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

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

For the quarterly period ended MARCH 31, 2007

o **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	**39-1486475**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
250 E. KILBOURN AVENUE MILWAUKEE, WISCONSIN	**53202**
(Address of principal executive offices)	(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 þ **NO** o

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 þ Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES o **NO** þ

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

CLASS OF STOCK	PAR VALUE	DATE	NUMBER OF SHARES
Common stock	$1.00	04/30/07	83,067,157

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

MGIC INVESTMENT CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
March 31, 2007 (Unaudited) and December 31, 2006

	March 31, 2007	December 31, 2006
	(In thousands of dollars)	
ASSETS		
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	
Total investment portfolio	5,327,871	5,252,422
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
Total assets	$ 6,647,690	$ 6,621,671
LIABILITIES AND SHAREHOLDERS EQUITY		
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
Total liabilities	2,192,274	2,325,794
Contingencies (note 3)		

Shareholders equity:		
Common stock, $1 par value, shares authorized 300,000,000; shares issued, 3/31/07 - 123,064,226 12/31/06 - 123,028,976; 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
Total shareholders equity	4,455,416	4,295,877
Total liabilities and shareholders equity	$ 6,647,690	$ 6,621,671

See accompanying notes to consolidated financial statements.

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

	Three Months Ended 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

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 March 31, 2007	Three Months Ended March 31, 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)
Net cash provided by operating activities	178,988	192,019
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
Net cash (used in) provided by investing activities	(83,666)	12,718
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

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 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 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 March 31, 2007	2006
	(in thousands)	
Weighted-average shares Basic	81,890	86,577
Common stock equivalents	464	650
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 March 31, 2007	2006
	(In thousands of dollars)	
Net income	$ 92,363	$ 163,453
Other comprehensive loss	(4,668)	(31,523)
Total comprehensive income	$ 87,695	$ 131,930
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
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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Note 6 Benefit Plans

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 March 31,			
	Pension and Supplemental Executive Retirement Plans		Other Postretirement 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		
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 Company	MGIC Consolidated	Other	Eliminations	Total
ASSETS					
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
Total assets	$ 5,070,453	$ 6,368,284	$ 367,503	$ (5,158,550)	$ 6,647,690

LIABILITIES AND SHAREHOLDERS EQUITY
Liabilities: