RADIAN GROUP INC
Form 10-Q
August 04, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2006

OR

¨ **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 1-11356

Radian Group Inc.

(Exact name of registrant as specified in its charter)

Delaware	**23-2691170**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
1601 Market Street, Philadelphia, PA	**19103**
(Address of principal executive offices)	**(Zip Code)**

(215) 231-1000

(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 x 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 x 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 x

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 81,698,472 shares of common stock, $0.001 par value per share, outstanding on July 28, 2006.

Radian Group Inc.

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Forward Looking Statements Safe Harbor Provisions

All statements in this report that address events, developments or results that we expect or anticipate may occur in the future are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, Section 21E of the Securities Exchange Act of 1934 and the U.S. Private Securities Litigation Reform Act of 1995. In most cases, forward-looking statements may be identified by words such as may, will, should, expect, intend, plan, goal, contemplate, believe, estimate, predict, project, potential, continue or the negative or words and other similar expressions. These statements are made on the basis of management s current views and assumptions with respect to future events. The forward-looking statements, as well as our prospects as a whole, are subject to risks and uncertainties, including the following:

changes in general financial and political conditions, such as extended national or regional economic recessions, changes in housing values, population trends and changes in household formation patterns, changes in unemployment rates, changes or volatility in interest rates, changes in the way investors perceive the strength of private mortgage insurers or financial guaranty providers, investor concern over the credit quality of municipalities, corporations and specific risks faced by the particular businesses, municipalities or pools of assets covered by our insurance;

economic changes or catastrophic events in geographic regions where our mortgage insurance or financial guaranty insurance in force is more concentrated;

the loss of a customer for whom we write a significant amount of our mortgage insurance or financial guaranty insurance;

increased severity or frequency of losses associated with certain of our products that are riskier than traditional mortgage insurance or financial guaranty insurance policies;

changes in persistency rates of our mortgage insurance policies caused by changes in refinancing activity, the amount of structured vs. flow business that we write, appreciating or depreciating home values and changes in the mortgage insurance cancellation requirements of mortgage lenders and investors;

downgrades of, or other ratings actions with respect to, our credit ratings or the insurance financial strength ratings assigned by the major rating agencies to any of our rated operating subsidiaries at any time, which actions have occurred in the past;

heightened competition for our mortgage insurance business from others such as the Federal Housing Administration and the Veterans Administration or other private mortgage insurers, from alternative products such as 80-10-10 loans or other forms of simultaneous second loan structures used by mortgage lenders, and from investors using forms of credit enhancement other than mortgage insurance as a partial or complete substitution for private mortgage insurance;

changes in the charters or business practices of Fannie Mae and Freddie Mac, the largest purchasers of mortgage loans that we insure;

heightened competition for financial guaranty business from other financial guaranty insurers, from other forms of credit enhancement such as letters of credit, guaranties and credit default swaps provided by foreign and domestic banks and other financial institutions and from alternative structures that permit insurers to securitize assets more cost-effectively without the need for other credit enhancement of the types we offer;

the application of existing federal or state consumer, lending, insurance and other applicable laws and regulations, or unfavorable changes in these laws and regulations or the way they are interpreted;

the possibility that we may fail to estimate accurately the likelihood, magnitude and timing of losses in connection with establishing loss reserves for our mortgage insurance or financial guaranty businesses or to estimate accurately the fair value amounts of derivative financial guaranty contracts in determining gains and losses on these contracts (See Part I, Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies);

increases in claim frequency as our mortgage insurance policies age; and

vulnerability to the performance of our strategic investments.

For more information regarding these risks and uncertainties as well as certain additional risks that we face, you should refer to the risks detailed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2005 and the material changes to these risks discussed in Part II, Item 1A of this report. We caution you not to place undue reliance on these forward-looking statements, which are current only as of the date on which we filed this report. We do not intend to, and we disclaim any duty or obligation to, update or revise any forward-looking statements made in this report to reflect new information or future events or for any other reason.

PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

Radian Group Inc.

