at March 19, 2007 it had 80.3 million shares of common stock outstanding and eligible to vote at its shareholder meeting. The transaction has been unanimously approved by each company's board of directors and is expected to be completed late in the third quarter or early in the fourth quarter of 2007, subject to regulatory and shareholder approvals. At our 2007 annual meeting, which will be held on May 10, 2007, we will ask our shareholders to approve the Merger Agreement. Radian will ask the same of their shareholders at their annual meeting on May 9, 2007. The results of the shareholder votes were not known at the time we finalized this Quarterly Report.

We would almost double in size if the Merger occurs. See Note 16 to our consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2006. We would also be engaged in the financial guaranty business and intend to dispose of certain of the interests that the combined company would have held in the Credit-Based Asset Servicing and Securitization LLC (C-BASS) and Sherman Financial Group LLC (Sherman) joint ventures to avoid the potentially adverse impact that owning more than 50% may have on the combined company's financial ratings. The

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business description, financial results and any forward looking statements that follow apply only to our business, and do not reflect the effects of the Merger. For further information regarding the Merger, you should read our Current Reports on Form 8-K filed on February 6 and 12, 2007, as well as our S-4/A filed on April 5, 2007 and our Joint Proxy Statement/Prospectus on Form 424B3 filed on April 9, 2007.

*Business and General Environment*

Through our subsidiary Mortgage Guaranty Insurance Corporation ( MGIC ), we are the leading provider of private mortgage insurance in the United States to the home mortgage lending industry. Our principal products are primary mortgage insurance and pool mortgage insurance. Primary mortgage insurance may be written through the flow market channel, in which loans are insured in individual, loan-by-loan transactions. Primary mortgage insurance may also be written through the bulk market channel, in which portfolios of loans are individually insured in single, bulk transactions.

As used below, we and our refer to MGIC Investment Corporation's consolidated operations. The discussion below should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2006. We refer to this Discussion as the 10-K MD&A.

Our results of operations are affected by:

Premiums written and earned

Premiums written and earned in a year are influenced by:

New insurance written, which increases the size of the in force book of insurance. New insurance written is the aggregate principal amount of the mortgages that are insured during a period and is referred to as

NIW. NIW is affected by many factors, including the volume of low down payment home mortgage originations and competition to provide credit enhancement on those mortgages, including competition from other mortgage insurers and alternatives to mortgage insurance, such as piggyback loans.

Cancellations, which reduce the size of the in force book of insurance that generates premiums.

Cancellations due to refinancings are affected by the level of current mortgage interest rates compared to the mortgage coupon rates throughout the in force book, as well as by home price appreciation.

Premium rates, which are affected by the risk characteristics of the loans insured and the percentage of coverage on the loans.

Premiums ceded to reinsurance subsidiaries of certain mortgage lenders and risk sharing arrangements with the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation (government sponsored entities or GSEs).

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Premiums are generated by the insurance that is in force during all or a portion of the period. Hence, lower average insurance in force in one period compared to another is a factor that will reduce premiums written and earned, although this effect may be mitigated (or enhanced) by differences in the average premium rate between the two periods as well as by premium that is ceded. Also, NIW and cancellations during a period will generally have a greater effect on premiums written and earned in subsequent periods than in the period in which these events occur.

**Investment income**

The investment portfolio is comprised almost entirely of highly rated, fixed income securities. The principal factors that influence investment income are the size of the portfolio and its yield. As measured by amortized cost (which excludes changes in fair market value, such as from changes in interest rates), the size of the investment portfolio is mainly a function of cash generated from operations, including investment earnings, less cash used for non-investment purposes, such as share repurchases. Realized gains and losses are a function of the difference between the amount received on sale of a security and the security's amortized cost. The amount received on sale is affected by the coupon rate of the security compared to the yield of comparable securities.

**Losses incurred**

Losses incurred are the expense that results from a payment delinquency on an insured loan. As explained under Critical Accounting Policies in the 10-K MD&A, this expense is recognized only when a loan is delinquent. Losses incurred are generally affected by:

The state of the economy, which affects the likelihood that loans will become delinquent and whether loans that are delinquent cure their delinquency. The level of delinquencies has historically followed a seasonal pattern, with a reduction in delinquencies in the first part of the year, followed by an increase in the latter part of the year.

The product mix of the in force book, with loans having higher risk characteristics generally resulting in higher delinquencies and claims.

The average claim payment, which is affected by the size of loans insured (higher average loan amounts tend to increase losses incurred), the percentage coverage on insured loans (deeper average coverage tends to increase incurred losses), and housing values, which affect our ability to mitigate our losses through sales of properties with delinquent mortgages.

The distribution of claims over the life of a book. Historically, the first two years after a loan is originated are a period of relatively low claims, with claims increasing substantially for several years subsequent and then declining, although persistency and the condition of the economy can affect this pattern.



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Underwriting and other expenses

Our operating expenses generally vary with the level of mortgage origination activity, contract underwriting volume and expansion into international markets. Contract underwriting generates fee income included in Other revenue.

Income from joint ventures

Our results of operations are also affected by income from joint ventures. Joint venture income principally consists of the aggregate results of our investment in two less than majority owned joint ventures, C-BASS and Sherman.

C-BASS: C-BASS is primarily an investor in the credit risk of credit-sensitive single-family residential mortgages. It finances these activities through borrowings included on its balance sheet and by securitization activities generally conducted through off-balance sheet entities. C-BASS generally retains the first-loss and other subordinate securities created in the securitization. The mortgage loans owned by C-BASS and underlying C-BASS's mortgage securities investments are generally serviced by Litton Loan Servicing LP, a subsidiary of C-BASS ( Litton ). Litton's servicing operations primarily support C-BASS's investment in credit risk, and investments made by funds managed or co-managed by C-BASS, rather than generating fees for servicing loans owned by third-parties.

C-BASS's consolidated results of operations are affected by:

Portfolio revenue, which in turn is primarily affected by net interest income, gain on sale and liquidation, gain on securitization and hedging gains and losses related to portfolio assets and securitization, net of mark-to-market and whole loan reserve changes.

