RADIAN GROUP INC
Form 10-Q
August 09, 2012

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, 2012

OR

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 1-11356

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 o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

Large accelerated filer x	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company 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 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: 133,645,317 shares of common stock, $0.001 par value per share, outstanding on August 1, 2012.

Radian Group Inc.
INDEX

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 United States ("U.S.") Private Securities Litigation Reform Act of 1995. In most cases, forward-looking statements may be identified by words such as "anticipate," "may," "will," "could," "should," "would," "expect," "intend," "plan," "goal," "contemplate," "believe," "estimate," "predict," "project," "potential," "continue," or other variations on these words and other similar expressions. These statements, which may include, without limitation, projections regarding our future performance and financial condition, are made on the basis of management's current views and assumptions with respect to future events. Any forward-looking statement is not a guarantee of future performance and actual results could differ materially from those contained in the forward-looking statement. The forward-looking statements, as well as our prospects as a whole, are subject to risks and uncertainties that could cause actual results to differ materially from those set forth in the forward-looking statements, including the following:

- changes in general economic and political conditions, including high unemployment rates and continued weakness in the U.S. housing and mortgage credit markets, the U.S. economy reentering a recessionary period, a significant downturn in the global economy, a lack of meaningful liquidity in the capital or credit markets, changes or volatility in interest rates or consumer confidence and changes in credit spreads, each of which may be accelerated or intensified by, among other things, further actual or threatened downgrades of U.S. credit ratings;
- changes in the way customers, investors, regulators or legislators perceive the strength of private mortgage insurers or financial guaranty providers, in particular in light of developments in the private mortgage insurance and financial guaranty industries in which certain of our former competitors have ceased writing new insurance business and have been placed under supervision or receivership by insurance regulators;
- catastrophic events or economic changes in geographic regions, including governments and municipalities, where our mortgage insurance exposure is more concentrated or where we have financial guaranty exposure;
- our ability to maintain sufficient holding company liquidity to meet our short- and long-term liquidity needs, including in particular, the repayment of our long-term debt and additional capital contributions that may be required to support our mortgage insurance business;
- a further reduction in, or prolonged period of depressed levels of, home mortgage originations due to reduced liquidity in the lending market, tighter underwriting standards, general reduced housing demand in the U.S. and potential risk retention requirements established under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act");
- the potential adverse impact on the mortgage origination market and private mortgage insurers due to increases in capital requirements for banks and bank holding companies for mortgage loans under proposed interagency rules to implement the third Basel Capital Accord ("Basel III"), including in particular the possibility that loans insured by the Federal Housing Administration ("FHA") will receive a more advantageous capital treatment than loans with private mortgage insurance;
- our ability to maintain an adequate risk-to-capital position and surplus requirements in our mortgage insurance business, including if necessary, our ability to write new mortgage insurance while maintaining a capital position that is in excess of risk-based capital limitations imposed in certain states, either through waivers of these limitations or through use of another mortgage insurance subsidiary, and the possibility that state regulators could pursue regulatory actions or proceedings, including possible supervisory or receivership actions, against Radian Guaranty Inc. ("Radian Guaranty"), in the event Radian Guaranty's risk-to-capital position exceeds levels that are acceptable to such regulators;
- our ability to continue to effectively mitigate our mortgage insurance and financial guaranty losses;
- the ability of our primary insurance customers in our financial guaranty reinsurance business to provide appropriate surveillance and to mitigate losses adequately with respect to our assumed insurance portfolio;
- a more rapid than expected decrease in the level of insurance rescissions and claim denials from the current elevated levels, which have reduced our paid losses and resulted in a significant reduction in our loss reserves, including a decrease in rescissions or denials resulting from an increase in the number of successful challenges to previously rescinded policies or claim denials, or caused by the government-sponsored entities ("GSEs") intervening in mortgage

insurers' loss mitigation practices, including settlements of disputes;