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(In thousands, except share and per-share amounts)	**June 30 2006**	**December 31 2005**
Assets		
Investments		
Fixed maturities held to maturity at amortized cost (fair value $111,032 and $130,227)	$ 108,299	$ 125,935
Fixed maturities available for sale at fair value (amortized cost $4,735,092 and $4,493,789)	4,774,422	4,608,460
Trading securities at fair value (cost $76,331 and $68,078)	105,691	89,440
Equity securities at fair value (cost $223,055 and $258,768)	279,131	325,117
Short-term investments	266,369	361,937
Other invested assets	2,531	2,825
Total investments	5,536,443	5,513,714
Cash	61,725	7,847
Investment in affiliates	492,175	446,151
Deferred policy acquisition costs	215,803	208,325
Prepaid federal income taxes	709,304	585,514
Provisional losses recoverable	12,110	25,388
Accrued investment income	62,705	60,124
Accounts and notes receivable (less allowance of $1,494 and $1,279)	66,142	59,136
Property and equipment, at cost (less accumulated depreciation of $74,214 and $61,285)	46,981	52,062
Other assets	303,959	272,349
Total assets	$ 7,507,347	$ 7,230,610
Liabilities and Stockholders Equity		
Unearned premiums	$ 913,879	$ 849,360
Reserve for losses and loss adjustment expenses	789,701	801,002
Long-term debt	747,615	747,466
Deferred federal income taxes	1,020,720	961,993
Accounts payable and accrued expenses	205,264	207,909
Total liabilities	3,677,179	3,567,730
Commitments and Contingencies (Note 13)		
Stockholders equity		
Common stock: par value $.001 per share; 200,000,000 shares authorized; 97,473,548 and 97,373,169 shares issued at June 30, 2006 and December 31, 2005, respectively; 81,583,869 and 83,032,456 shares outstanding at June 30, 2006 and December 31, 2005, respectively	97	97
Treasury stock: 15,889,679 and 14,340,713 shares in 2006 and 2005, respectively	(795,117)	(688,048)
Additional paid-in capital	1,333,815	1,318,910
Deferred compensation		(1,843)
Retained earnings	3,222,189	2,913,649
Accumulated other comprehensive income	69,184	120,115
Total stockholders equity	3,830,168	3,662,880

Total liabilities and stockholders equity	$ 7,507,347	$ 7,230,610

See notes to unaudited condensed consolidated financial statements.

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Radian Group Inc.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(In thousands, except per-share amounts)	Three Months Ended June 30 2006	Three Months Ended June 30 2005	Six Months Ended June 30 2006	Six Months Ended June 30 2005
Revenues:				
Premiums written:				
Direct	$ 299,462	$ 289,698	$ 582,241	$ 545,083
Assumed	35,830	32,208	60,105	16,198
Ceded	(36,417)	(22,688)	(63,866)	(47,223)
Net premiums written	298,875	299,218	578,480	514,058
Increase in unearned premiums	(39,789)	(55,240)	(65,697)	(23,055)
Net premiums earned	259,086	243,978	512,783	491,003
Net investment income	59,678	50,004	113,938	100,866
Net gains on securities	5,324	8,723	28,178	20,249
Change in fair value of derivative instruments	(25,287)	987	(7,657)	(7,973)
Other income	5,778	6,635	10,989	12,743
Total revenues	304,579	310,327	658,231	616,888
Expenses:				
Provision for losses	84,860	83,827	163,494	193,327
Policy acquisition costs	26,820	31,072	54,184	60,428
Other operating expenses	58,099	52,418	118,376	104,088
Interest expense	12,538	9,978	24,378	18,936
Total expenses	182,317	177,295	360,432	376,779
Equity in net income of affiliates	72,038	63,878	130,378	115,174
Pretax income	194,300	196,910	428,177	355,283
Provision for income taxes	46,155	56,686	116,334	99,447
Net income	$ 148,145	$ 140,224	$ 311,843	$ 255,836
Basic net income per share	$ 1.81	$ 1.64	$ 3.79	$ 2.92
Diluted net income per share	$ 1.79	$ 1.56	$ 3.75	$ 2.79
Average number of common shares outstanding basic	81,921	85,464	82,355	87,476
Average number of common and common equivalent shares outstanding diluted	82,756	90,116	83,100	92,187
Dividends declared per share	$ 0.02	$ 0.02	$ 0.04	$ 0.04

See notes to unaudited condensed consolidated financial statements.

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Radian Group Inc.