Net interest income

Net interest income is principally a function of the size of C-BASS's portfolio of whole loans and mortgages and other securities, and the spread between the interest income generated by these assets and the interest expense of funding them. Interest income from a particular security is recognized based on the expected yield for the security.

Gain on sale and liquidation

Gain on sale and liquidation results from sales of mortgage and other securities, and liquidation of mortgage loans. Securities may be sold in the normal course of business or because of the exercise of call rights by third parties. Mortgage loan liquidations result from loan payoffs, from foreclosure or from sales of real estate acquired through foreclosure.

Gain on securitization

Gain on securitization is a function of the face amount of the collateral in the securitization and the margin realized in the securitization. This margin

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depends on the difference between the proceeds realized in the securitization and the purchase price paid by C-BASS for the collateral. The proceeds realized in a securitization include the value of securities created in the securitization that are retained by C-BASS.

Hedging gains and losses, net of mark-to-market and whole loan reserve changes

Hedging gains and losses primarily consist of changes in the value of derivative instruments (including interest rate swaps, interest rate caps and futures) and short positions, as well as realized gains and losses from the closing of hedging positions. C-BASS uses derivative instruments and short sales in a strategy to reduce the impact of changes in interest rates on the value of its mortgage loans and securities. Changes in value of derivative instruments are subject to current recognition through the income statement because C-BASS does not account for the derivatives as hedges under SFAS No. 133. Mortgage and other securities are classified by C-BASS as trading securities and are carried at fair value, as estimated by C-BASS. Changes in fair value between period ends (a mark-to-market ) are reflected in C-BASS's statement of operations as unrealized gains or losses. Changes in fair value of mortgage and other securities may relate to changes in credit spreads or to changes in the level of interest rates or the slope of the yield curve. Mortgage loans are not marked-to-market and are carried at the lower of cost or fair value on a portfolio basis, as estimated by C-BASS. During a period in which short-term interest rates decline, in general, C-BASS's hedging positions will decline in value and the change in value, to the extent that the hedges related to whole loans, will be reflected in C-BASS's earnings for the period as an unrealized loss. The related increase, if any, in the value of mortgage loans will not be reflected in earnings but, absent any countervailing factors, when mortgage loans owned during the period are securitized, the proceeds realized in the securitization should increase to reflect the increased value of the collateral.

Servicing revenue

Servicing revenue is a function of the unpaid principal balance of mortgage loans serviced and servicing fees and charges. The unpaid principal balance of mortgage loans serviced by Litton is affected by mortgages acquired by C-BASS because servicing on subprime and other mortgages acquired is generally transferred to Litton. Litton also services or provides special servicing on loans in mortgage securities owned by funds managed or co-managed by C-BASS. Litton also may obtain servicing on loans in third party mortgage securities acquired by C-BASS or when the loans become delinquent by a specified number of payments (known as special servicing ).

Revenues from money management activities

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These revenues include management fees from C-BASS issued collateralized bond obligations ( CBOs ), equity in earnings from C-BASS investments in investment funds managed or co-managed by C-BASS and management fees and incentive income from investment funds managed or co-managed by C-BASS.

*Sherman:* Sherman is principally engaged in purchasing and collecting for its own account delinquent consumer receivables, which are primarily unsecured, and in originating and servicing subprime credit card receivables. The borrowings used to finance these activities are included in Sherman's balance sheet.

Sherman's consolidated results of operations are affected by:

Revenues from delinquent receivable portfolios

These revenues are the cash collections on such portfolios, and depend on the aggregate amount of delinquent receivables owned by Sherman, the type of receivable and the length of time that the receivable has been owned by Sherman.

Amortization of delinquent receivable portfolios

Amortization is the recovery of the cost to purchase the receivable portfolios. Amortization expense is a function of estimated collections from the portfolios over their estimated lives. If estimated collections cannot be reasonably predicted, cost is fully recovered before any net revenue (the difference between revenues from a receivable portfolio and that portfolio's amortization) is recognized.

Credit card interest and fees, along with the coincident provision for losses for uncollectible amounts.

Costs of collection, which include servicing fees paid to third parties to collect receivables.

**2007 First Quarter Results**

Our results of operations in the first quarter of 2007 were principally affected by:

Losses incurred

Losses incurred for the first quarter of 2007 increased compared to the same period in 2006 primarily due to a smaller decrease in the default inventory and a larger increase in the estimates regarding how much will be paid on claims (severity), when each are compared to the same period in 2006. The increase in estimated severity is primarily the result of the default inventory containing higher loan exposures with expected higher average claim payments as well as a decrease in our ability to mitigate losses through the sale of properties in some geographical areas due to slowing home price appreciation in such areas.

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Premiums written and earned

Premiums written and earned during the first quarter of 2007 were flat when compared to the same period in 2006. The average insurance in force continues to increase, but has been offset by lower average premium yields due to a higher proportion of insurance in force written through the flow channel compared to the same period a year ago.

Underwriting and other expenses

Underwriting and other expenses for the first quarter of 2007 increased slightly when compared to the same period in 2006. The increase was primarily due to international expansion.

Investment income

Investment income in the first quarter of 2007 was higher when compared to the same period 2006 due to an increase in the pre-tax yield.

Income from joint ventures

Income from joint ventures decreased in the first quarter of 2007 compared to the same period in 2006. This decrease was primarily due to an operating loss at C-BASS in the first quarter of 2007, our portion of which was \$6.6 million, compared to operating income in the first quarter of 2006, our portion of which was \$30.1 million. C-BASS's loss during the first quarter of 2007 was primarily due to a write down in their securities portfolio due to spread widening and an increase in loss assumptions, securitization losses, negative mark-to-market adjustments on their whole loan portfolio and write-offs of claims against certain counterparties whose creditworthiness became impaired.

**Table of Contents****RESULTS OF CONSOLIDATED OPERATIONS**

As discussed under *Forward Looking Statements and Risk Factors* below, actual results may differ materially from the results contemplated by forward looking statements. We are not undertaking any obligation to update any forward looking statements we may make in the following discussion or elsewhere in this document even though these statements may be affected by events or circumstances occurring after the forward looking statements were made.