3

- the negative impact our insurance rescissions and claim denials or claim curtailments may have on our relationships with customers and potential customers, including the potential loss of business and the heightened risk of disputes and litigation;
- the need, in the event that we are unsuccessful in defending our rescissions or denials, to increase our loss reserves for, and reassume risk on, rescinded or denied loans, and to pay additional claims;
- any disruption in the servicing of mortgages covered by our insurance policies and poor servicer performance;
- adverse changes in the severity or frequency of losses associated with certain products that we formerly offered (and currently insure) that are riskier than traditional mortgage insurance or financial guaranty insurance policies;
- a decrease in persistency rates of our mortgage insurance policies, which has the effect of reducing our premium income without a corresponding decrease in incurred losses;
- an increase in the risk profile of our existing mortgage insurance portfolio due to the refinancing of existing mortgage loans for only the most qualified borrowers in the current mortgage and housing market;
- changes in the criteria for assigning credit or similar ratings, further downgrades or threatened downgrades of, or other ratings actions with respect to, our credit ratings or the ratings assigned to any of our rated insurance subsidiaries at any time, including in particular, the credit ratings of Radian Group Inc. (“Radian Group”) and the financial strength ratings assigned to Radian Guaranty;
- heightened competition for our mortgage insurance business from others such as the FHA, the Department of Veterans Affairs (“VA”) and other private mortgage insurers (in particular, the FHA and those private mortgage insurers that have been assigned higher ratings than we from the major rating agencies, that may have access to greater amounts of capital than we do, or that are new entrants to the industry and are therefore not burdened by legacy obligations);
- changes in the charters or business practices of, or rules or regulations applicable to, Federal National Mortgage Association (“Fannie Mae”) and Freddie Mac, the largest purchasers of mortgage loans that we insure, and our ability to remain an eligible provider to both Fannie Mae and Freddie Mac;
- changes to the current system of housing finance, including the possibility of a new system in which private mortgage insurers are not required or their products are significantly limited in scope;
- the effect of the Dodd-Frank Act on the financial services industry in general and on our mortgage insurance and financial guaranty businesses in particular, including: (1) whether and to what extent loans with mortgage insurance are considered “qualified residential mortgages” for purposes of the Dodd-Frank Act securitization provisions or “qualified mortgages” for purposes of the ability to repay provisions of the Dodd-Frank Act, and the possibility that the ultimate definitions of “qualified residential mortgages” and “qualified mortgages” could reduce the size of the mortgage market and potentially reduce the number of insurable loans; and (2) the possibility that our financial guaranty business could be subject to additional registration, reporting, capital and margin requirements, including potentially, the posting of collateral for certain existing derivative contracts;
- the application of existing federal or state consumer, lending, insurance, tax, securities and other applicable laws and regulations, or changes in these laws and regulations or the way they are interpreted, including, without limitation any such results from: (i) the resolution of existing, or the possibility of additional, lawsuits or investigations; and (ii) legislative and regulatory changes (a) impacting the demand for private mortgage insurance, (b) limiting or restricting our use of (or increasing requirements for) additional capital and the products we may offer, (c) affecting the form in which we execute credit protection, or (d) impacting our existing financial guaranty portfolio;
- the amount and timing of potential payments or adjustments associated with federal or other tax examinations;
- 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 premium deficiencies for our mortgage insurance business, or to estimate accurately the fair value amounts of derivative instruments in determining gains and losses on these instruments;
- volatility in our earnings caused by changes in the fair value of our assets and liabilities carried at fair value, including our derivative instruments, and our need to reevaluate the possibility of a premium deficiency in our mortgage insurance business on a quarterly basis;

- our ability to realize the tax benefits associated with our gross deferred tax assets, which will depend on our ability to generate sufficient sustainable taxable income in future periods;
- changes in accounting principles, rules and guidance, or their interpretation, from the Securities and Exchange Commission or the Financial Accounting Standards Board; and
- legal and other limitations on amounts we may receive from our subsidiaries as dividends or through our tax- and expense-sharing arrangements with our subsidiaries.

For more information regarding these risks and uncertainties as well as certain additional risks that we face, you should refer to the Risk Factors detailed in Item 1A of Part I of our Annual Report on Form 10-K for the year ended December 31, 2011, and in Item 1A of Part II of this Quarterly Report on Form 10-Q. 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. (Unaudited)

Radian Group Inc.