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN COMMON STOCKHOLDERS EQUITY

(UNAUDITED)

(In thousands)	Common Stock	Treasury Stock	Additional Paid-in Capital	Deferred Compensation	Retained Earnings	Accumulated Other Comprehensive Income (Loss): Foreign Currency Translation Adjustment	Accumulated Other Comprehensive Income (Loss): Unrealized Holding Gains (Losses)	Total
BALANCE, JANUARY 1, 2005	$ 97	$ (176,242)	$ 1,282,433	$	$ 2,397,626	$ 14,397	$ 170,744	$ 3,689,055
Comprehensive income:								
Net income					255,836			255,836
Unrealized foreign currency translation adjustment, net of tax benefit of $4,949						(9,289)		(9,289)
Unrealized holding losses arising during period, net of tax benefit of $22,575							(2,965)	
Less: Reclassification adjustment for net gains included in net income, net of tax of $5,836							(3,605)	
Net unrealized loss on investments net of tax benefit of $28,411							(6,570)	(6,570)
Comprehensive income								239,977
Issuance of common stock under incentive plans		7,454	12,239					19,693
Issuance of restricted stock				(1,856)				(1,856)
Amortization of restricted stock				109				109
Treasury stock purchased		(373,857)						(373,857)
Dividends paid					(3,471)			(3,471)
Warrants repurchased by affiliate			(2,075)					(2,075)
BALANCE, JUNE 30, 2005	$ 97	$ (542,645)	$ 1,292,597	$ (1,747)	$ 2,649,991	$ 5,108	$ 164,174	$ 3,567,575
BALANCE, JANUARY 1, 2006	$ 97	$ (688,048)	$ 1,318,910	$ (1,843)	$ 2,913,649	$ 2,135	$ 117,980	$ 3,662,880
Comprehensive income:								
Net income					311,843			311,843
Unrealized foreign currency translation adjustment, net of tax of $2,701						5,016		5,016
Unrealized holding losses arising during the period, net of tax benefit of $27,339							(50,772)	
Less: Reclassification adjustment for net gains included in net income, net of tax of $2,786							(5,175)	
Net unrealized loss on investments, net of tax benefit of $30,125							(55,947)	(55,947)
Comprehensive income								260,912
Issuance of common stock under incentive plans		14,853	11,891					26,744
Issuance of restricted stock			(1,583)					(1,583)
Amortization of restricted stock			732					732
Reclassification of deferred compensation (a)			(1,843)	1,843				
Stock-based compensation expense-options			5,708					5,708
Treasury stock purchased		(121,922)						(121,922)
Dividends paid					(3,303)			(3,303)

BALANCE, JUNE 30, 2006	$	97	$	(795,117)	$	1,333,815	$		$	3,222,189	$	7,151	$	62,033	$ 3,830,168

(a) See Restricted Stock in Note 8 for information related to the reclassification of the amount in deferred compensation.

See notes to unaudited condensed consolidated financial statements.

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Radian Group Inc.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six Months Ended	
	June 30	
(In thousands)	**2006**	**2005**
Cash flows from operating activities	$ 243,134	$ 243,649
Cash flows from investing activities:		
Proceeds from sales of fixed-maturity investments available for sale	450,098	203,225
Proceeds from sales of equity securities available for sale	70,935	53,360
Proceeds from redemptions of fixed-maturity investments available for sale	79,995	166,503
Proceeds from redemptions of fixed-maturity investments held to maturity	19,359	21,955
Purchases of fixed-maturity investments available for sale	(777,800)	(364,159)
Purchases of equity securities available for sale	(12,522)	(10,870)
Sales (purchases) of short-term investments, net	96,813	(192,687)
Sales of other invested assets	600	631
Purchases of property and equipment	(9,151)	(4,085)
Other		(265)
Net cash used in by investing activities	(81,673)	(126,392)
Cash flows from financing activities:		
Dividends paid	(3,303)	(3,471)
Issuance of long-term debt		248,892
Debt issuance costs		(1,834)
Proceeds from issuance of common stock under incentive plans	17,665	7,567
Excess tax benefits from stock-based awards	1,374	
Purchase of treasury stock	(121,922)	(373,857)
Redemption of long-term debt		(663)
Net cash used in financing activities	(106,186)	(123,366)
Effect of exchange rate changes on cash	(1,397)	
Increase (decrease) in cash	53,878	(6,109)
Cash, beginning of period	7,847	30,680
Cash, end of period	$ 61,725	$ 24,571
Supplemental disclosures of cash flow information:		
Income taxes paid	$ 100,537	$ 118,902
Interest paid	$ 23,983	$ 19,436
Supplemental disclosures of non-cash items:		
Stock-based compensation	$ 5,708	$ 1,562

See notes to unaudited condensed consolidated financial statements.