*NIW*

The amount of our NIW (this term is defined under *Premiums written and earned* in the *Overview Business and General Environment* section) during the three months ended March 31, 2007 and 2006 was as follows:

|                  | Three Months Ended<br>March 31, |             |
|------------------|---------------------------------|-------------|
|                  | 2007                            | 2006        |
|                  | (\$ billions)                   |             |
| NIW-Flow Channel | \$ 10.4                         | \$ 7.9      |
| NIW-Bulk Channel | 2.3                             | 2.1         |
| <br>Total NIW    | <br>\$ 12.7                     | <br>\$ 10.0 |

|   |     |     |
|---|-----|-----|
| Refinance volume as a % of primary flow NIW | 27% | 28% |
|---|-----|-----|

The increase in NIW on a flow basis in the first quarter of 2007, compared to the same period in 2006, was primarily due to a renewed interest in credit quality protection, along with changes in interest rates, slowing property appreciation and mortgage insurance tax deductibility. For a discussion of NIW written through the bulk channel, see *Bulk transactions* below.

**Table of Contents***Cancellations and insurance in force*

NIW and cancellations of primary insurance in force during the three months ended March 31, 2007 and 2006 were as follows:

|   | Three Months Ended<br>March 31,<br>2007      2006<br>(in billions) |                   |
|---|--|-------------------|
| NIW<br>Cancellations                                  | \$ 12.7<br>(10.9)  | \$ 10.0<br>(13.1) |
| <br>Change in primary insurance in force              | <br>\$ 1.8   | <br>\$ (3.1)      |
| <br>Direct primary insurance in force as of March 31, | <br>\$ 178.3   | <br>\$ 166.9      |

In the first quarter of 2007 insurance in force increased \$1.8 billion. This was the fourth consecutive quarter of growth in the in force book.

Cancellation activity has historically been affected by the level of mortgage interest rates and the level of home price appreciation. Cancellations generally move inversely to the change in the direction of interest rates, although they generally lag a change in direction. Our persistency rate (percentage of insurance remaining in force from one year prior) was 70.3% at March 31, 2007, an increase from 69.6% at December 31, 2006 and 62.0% at March 31, 2006. These persistency rate improvements and the related decline in cancellations reflect the general upward trend in mortgage interest rates and declining rate of home price appreciation over these periods. We continue to expect modest improvement in the persistency rate in 2007, although this expectation assumes the absence of significant declines in the level of mortgage interest rates from their level in late April 2007.

*Bulk transactions*

Our writings of bulk insurance are in part sensitive to the volume of securitization transactions involving non-conforming loans. Our writings of bulk insurance are, in part, also sensitive to competition from other methods of providing credit enhancement in a securitization, including an execution in which the subordinate tranches in the securitization rather than mortgage insurance bear the first loss from mortgage defaults. Competition from such an execution depends on, among other factors, the yield at which investors are willing to purchase tranches of the securitization that involve a higher degree of credit risk compared to the yield for tranches involving the lowest credit

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risk (the difference in such yields is referred to as the spread), the amount of higher risk tranches that investors are willing to purchase, and the amount of credit for losses that a rating agency will give to mortgage insurance. As the spread narrows, competition from an execution in which the subordinate tranches bear the first loss increases. The competitiveness of the mortgage insurance execution in the bulk channel may also be impacted by changes in our view of the risk of the business, which is affected by the historical performance of previously insured pools and our expectations for regional and local real estate values. As a result of the sensitivities discussed above, bulk volume can vary materially from period to period.

NIW for bulk transactions was \$2.3 billion in the first quarter of 2007 compared to \$2.1 billion in the first quarter of 2006. We price our bulk business to generate acceptable returns; there can be no assurance, however, that the assumptions underlying the premium rates will achieve this objective.

*Pool insurance*

In addition to providing primary insurance coverage, we also insure pools of mortgage loans. New pool risk written during the three months ended March 31, 2007 and 2006 was \$39 million and \$68 million, respectively. Our direct pool risk in force was \$3.0 billion, \$3.1 billion and \$3.0 billion at March 31, 2007, December 31, 2006 and March 31, 2006, respectively. These risk amounts represent pools of loans with contractual aggregate loss limits and those without such limits. For pools of loans without such limits, risk is estimated based on the amount that would credit enhance the loans in the pool to a AA level based on a rating agency model. Under this model, at March 31, 2007, December 31, 2006 and March 31, 2006, for \$4.3 billion, \$4.4 billion and \$4.8 billion, respectively, of risk without such limits, risk in force is calculated at \$473 million, \$473 million and \$470 million, respectively. For the three months ended March 31, 2007 and 2006 for \$13 million and \$21 million, respectively, of risk without contractual aggregate loss limits, new risk written under this model was \$0.5 million and \$1.2 million, respectively.

*Net premiums written and earned*

Net premiums written and earned during the first quarter of 2007 were flat when compared to the same period in 2006. The average insurance in force continues to increase, but has been offset by lower average premium yields due to a higher proportion of insurance in force written through the flow channel compared to the same period a year ago. Assuming no significant decline in interest rates from their level at the end of April 2007, we expect the average insurance in force during 2007 to continue to be higher than in 2006 based on our expectation that private mortgage insurance will be used on a greater percentage of mortgage originations in 2007.

*Risk sharing arrangements*

For the quarter ended December 31, 2006, approximately 48.3% of our new insurance written on a flow basis was subject to arrangements with reinsurance

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subsidiaries of certain mortgage lenders or risk sharing arrangements with the GSEs compared to 48.0% for the quarter ended March 31, 2006. The percentage of new insurance written during a period covered by such arrangements normally increases after the end of the period because, among other reasons, the transfer of a loan in the secondary market can result in a mortgage insured during a period becoming part of such an arrangement in a subsequent period. Therefore, the percentage of new insurance written covered by such arrangements is not shown for the most recently ended quarter. Premiums ceded in such arrangements are reported in the period in which they are ceded regardless of when the mortgage was insured.

*Investment income*

Investment income for the first quarter of 2007 increased when compared to the same period in 2006 due to an increase in the average investment yield. The portfolio's average pre-tax investment yield was 4.54% at March 31, 2007 and 4.35% at March 31, 2006. The portfolio's average after-tax investment yield was 4.06% at March 31, 2007 and 3.87% at March 31, 2006.