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(In thousands, except share and per share amounts)	June 30, 2012	December 31, 2011
ASSETS		
Investments		
Fixed-maturities held to maturity—at amortized cost (fair value $2,524 and $2,748)	$2,470	$2,640
Fixed-maturities available for sale—at fair value (amortized cost $72,500 and $120,757)	75,516	118,733
Equity securities available for sale—at fair value (cost $88,768 and $114,425)	108,381	128,424
Trading securities—at fair value (including variable interest entity (“VIE”) securities of $0 and $94,521)	4,228,522	4,211,059
Short-term investments—at fair value (including VIE investments of $0 and $149,981)	705,744	1,261,703
Other invested assets (including VIE assets of $75,413 and $0)	134,548	61,000
Total investments	5,255,181	5,783,559
Cash	32,617	35,589
Restricted cash	26,185	27,020
Deferred policy acquisition costs	99,386	139,906
Accrued investment income	31,456	32,262
Accounts and notes receivable	91,154	102,647
Property and equipment, at cost (less accumulated depreciation of $98,542 and $96,403)	7,341	11,044
Derivative assets (including VIE derivative assets of $1,750 and $1,602)	14,229	17,212
Deferred income taxes, net	15,975	15,975
Reinsurance recoverables	103,143	157,985
Other assets (including VIE other assets of $100,724 and $105,903)	354,863	333,566
Total assets	$6,031,530	$6,656,765
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Unearned premiums	$588,431	$637,372
Reserve for losses and loss adjustment expenses (“LAE”)	3,250,280	3,310,902
Reserve for premium deficiency	4,183	3,644
Long-term debt	666,806	818,584
VIE debt—at fair value	107,833	228,240
Derivative liabilities (including VIE derivative liabilities of $75,413 and $19,501)	219,960	126,006
Payable for securities purchased	3,767	46,368
Accounts payable and accrued expenses (including VIE accounts payable of $390 and $530)	289,382	303,358
Total liabilities	5,130,642	5,474,474
Commitments and Contingencies (Note 16)		
Stockholders’ equity		
Common stock: par value $.001 per share; 325,000,000 shares authorized; 151,001,568 and 150,666,446 shares issued at June 30, 2012 and December 31, 2011, respectively; 133,520,514 and 133,199,159 shares outstanding at June 30, 2012 and December 31, 2011, respectively	151	151
Treasury stock, at cost: 17,481,054 and 17,467,287 shares at June 30, 2012, and December 31, 2011, respectively	(892,084)	(892,052)
Additional paid-in capital	1,966,767	1,966,565
Retained (deficit) earnings	(192,264)	96,227
Accumulated other comprehensive income	18,318	11,400

Total stockholders’ equity	900,888	1,182,291
Total liabilities and stockholders’ equity	$6,031,530	$6,656,765

See notes to unaudited condensed consolidated financial statements.

Radian Group Inc.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(In thousands, except per share amounts)	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Revenues:				
Premiums written—insurance:				
Direct	$214,349	$174,008	$418,102	$364,849
Assumed	(1,028)	(11,788)	(88,516)	(10,164)
Ceded	(31,389)	(9,442)	(69,976)	(19,158)
Net premiums written	181,932	152,778	259,610	335,527
Decrease in unearned premiums	4,847	36,156	94,534	56,430
Net premiums earned—insurance	186,779	188,934	354,144	391,957
Net investment income	30,877	43,823	65,590	86,063
Net gains on investments	26,419	44,236	93,878	81,671
Total other-than-temporary impairment (“OTTI”) losses	—	(11)	—	(11)
Losses recognized in other comprehensive income (loss)	—	—	—	—
Net impairment losses recognized in earnings	—	(11)	—	(11)
Change in fair value of derivative instruments	(33,124)	188,726	(105,881)	432,618
Net (losses) gains on other financial instruments	(61,862)	5,047	(79,714)	80,298
Gain on sale of affiliate	7,708	—	7,708	—
Other income	1,395	1,196	2,835	2,644
Total revenues	158,192	471,951	338,560	1,075,240
Expenses:				
Provision for losses	210,868	263,566	477,022	690,939
Change in reserve for premium deficiency	559	(3,102)	539	(4,485)
Policy acquisition costs	10,805	14,387	38,851	28,518
Other operating expenses	40,193	45,954	90,347	92,173
Interest expense	12,581	16,079	26,729	33,103
Total expenses	275,006	336,884	633,488	840,248
Equity in net (loss) income of affiliates	(2)	—	(13)	65
Pretax (loss) income	(116,816)	135,067	(294,941)	235,057
Income tax provision (benefit)	2,443	(2,048)	(6,450)	(5,064)
Net (loss) income	$(119,259)	$137,115	$(288,491)	$240,121
Basic net (loss) income per share	$(0.90)	$1.04	$(2.18)	$1.82
Diluted net (loss) income per share	$(0.90)	$1.03	$(2.18)	$1.80
Weighted-average number of common shares outstanding—basic	132,346	132,185	132,350	132,185
Weighted-average number of common and common equivalent shares outstanding—diluted	132,346	133,614	132,350	133,724
Dividends per share	$0.0025	$0.0025	$0.0050	$0.0050

See notes to unaudited condensed consolidated financial statements.