Radian Group Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

1 Condensed Consolidated Financial Statements Basis of Presentation

Our condensed consolidated financial statements include the accounts of Radian Group Inc. and its subsidiaries, including its principal mortgage guaranty operating subsidiaries, Radian Guaranty Inc. (Radian Guaranty), Amerin Guaranty Corporation (Amerin Guaranty), Radian Insurance Inc. (Radian Insurance) and Radian Europe Limited (Radian Europe), and its principal financial guaranty operating subsidiaries, Radian Asset Assurance Inc. (Radian Asset Assurance) and Radian Asset Assurance Limited (RAAL). We refer to Radian Group Inc. together with its consolidated subsidiaries as we, us or our, unless the context requires otherwise. We generally refer to Radian Group Inc. alone, without its consolidated subsidiaries, as the parent company. We also have a 46.0% interest in Credit-Based Asset Servicing and Securitization LLC (C-BASS) and a 34.58% interest in Sherman Financial Group LLC (Sherman), each of which are active credit-based asset businesses.

We have presented our condensed consolidated financial statements on the basis of accounting principles generally accepted in the United States of America (GAAP). We have condensed or omitted certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with GAAP pursuant to the SEC s rules and regulations.

The financial information presented for interim periods is unaudited; however, such information reflects all adjustments that are, in the opinion of management, necessary for a fair presentation of the financial position, results of operations, and cash flows for the interim periods. These interim financial statements should be read in conjunction with the audited financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2005. The results of operations for interim periods are not necessarily indicative of results to be expected for the full year or for any other period.

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results may differ from these estimates and assumptions.

Basic net income per share is based on the weighted average number of common shares outstanding, while diluted net income per share is based on the weighted average number of common shares outstanding and common share equivalents that would be issuable upon the exercise of stock options, the vesting of restricted stock and phantom stock and the conversion of our senior convertible debentures. We redeemed all of the principal amount outstanding of our senior convertible debentures on August 1, 2005, as discussed in Note 7.

The current period presentation includes changes from the prior period presentation that are consistent with clarification of GAAP rules regarding presentation in the statement of cash flows. In particular, the prior period presentation of the cash flows from investing activities section of the condensed consolidated statements of cash flows has been conformed to the current period presentation by reclassifying distributions from equity affiliates of $69.1 million into the cash flows from operating activities section. This reclassification affects the presentation of the condensed consolidated statements of cash flows, but does not affect the change in cash balance for the period. On January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123R Share-Based Payment (SFAS No. 123R) using a modified prospective application as permitted by SFAS No. 123R. Accordingly, prior period amounts have not been restated. Certain other prior period balances have been reclassified to conform to the current period presentation.

Radian Group Inc.

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

2 Derivative Instruments and Hedging Activities

We account for derivatives under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended and interpreted (SFAS No. 133). In general, SFAS No. 133 requires that all derivative instruments be recorded on the balance sheet at their respective fair values. All derivative instruments are recognized in our condensed consolidated balance sheets as either assets or liabilities depending on the rights or obligations under the contracts. Transactions that we have entered into that are accounted for under SFAS No. 133 include investments in convertible debt securities, interest rate swaps, selling credit protection in the form of credit default swaps and certain financial guaranty contracts that are considered credit default swaps. Credit default swaps and certain financial guaranty contracts that are accounted for under SFAS No. 133 are part of our overall business strategy of offering mortgage credit enhancement and financial guaranty protection to our customers. The interest rate swaps that we have entered into qualify as hedges and are accounted for as fair value hedges. The embedded equity derivatives contained within our investments in fixed-maturity securities, the forward foreign currency contracts and credit protection in the form of credit default swaps do not qualify as hedges under SFAS No. 133, so changes in their fair value are included in current earnings in our condensed consolidated statements of income. Net unrealized gains and losses on credit default swaps and certain other financial guaranty contracts are included in assets or liabilities, as appropriate, on our condensed consolidated balance sheets. We do not recognize a reserve for losses on derivative financial guaranty contracts. Any equivalent reserve would be embedded in the unrealized gains and losses on derivative financial guaranty contracts. Settlements under derivative financial guaranty contracts are charged to assets or liabilities, as appropriate, on the condensed consolidated balance sheets. During the six months ended June 30, 2006, we received $2.6 million, net, of recoveries of previous default payments and paid $68.0 million in connection with the termination of a derivative financial guaranty contract. See below for further discussion. We received $4.4 million of recoveries of previous default payments on derivative financial guaranty contracts in the corresponding period of 2005.

SFAS No. 133 requires that we split the convertible fixed-maturity securities in our investment portfolio into their derivative and fixed-maturity security components. Over the term of the securities, changes in the fair value of fixed-maturity securities available for sale are recorded in our condensed consolidated statements of changes in common stockholders equity through accumulated other comprehensive income or loss. Concurrently, a deferred tax liability or benefit is recognized as the recorded value of the fixed-maturity security increases or decreases. A change in the fair value of the derivative component is recorded as a gain or loss in our condensed consolidated statements of income.

In February 2006, the Financial Accounting Standards Board (the FASB) issued Statement No. 155, Accounting for Certain Hybrid Financial Instruments (SFAS No. 155), an amendment of FASB Statements No. 133 and 140. SFAS No. 155 (i) permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, (ii) clarifies which interest-only strips and principal-only strips are not subject to the requirements of FASB Statement No. 133, (iii) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, (iv) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and (v) amends FASB Statement No. 140 to eliminate the exemption from applying the requirements of FASB Statement No. 133 on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity s first fiscal year that begins after September 15, 2006 (the fiscal year beginning January 1, 2007 for us). Management is considering the impact, if any, that may result from the adoption of SFAS No. 155.

Radian Group Inc.

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

With respect to our direct derivative financial guaranty contracts, estimated fair value amounts are determined by us using market information to the extent available, and appropriate valuation methodologies. For collateralized debt obligations (CDOs), credit spreads on individual names in our collateral pool are used to determine an equivalent risk tranche on an industry standard credit default swap index. We then estimate the price of our equivalent risk tranche based on observable market prices of standard risk tranches on the industry standard credit default swap index. When credit spreads on individual names are not available, the average credit spread on the credit rating of the name is used. For certain structured transactions, dealer quotes on similar structured transactions are used. Significant differences may exist with respect to the available market information and assumptions used to determine gains and losses on derivative financial guaranty contracts. Considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates are not necessarily indicative of amounts we could realize in a current market exchange due to the lack of a liquid market. The use of different market assumptions and/or estimation methodologies may have a significant effect on the estimated fair value amounts.

In the fourth quarter of 2005, we refined our mark-to-market model to use actual credit spreads by individual name, when available as discussed above, as compared to our previous version of the model, which used average spreads for similarly rated names. While application of the new model resulted in immaterial changes for most of our derivative transactions, one synthetic CDO showed a large difference due to greater spread volatility in the underlying high-yield corporate names included in this transaction. At December 31, 2005, our refined model indicated we had a $50.8 million loss, which was recognized in 2005, on one transaction. In the first quarter of 2006, we recognized an additional loss of $17.2 million on this transaction as a result of our paying $68.0 million to terminate this transaction in March 2006.

A summary of our derivative information, as of and for the periods indicated, is as follows:

Balance Sheets (In millions)	**June 30 2006**	**December 31 2005**	**June 30 2005**
Trading Securities			
Cost	$ 64.1	$ 68.1	$ 67.4
Fair value	93.7	89.4	79.4
Derivative financial guaranty contracts			
Notional value	$ 42,526.0	$ 30,208.0	$ 14,300.0
Gross unrealized gains	$ 109.9	$ 98.3	$ 65.5
Gross unrealized losses	34.7	72.1	44.6
Net unrealized gains	$ 75.2	$ 26.2	$ 20.9