*Other revenue*

Other revenue for the first quarter of 2007 decreased when compared to the same period in 2006. The decrease in other revenue is primarily the result of a decrease in revenue from contract underwriting.

*Losses*

As discussed in *Critical Accounting Policies* in the 10-K MD&A, consistent with industry practices, loss reserves for future claims are established only for loans that are currently delinquent. (The terms *delinquent* and *default* are used interchangeably by us and are defined as an insured loan with a mortgage payment that is 45 days or more past due.) Loss reserves are established by management's estimation of the number of loans in our inventory of delinquent loans that will not cure their delinquency and thus result in a claim (historically, a substantial majority of delinquent loans have cured), which is referred to as the claim rate, and further estimating the amount that we will pay in claims on the loans that do not cure, which is referred to as claim severity. Estimation of losses that we will pay in the future is inherently judgmental. The conditions that affect the claim rate and claim severity include the current and future state of the domestic economy and the current and future strength of local housing markets.

Losses incurred for the first quarter of 2007 increased compared to the same period in 2006 primarily due to a smaller decrease in the default inventory and a larger increase in the estimates regarding how much will be paid on claims (severity), when each are compared to the same period in 2006. Our estimates are determined based upon historical experience. The increase in estimated severity is primarily the result of the default inventory containing higher loan exposures with expected higher average claim payments as well as a decrease in our ability to mitigate losses through the sale of properties in some geographical areas. Although the total default inventory has



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decreased we have experienced increases in certain markets. In California we have experienced an increase in delinquencies, from 1,900 as of March 31, 2006 to 3,400 as of March 31, 2007. Also the average claim paid on California loans is twice as high as the average claim paid for the remainder of the country. We have also experienced an increase in delinquencies in Arizona, Florida and Massachusetts and those delinquencies also have above average loan balances.

We anticipate that losses incurred during the remainder of 2007 will exceed net paid claims during this period and exceed the 2006 level of losses incurred.

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Information about the composition of the primary insurance default inventory at March 31, 2007, December 31, 2006 and March 31, 2006 appears in the table below.

|   | March 31,<br>2007 | December<br>31,<br>2006 | March 31,<br>2006 |
|---|-------------------|-------------------------|-------------------|
| Total loans delinquent  | 76,122            | 78,628                  | 76,362            |
| Percentage of loans delinquent (default rate)                 | 5.92%             | 6.13%                   | 6.00%             |
| Prime loans delinquent*                                       | 35,436            | 36,727                  | 36,114            |
| Percentage of prime loans delinquent (default rate)           | 3.56%             | 3.71%                   | 3.65%             |
| A-minus loans delinquent*                                     | 17,047            | 18,182                  | 18,109            |
| Percentage of A-minus loans delinquent (default rate)         | 15.77%            | 16.81%                  | 16.04%            |
| Subprime credit loans delinquent*                             | 11,246            | 12,227                  | 12,297            |
| Percentage of subprime credit loans delinquent (default rate) | 25.86%            | 26.79%                  | 24.03%            |
| Reduced documentation loans delinquent                        | 12,393            | 11,492                  | 9,842             |
| Percentage of reduced doc loans delinquent (default rate)     | 8.92%             | 8.19%                   | 8.19%             |

\* Prime loans have FICO credit scores of 620 or greater, as reported to us at the time a commitment to insure is issued. A-minus loans have FICO credit scores of 575-619, and subprime credit loans have FICO credit scores of less than 575. Most A-minus and subprime credit loans are written through the bulk channel.

The average primary claim paid for the three months ended March 31, 2007 was \$30,841 compared to \$26,857 for the same period in 2006. We expect increases in the average primary claim paid throughout 2007 and beyond. These increases are expected to be driven by our higher average insured loan sizes as well as decreases in our ability to mitigate losses through the sale of properties in some geographical regions, as certain housing markets, like California and Florida, become less favorable. The average loan size on our bulk business has grown from \$147,000 in 2003 to \$236,000 in 2006 and the flow average loan size has increased from \$144,000 in 2003 to \$161,000 in 2006.

The pool notice inventory increased slightly from 20,458 at December 31, 2006 to 20,665 at March 31, 2007; the pool notice inventory was 21,127 at March 31, 2006.

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Information about net losses paid during the three months ended March 31, 2007 and 2006 appears in the table below.

|                               | Three Months Ended<br>March 31, |        |
|-------------------------------|---------------------------------|--------|
|                               | 2007                            | 2006   |
| Net paid claims (\$ millions) |                                 |        |
| Prime (FICO 620 & >)          | \$ 67                           | \$ 57  |
| A-Minus (FICO 575-619)        | 34                              | 28     |
| Subprime (FICO < 575)         | 19                              | 13     |
| Reduced doc (All FICOs)       | 26                              | 17     |
| Other                         | 20                              | 20     |
|                               | \$ 166                          | \$ 135 |

We anticipate that net paid claims in the remainder of 2007 will exceed their 2006 level.

As of March 31, 2007, 72% of our primary insurance in force was written subsequent to December 31, 2003. On our flow business, the highest claim frequency years have typically been the third and fourth year after the year of loan origination. However, the pattern of claims frequency can be affected by many factors, including low persistency (which can have the effect of accelerating the period in the life of a book during which the highest claim frequency occurs) and deteriorating economic conditions (which can result in increasing claims following a period of declining claims). On our bulk business, the period of highest claims frequency has generally occurred earlier than in the historical pattern on our flow business.

*Underwriting and other expenses*

Underwriting and other expenses for the first quarter of 2007 increased slightly when compared to the same period in 2006. We anticipate that expenses for the remainder of 2007 will increase compared to 2006, due primarily to international expansion.