Radian Group Inc.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME (UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2012	2011	2012	2011
Net (loss) income	$(119,259)	$137,115	$(288,491)	$240,121
Other comprehensive (loss) income, net of tax (see Note 12):				
Foreign currency translation adjustments:				
Unrealized foreign currency translation adjustment	(8)	4,955	(8)	6,520
Less: Reclassification adjustment for net gains included in net (loss) income	—	28,246	—	27,954
Net foreign currency translation adjustments	(8)	(23,291)	(8)	(21,434)
Unrealized (losses) gains on investments:				
Unrealized holding (losses) gains arising during the period	(1,419)	5,549	15,795	13,615
Less: Reclassification adjustment for net (losses) gains included in net (loss) income	(741)	(35,016)	8,869	(34,938)
Net unrealized (losses) gains on investments	(678)	40,565	6,926	48,553
Other comprehensive (loss) income	(686)	17,274	6,918	27,119
Comprehensive (loss) income	$(119,945)	$154,389	$(281,573)	$267,240

See notes to unaudited condensed consolidated financial statements.

Radian Group Inc.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN COMMON STOCKHOLDERS' EQUITY (UNAUDITED)

(In thousands)	Common Stock	Treasury Stock	Additional Paid-in Capital	Retained Earnings/(Deficit)	Foreign Currency Translation Adjustment	Unrealized Holding Gains (Losses)	Other	Total
BALANCE, JANUARY 1, 2011	$ 150	$ (892,012)	$ 1,963,092	$ (204,926)	$ 21,094	$ (27,857)	$ 239	$ 859,780
Net income	—	—	—	240,121	—	—	—	240,121
Net foreign currency translation adjustment, net of tax	—	—	—	—	(21,434)	—	—	(21,434)
Net unrealized gain on investments, net of tax	—	—	—	—	—	48,553	—	48,553
Repurchases of common stock under incentive plans	—	(24)	—	—	—	—	—	(24)
Issuance of common stock under benefit plans	1	—	404	—	—	—	—	405
Amortization of restricted stock	—	—	1,603	—	—	—	—	1,603
Additional convertible debt issuance costs, net	—	—	(22)	—	—	—	—	(22)
Stock-based compensation expense	—	—	995	—	—	—	—	995
Dividends declared	—	—	(333)	(334)	—	—	—	(667)
BALANCE, JUNE 30, 2011	$ 151	$ (892,036)	$ 1,965,739	$ 34,861	$ (340)	$ 20,696	$ 239	$ 1,129,310
BALANCE, JANUARY 1, 2012	$ 151	$ (892,052)	$ 1,966,565	$ 96,227	$ 54	$ 11,471	$ (125)	$ 1,182,291
Net loss	—	—	—	(288,491)	—	—	—	(288,491)
Net foreign currency translation adjustment, net of tax	—	—	—	—	(8)	—	—	(8)
Net unrealized gain on investments, net of tax	—	—	—	—	—	6,926	—	6,926
Repurchases of common stock under incentive plans	—	(32)	—	—	—	—	—	(32)
Issuance of common stock under benefit plans	—	—	213	—	—	—	—	213
Amortization of restricted stock	—	—	1,101	—	—	—	—	1,101
Stock-based compensation expense	—	—	(446)	—	—	—	—	(446)
Dividends declared	—	—	(666)	—	—	—	—	(666)
BALANCE, JUNE 30, 2012	$ 151	$ (892,084)	$ 1,966,767	$ (192,264)	$ 46	$ 18,397	$ (125)	$ 900,888

See notes to unaudited condensed consolidated financial statements.

Radian Group Inc.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In thousands)	Six Months Ended June 30, 2012	2011
Cash flows used in operating activities	$(361,899)	$(608,917)
Cash flows from investing activities:		
Proceeds from sales of fixed-maturity investments available for sale	44,935	101,648
Proceeds from sales of equity securities available for sale	30,727	555
Proceeds from sales of trading securities	2,066,088	2,444,549
Proceeds from redemptions of fixed-maturity investments available for sale	3,738	28,032
Proceeds from redemptions of fixed-maturity investments held to maturity	250	3,195
Purchases of trading securities	(2,137,677)	(2,206,653)
Sales and redemptions of short-term investments, net	556,048	407,494
Purchases of other invested assets, net	(74,999)	(2,717)
Proceeds from sale of investment in affiliate	14,700	—
Purchases of property and equipment, net	(452)	(5,729)
Net cash provided by investing activities	503,358	770,374
Cash flows used in financing activities:		
Dividends paid	(666)	(667)
Redemption of long-term debt	(143,770)	(160,000)
Net cash used in financing activities	(144,436)	(160,667)
Effect of exchange rate changes on cash	5	(2)
(Decrease) increase in cash	(2,972)	788
Cash, beginning of period	35,589	20,334
Cash, end of period	$32,617	$21,122
Supplemental disclosures of cash flow information:		
Income taxes paid (received)	$1,498	$(1,275)
Interest paid	$21,820	