**Table of Contents***Consolidated ratios*

The table below presents our consolidated loss, expense and combined ratios for the three months ended March 31, 2007 and 2006.

|                                    | Three Months Ended<br>March 31, |       |
|------------------------------------|---------------------------------|-------|
|                                    | 2007                            | 2006  |
| Consolidated Insurance Operations: |                                 |       |
| Loss ratio                         | 60.8%                           | 38.3% |
| Expense ratio                      | 17.8%                           | 17.5% |
| Combined ratio                     | 78.6%                           | 55.8% |

The loss ratio (expressed as a percentage) is the ratio of the sum of incurred losses and loss adjustment expenses to net premiums earned. The increase in the loss ratio in the first quarter of 2007, compared to the same period in 2006, is due to an increase in losses incurred. The expense ratio (expressed as a percentage) is the ratio of underwriting expenses to net premiums written. The increase in the expense ratio in the first quarter of 2007, compared to the same period in 2006, is due to an increase in our expenses. The combined ratio is the sum of the loss ratio and the expense ratio.

*Income taxes*

The effective tax rate was 23.1% in the first quarter of 2007, compared to 27.1% in the first quarter of 2006. During those periods, the effective tax rate was below the statutory rate of 35%, reflecting the benefits recognized from tax-preferenced investments. Our tax-preferenced investments that impact the effective tax rate consist almost entirely of tax-exempt municipal bonds. Changes in the effective tax rate principally result from a higher or lower percentage of total income before tax being generated from tax-preferenced investments. The lower effective tax rate in the first quarter of 2007 resulted from a higher percentage of total income before tax being generated from tax-preferenced investments, which resulted from lower levels of underwriting income.

*Joint ventures*

Our equity in the earnings from the C-BASS and Sherman joint ventures with Radian and certain other joint ventures and investments, accounted for in accordance with the equity method of accounting, is shown separately, net of tax, on our consolidated statement of operations. Income from joint ventures decreased in the first quarter of 2007 compared to the same period in 2006. This decrease was primarily due to an operating loss at C-BASS in the first quarter of 2007, our portion of which was \$6.6 million, compared to operating income in the first quarter of 2006, our portion of which was \$30.1 million. C-BASS's loss during the first quarter of 2007 was primarily due to a write down in their securities portfolio due to spread widening and an increase in loss assumptions, securitization losses, negative mark-to-market adjustments on their whole loan portfolio and write-offs of claims against certain counterparties whose creditworthiness became impaired.

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**C-BASS**

*Fieldstone:* On February 15, 2007, C-BASS and Fieldstone Investment Corporation ( Fieldstone ) entered into a merger agreement, which was subsequently amended to reduce the purchase price on March 13, 2007. The reduction in purchase price reflects the cost to provide Fieldstone with needed additional liquidity, pending the closing of the merger. This additional liquidity will be provided through the sale to C-BASS, at Fieldstone's option, of securities and mortgage loans owned by Fieldstone. Under the terms of the amended agreement, C-BASS will acquire all of the outstanding common stock of Fieldstone for approximately \$188 million in cash. Completion of the transaction, which is currently expected to occur in the second quarter of 2007, is contingent on various closing conditions, including regulatory approvals and the approval of Fieldstone's stockholders. At the close of the transaction, Fieldstone will become a wholly owned subsidiary of C-BASS. At December 31, 2006, Fieldstone owned and managed a portfolio of over \$5.7 billion of non-conforming mortgage loans originated primarily by a Fieldstone subsidiary. These mortgage loans are financed through securitizations that are structured as debt with the result that both the mortgage loans and the related debt appear on Fieldstone's balance sheet. The closing of the acquisition will not change this balance sheet treatment. At December 31, 2006, according to information filed by Fieldstone with the Securities and Exchange Commission, Fieldstone's assets were \$6.4 billion; its liabilities were \$6.0 billion; and its shareholder's equity was \$0.4 billion. At the closing, Fieldstone's assets and liabilities will be adjusted to reflect the purchase price, as required by generally accepted accounting principles.

*Subprime Market:* Significant dislocation occurred in the subprime mortgage market during the first quarter of 2007. This was primarily due to the poor performance of subprime mortgage loans originated in 2006, as demonstrated by a significant increase in early pay/first pay defaults. Spreads on non-investment grade and non-rated subprime mortgage securities, which are the bulk of C-BASS's mortgage securities portfolio, increased dramatically during the latter part of February and through March 2007. This created liquidity issues in the subprime industry, resulting in a significant decline in the volume of originations, and impairment of the financial strength of many subprime originators.

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## Results of Operations and Financial Condition

Summary C-BASS balance sheets and income statements at the dates and for the periods indicated appear below.

## C-BASS Summary Balance Sheet:

| (March 31, 2007 unaudited<br>December 31, 2006 audited) | March<br>31,<br>2007 | December<br>31,<br>2006 |
|---|----------------------|-------------------------|
|   | (\$ millions)        |                         |
| Assets:   |                      |                         |
| Whole loans   | \$ 3,066             | \$ 4,596                |
| Securities  | 2,331                | 2,422                   |
| Servicing   | 671                  | 656                     |
| Other   | 800                  | 1,127                   |
| <b>Total Assets</b>                                     | <b>\$ 6,868</b>      | <b>\$ 8,801</b>         |
| <br>  |                      |                         |
| Total Liabilities                                       | \$ 5,956             | \$ 7,875                |
| <br>  |                      |                         |
| Debt (1)  | \$ 4,778             | \$ 6,140                |
| <br>  |                      |                         |
| Owners Equity   | \$ 912               | \$ 926                  |

(1) Most of which is scheduled to mature within one year or less.

Included in whole loans and total liabilities at March 31, 2007 and December 31, 2006 were approximately \$530 million and \$741 million, respectively, of assets and \$511 million and \$720 million, respectively, of liabilities from third party securitizations that did not qualify for off-balance sheet treatment. The liabilities from these securitizations are not included in Debt in the table above.

| C-BASS Summary Income Statement:<br>(unaudited) | Three Months Ended<br>March 31, |         |
|---|---------------------------------|---------|
|   | 2007                            | 2006    |
|   | (in millions)                   |         |
| Portfolio                                       | \$ (16.1)                       | \$ 76.3 |
| Net servicing                                   | 52.0                            | 44.9    |
| Money management and other                      | 3.1                             | 8.1     |
| <br>  |                                 |         |
| Total revenue                                   | 39.0                            | 129.3   |
| <br>  |                                 |         |
| Total expense                                   | 53.7                            | 63.8    |
| <br>  |                                 |         |
| Income (loss) before tax                        | \$ (14.7)                       | \$ 65.5 |
| <br>  |                                 |         |
| Company's share of pre-tax income (loss)        | \$ (6.6)                        | \$ 30.1 |





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See Overview Business and General Environment Income from Joint Ventures C-BASS for a description of the components of the revenue lines.

The \$14.7 million pre-tax loss in the first quarter of 2007 was primarily due to a write down in their securities portfolio due to spread widening and an increase in loss assumptions, securitization losses, negative mark-to-market adjustments on their whole loan portfolio and write-offs of claims against certain counterparties whose creditworthiness became impaired. These losses were offset by an operating profit, loan servicing, interest income on portfolios and reduced compensation expenses.

Our investment in C-BASS on an equity basis at March 31, 2007 was \$442.9 million. There were no distributions from C-BASS during the first quarter of 2007.

Sherman

Summary Sherman balance sheets and income statements at the dates and for the periods indicated appear below.

| Sherman Summary Balance Sheet:<br>(March 31, 2007 unaudited<br>December 31, 2006 audited) | March 31,<br>2007 | December<br>31,<br>2006 |
|---|-------------------|-------------------------|
|   | (\$ millions)     |                         |
| Total Assets  | \$ 1,234          | \$ 1,204                |
| Total Liabilities   | \$ 1,001          | \$ 923                  |
| Debt  | \$ 845            | \$ 761                  |
| Members Equity  | \$ 233            | \$ 281                  |

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| Sherman Summary Income Statement:<br>(unaudited) | Three Months Ended<br>March 31,<br>(\$ millions) |          |
|--|--|----------|
|  | 2007   | 2006     |
| Revenues from receivable portfolios              | \$ 281.0   | \$ 284.9 |
| Portfolio amortization                           | 122.1  | 101.2    |
| Revenues, net of amortization                    | 158.9  | 183.7    |
| Credit card interest income and fees             | 118.5  | 72.3     |
| Other revenue                                    | 8.0  | 4.8      |
| Total revenues                                   | 285.4  | 260.8    |
| Total expenses                                   | 204.3  | 178.9    |
| Income before tax                                | \$ 81.1  | \$ 81.9  |
| Company's share of pre-tax income                | \$ 27.7  | \$ 28.3  |

Sherman's increased revenues in the first quarter of 2007, compared to the same period in 2006, was primarily due to increased credit card income and fees generated by Credit One Bank (Credit One). The increase in expenses from the first quarter of 2006 to the first quarter of 2007 was also related to Credit One.

Our investment in Sherman on an equity basis at March 31, 2007 was \$138.2 million. We received \$51.5 million of distributions from Sherman during the first quarter of 2007.

The Company's share of pre-tax income line item in the table above includes \$5.4 million of additional amortization expense for the three months ended March 31, 2007, above Sherman's actual amortization expense, related to additional interests in Sherman that we purchased during the third quarter of 2006 at a price in excess of book value. Due to the additional interest purchased in 2006, we hold a greater equity interest in Sherman during the first quarter of 2007, compared to the first quarter of 2006.

**Financial Condition**

In March 2007 we repaid the \$200 million, 6% Senior Notes that came due with funds raised from the September 2006 public debt offering. At March 31, 2007 we had \$200 million, 5.625% Senior Notes due in September 2011 and \$300 million, 5.375% Senior Notes due in November 2015. At March 31, 2006 we had \$300 million, 5.375% Senior Notes due in November 2015 and \$200 million, 6% Senior Notes due in March 2007. At

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March 31, 2007, December 31, 2006 and March 31, 2006, the market value of the outstanding debt (which also includes commercial paper) was \$609.5 million, \$783.2 million and \$588.4 million, respectively.

See Results of Operations Joint ventures above for information about the financial condition of C-BASS and Sherman.

As of March 31, 2007, 85% of our investment portfolio was invested in tax-preferenced securities. In addition, at March 31, 2007, based on book value, approximately 96% of our fixed income securities were invested in A rated and above, readily marketable securities, concentrated in maturities of less than 15 years.

At March 31, 2007, our derivative financial instruments in our investment portfolio were immaterial. We primarily place our investments in instruments that meet high credit quality standards, as specified in our investment policy guidelines; the policy also limits the amount of credit exposure to any one issue, issuer and type of instrument. At March 31, 2007, the effective duration of our fixed income investment portfolio was 4.7 years. This means that for an instantaneous parallel shift in the yield curve of 100 basis points there would be an approximate 4.7% change in the market value of our fixed income portfolio.

**Liquidity and Capital Resources**

Our consolidated sources of funds consist primarily of premiums written and investment income. Positive cash flows are invested pending future payments of claims and other expenses. Management believes that future cash inflows from premiums will be sufficient to meet future claim payments. Cash flow shortfalls, if any, could be funded through sales of short-term investments and other investment portfolio securities subject to insurance regulatory requirements regarding the payment of dividends to the extent funds were required by other than the seller. Substantially all of the investment portfolio securities are held by our insurance subsidiaries.

We have a \$300 million commercial paper program, which is rated A-1 by S&P and P-1 by Moody's. At March 31, 2007, December 31, 2006 and March 31, 2006, we had \$110.3 million, \$84.1 million and \$100.0 million in commercial paper outstanding with a weighted average interest rate of 5.34%, 5.35% and 4.74%, respectively.

We have a \$300 million, five year revolving credit facility expiring in 2010 which will continue to be used as a liquidity back up facility for the outstanding commercial paper. Under the terms of the credit facility, we must maintain shareholders' equity of at least \$2.25 billion and MGIC must maintain a risk-to-capital ratio of not more than 22:1 and maintain policyholders' position (which includes MGIC's statutory surplus and its contingency reserve) of not less than the amount required by Wisconsin insurance regulation. At March 31, 2007, these requirements were met. The remaining credit available under the facility after reduction for the amount necessary to support the commercial paper was \$189.7 million, \$215.9 million and \$200.0 million at March 31, 2007, December 31, 2006 and March 31, 2006, respectively.

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During 2006, an outstanding interest rate swap contract was terminated. This swap was placed into service to coincide with our committed credit facility, used as a backup for the commercial paper program. Under the terms of the swap contract, we paid a fixed rate of 5.07% and received a variable interest rate based on LIBOR. The swap had an expiration date coinciding with the maturity of our credit facility and was designated as a cash flow hedge. At March 31, 2007 we had no interest rate swaps outstanding.

(Income) expense on interest rate swaps for the three months ended March 31, 2006 of approximately (\$0.1) million was included in interest expense. Gains or losses arising from the amendment or termination of interest rate swaps are deferred and amortized to interest expense over the life of the hedged items.

The commercial paper, back-up credit facility and the Senior Notes are obligations of MGIC Investment Corporation and not of its subsidiaries. We are a holding company and the payment of dividends from our insurance subsidiaries is restricted by insurance regulation. MGIC is the principal source of dividend-paying capacity. In February 2007, MGIC paid a quarterly dividend of \$55 million. As a result of extraordinary dividends paid, MGIC cannot currently pay any dividends without regulatory approval. For additional information about our financial condition, results of operations and cash flows on a parent company basis, and MGIC, on a consolidated basis, see Note 8 to our consolidated financial statements in Item 1.

Effective January 1, 2007, we adopted FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes. As a result of the adoption we recognized a decrease of \$85.5 million in the liability for unrecognized tax benefits, which was accounted for as an increase to the January 1, 2007 balance of retained earnings. The total amount of unrecognized tax benefits as of January 1, 2007 is \$81.0 million. Included in that total are \$71.3 million in benefits that would affect the effective tax rate. We recognize interest accrued and penalties related to unrecognized tax benefits in income taxes. We have \$16.5 million for the payment of interest accrued as of January 1, 2007. It is reasonably possible that we could make a deposit of taxes during the next twelve months to eliminate the further accrual of interest. The occurrence, amount and timing of any deposit are discretionary and cannot be determined at this time.

The establishment of this liability requires estimates of potential outcomes of various issues and requires significant judgment. Although the resolutions of these issues are uncertain, we believe that sufficient provisions for income taxes have been made for potential liabilities that may result. If the resolutions of these matters differ materially from these estimates, it could have a material impact on our effective tax rate, results of operations and cash flows.

On April 30, 2007, as a result of an examination by the Internal Revenue Service ( IRS ) for taxable years 2000 through 2004, we received several Notices of Proposed Adjustment. The notices would greatly increase reported taxable income for those years and, if upheld, would require us to pay a total of \$188 million in taxes and accuracy related penalties, plus applicable interest. The IRS disagrees with our treatment of the flow through income and loss from an investment in a portfolio of the residual interests of Real Estate Mortgage Investment Conduits ( REMICS ). The IRS has indicated that it does not believe that, for various reasons, we have established sufficient tax basis in

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the REMIC residual interests to deduct the losses from taxable income. We disagree with this conclusion and believe that the flow through income and loss from these investments was properly reported on our federal income tax returns in accordance with applicable tax laws and regulations in effect during the periods involved and intend to use appropriate means to appeal these adjustments.

During the first quarter of 2007, we did not repurchase any shares of Common Stock under publicly announced programs due to our pending merger with Radian. While in discussions with Radian in January, we were unable to buy any of our shares and after the transaction was announced, we were limited by SEC rules to an immaterial level of purchases. At March 31, 2007, we had Board approval to purchase an additional 4.7 million shares under these programs.

In connection with the merger, we agreed not to purchase Radian stock prior to July 13, 2007 without approval from Radian. Radian's board has authorized certain of its officers to allow us to purchase Radian shares, but only in an amount not to exceed two million shares in the aggregate, subject to certain conditions. We expect that Radian's officers will authorize us to begin purchasing shares of Radian stock shortly after our annual meeting of shareholders on May 10, 2007.

For additional information regarding stock repurchases, see Item 2(c) of Part II of this Quarterly Report on Form 10-Q. From mid-1997 through December 31, 2006, we repurchased 41.6 million shares under publicly announced programs at a cost of \$2.3 billion. Funds for the shares repurchased by us since mid-1997 have been provided through a combination of debt, including the Senior Notes and the commercial paper, and internally generated funds.

Our principal exposure to loss is our obligation to pay claims under MGIC's mortgage guaranty insurance policies. At March 31, 2007, MGIC's direct (before any reinsurance) primary and pool risk in force (which is the unpaid principal balance of insured loans as reflected in our records multiplied by the coverage percentage, and taking account of any loss limit) was approximately \$54.3 billion. In addition, as part of our contract underwriting activities, we are responsible for the quality of our underwriting decisions in accordance with the terms of the contract underwriting agreements with customers. Through March 31, 2007, the cost of remedies provided by us to customers for failing to meet the standards of the contracts has not been material. However, the decreasing trend of home mortgage interest rates over the last several years may have mitigated the effect of some of these costs since the general effect of lower interest rates can be to increase the value of certain loans on which remedies are provided. There can be no assurance that contract underwriting remedies will not be material in the future.

Our consolidated risk-to-capital ratio was 7.5:1 at both March 31, 2007 and December 31, 2006.

The risk-to-capital ratios set forth above have been computed on a statutory basis. However, the methodology used by the rating agencies to assign claims-paying ability ratings permits less leverage than under statutory requirements. As a result, the amount of capital required under statutory regulations may be lower than the capital required for rating agency purposes. In addition to capital adequacy, the rating agencies consider other factors in determining a mortgage insurer's claims-paying rating, including its

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historical and projected operating performance, business outlook, competitive position, management and corporate strategy.

**Forward-Looking Statements and Risk Factors**

*General:* Our revenues and losses could be affected by the risk factors referred to under Location of Risk Factors below that are applicable to us, and our income from joint ventures could be affected by the risk factors referred to under Location of Risk Factors that are applicable to C-BASS and Sherman. These risk factors are an integral part of Management's Discussion and Analysis.

These factors may also cause actual results to differ materially from the results contemplated by forward looking statements that we may make. Forward looking statements consist of statements which relate to matters other than historical fact. Among others, statements that include words such as we believe, anticipate or expect, or words of similar import, are forward looking statements. We are not undertaking any obligation to update any forward looking statements we may make even though these statements may be affected by events or circumstances occurring after the forward looking statements were made.

*Location of Risk Factors:* The risk factors are in Item 1 A of our Annual Report on Form 10-K for the year ended December 31, 2006, as supplemented by Part II, Item 1 A of this Quarterly Report on Form 10-Q. The risk factors in the 10-K, as supplemented by this 10-Q and through updating of various statistical and other information, are reproduced in Exhibit 99 to this Quarterly Report on Form 10-Q.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

At March 31, 2007, derivative financial instruments in our investment portfolio were immaterial. We primarily place our investments in instruments that meet investment grade credit quality standards, as specified in our investment policy guidelines; the policy also limits the amount of credit exposure to any one issue, issuer and type of instrument. At March 31, 2007, the effective duration of our fixed income investment portfolio was 4.7 years. This means that for each instantaneous parallel shift in the yield curve of 100 basis points there would be an approximate 4.7% change in the market value of our fixed income investment portfolio.

Our borrowings under our commercial paper program are subject to interest rates that are variable. See the fourth and fifth paragraphs under Management's Discussion and Analysis of Financial Condition and Results of Operations-Liquidity and Capital Resources for a discussion of our interest rate swaps.

**ITEM 4. CONTROLS AND PROCEDURES**

Our management, with the participation of our principal executive officer and principal financial officer, has evaluated our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended), as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on such evaluation, our

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principal executive officer and principal financial officer concluded that such controls and procedures were effective as of the end of such period. There was no change in our internal control over financial reporting that occurred during the first quarter of 2007 that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1 A. Risk Factors**

With the possible exception of the changes set forth below, there have been no material changes in our risk factors from the risk factors disclosed in our Annual Report on Form 10-K for the year ended December 31, 2006. The principal changes to the risk factors that are set forth below were also included in Exhibit 99 to our Current Report on Form 8-K dated April 11, 2007. Exhibit 99 sets forth our risk factors as part of our press release announcing earnings for the first quarter of 2007. Some of the information in the risk factors in the 10-K has been updated by information in the same risk factor included in that Exhibit 99.

**The Internal Revenue Service has proposed significant adjustments to our taxable income for 2000 through 2004.**

The Internal Revenue Service ( IRS ) has been conducting an examination of our federal income tax returns for taxable years 2000 through 2004. The examination is related to a portfolio of investments in the residual interests of Real Estate Mortgage Investment Conduits ( REMICs ). This portfolio has been managed and maintained during years prior to, during and subsequent to the examination period. On April 30, 2007, we received several Notices of Proposed Adjustment from the IRS for taxable years 2000 through 2004. The notices, if upheld, would greatly increase reported taxable income for those years and require us to pay a total of \$188 million in taxes and accuracy related penalties, plus applicable interest. The IRS disagrees with our treatment of the flow through income and loss from an investment in a portfolio of the residual interests of the REMICs. The IRS has indicated that it does not believe that, for various reasons, we have established sufficient tax basis in the REMIC residual interests to deduct the losses from taxable income. We disagree with this conclusion and believe that the flow through income and loss from this investment was properly reported on our federal income tax returns in accordance with applicable tax laws and regulations in effect during the periods involved and intend to use appropriate means to appeal these adjustments. The process to appeal these adjustments may take some time and a final resolution may not be reached until a date many months or years into the future. We believe, after discussions with outside counsel about the issues raised in the notices and the procedures for resolution of the disputed adjustments, that an adequate provision for income taxes has been made for potential liabilities that may result from these notices. If the outcome of this matter results in payments that differ materially from our expectations, it could have a material impact on our effective tax rate, results of operations and cash flows.

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**ITEM 2. UNREGISTERED SALE OF EQUITY SECURITIES & USE OF PROCEEDS**

(c) Repurchase of common stock:

We did not repurchase any shares of Common Stock during the first quarter of 2007. On January 26, 2006 we announced that our Board of Directors authorized the repurchase of up to ten million shares of our Common Stock in the open market or in private transactions. As of March 31, 2007 4.7 million of these 10 million shares remained available to be purchased.

In connection with the merger, we agreed not to purchase Radian stock prior to July 13, 2007 without approval from Radian. Radian's board has authorized certain of its officers to allow us to purchase Radian shares, but only in an amount not to exceed two million shares in the aggregate, subject to certain conditions. We expect that Radian's officers will authorize us to begin purchasing shares of Radian stock shortly after our annual meeting of shareholders on May 10, 2007.

**ITEM 6. EXHIBITS**

The accompanying Index to Exhibits is incorporated by reference in answer to this portion of this Item, and except as otherwise indicated in the next sentence, the Exhibits listed in such Index are filed as part of this Form 10-Q. Exhibit 32 is not filed as part of this Form 10-Q but accompanies this Form 10-Q.



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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized, on May 10, 2007.

**MGIC INVESTMENT  
CORPORATION**

\\ J. Michael Lauer  
J. Michael Lauer  
Executive Vice President and  
Chief Financial Officer

\\ Joseph J. Komanecki  
Joseph J. Komanecki  
Senior Vice President, Controller and  
Chief Accounting Officer

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**INDEX TO EXHIBITS  
(Part II, Item 6)**

| <b>Exhibit<br/>Number</b> | <b>Description of Exhibit</b>   |
|---------------------------|---|
| 2                         | Agreement and Plan of Merger, dated as of February 6, 2007, by and between, MGIC Investment Corporation and Radian Group Inc. (Incorporated by reference to Exhibit 2.1 in the Company's Current Report on Form 8-K filed on February 12, 2007) |
| 11                        | Statement Re Computation of Net Income Per Share  |
| 31.1                      | Certification of CEO under Section 302 of Sarbanes-Oxley Act of 2002  |
| 31.2                      | Certification of CFO under Section 302 of Sarbanes-Oxley Act of 2002  |
| 32                        | Certification of CEO and CFO under Section 906 of Sarbanes-Oxley Act of 2002 (as indicated in Item 6 of Part II, this Exhibit is not being filed )  |
| 99                        | Risk Factors included in Item 1 A of our Annual Report on Form 10-K for the year ended December 31, 2006, as supplemented by Part II, Item 1A of our Quarterly Report on Form 10-Q for the quarter ended March 31, 2007                         |