THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

RDN - Q2 2014 Radian Group Inc Earnings Call

EVENT DATE/TIME: AUGUST 07, 2014 / 2:00PM GMT

CORPORATE PARTICIPANTS

Emily Riley *Radian Group Inc - SVP Corporate Communications & IR*

S.A. Ibrahim *Radian Group Inc - CEO*

Bob Quint *Radian Group Inc - EVP & CFO*

Derek Brummer *Radian Group Inc - EVP & Chief Risk Officer*

Teresa Bryce Bazemore *Radian Group Inc - President Radian Guaranty Inc.*

CONFERENCE CALL PARTICIPANTS

Jack Micenko *Susquehanna Financial Group / SIG - Analyst*

Bose George *Keefe, Bruyette & Woods - Analyst*

Eric Beardsley *Goldman Sachs - Analyst*

Sean Dargan *Macquarie Research - Analyst*

Mark DeVries *Barclays Capital - Analyst*

Geoffrey Dunn *Dowling & Partners Securities - Analyst*

Douglas Harter *Credit Suisse - Analyst*

Chris Gamaitoni *Autonomous Research LLP - Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Radian second quarter 2014 earnings call.

(Operator Instructions)

As a reminder, this conference is being recorded. I'll now turn the conference over to Emily Riley, Senior Vice President, Investor Relations and Corporate Communications. Please go ahead.

Emily Riley - *Radian Group Inc - SVP Corporate Communications & IR*

Thank you, and welcome to Radian's second quarter 2014 conference call. Our press release, which contains Radian's financial results for the quarter, was issued earlier today and is posted to the Investor section of our website at www.radian.biz.

This press release includes a non-GAAP measure. A complete description of this measure and the reconciliation to GAAP may be found in press release Exhibit E and on the Investor section of our website.

During today's call you will hear from S.A. Ibrahim, Radian's Chief Executive Officer; and Bob Quint, Chief Financial Officer. Also on hand for the Q&A portion of the call are Teresa Bryce Bazemore, President of Radian Guaranty; David Beidler, President of Radian Asset Assurance; and Derek Brummer, Executive Vice President and Chief Risk Officer of Radian Group.

Before we begin, I would like to remind you that comments made during this call will include forward-looking statements. These statements are based on current expectations, estimates, projections and assumptions that are subject to risks and uncertainties which may cause actual results to differ materially. For a discussion of these risks, please review the cautionary statements regarding forward-looking statements included in our earnings release, and the risk factors included in our 2013 Form 10-K and subsequent reports filed with the SEC. These are also available on our website.

Now I would like to turn the call over to S.A.

S.A. Ibrahim - *Radian Group Inc - CEO*

Thank you, Emily. Thank you all for joining us and for your interest in Radian. I'm pleased to share with you today the results of our second quarter, which includes solid financial performance and strong credit trends for our mortgage insurance business, as well as the successful closing of our Clayton acquisition.

The primary driver of our profitability is the steadily increasing positive impact of our large and profitable MI book of business written after 2008, combined with the ongoing improvement in credit performance of our legacy MI book. Following my comments, Bob will cover the details of our financial position, and then I will summarize a few key points before opening the call to your questions.

Radian was profitable on a GAAP and operating basis in the second quarter, with net income of $175 million, or $0.78 per diluted share. This compares favorably to a net loss for the second quarter of last year of $33 million, or $0.19 per diluted share. Book value per share at June 30, 2014 was $8.29. Adjusted pretax operating income was $74 million for the second quarter.

Now I'd like to review several highlights from the quarter. First, and importantly, we continued to grow and improve our high-quality mortgage insurance in force which is the driver of future earnings. We wrote more than $9 billion of new MI business in the second quarter, an increase of more than one-third from the first quarter of this year.

The trend continued in July with NIW of $3.9 billion representing the fifth consecutive month of new business growth. This new business growth is representative of the stronger home lending trends seen in the second quarter after hitting a 14-year low in the first quarter of this year.

While overall mortgage origination volume is lower today than it was a year ago, business has shifted from mainly refinance to purchase. Given that purchase transactions are more likely to use mortgage insurance than refis, this is a positive trend for our business.

At Radian, our sales team continues to succeed in attracting new business as we signed 59 new customers in the second quarter alone. To support this new business growth, we hired four new account managers in 2014 including one dedicated solely to enhancing Radian's commitment to the Hispanic community, which is expected to be one of the fastest growing demographic groups for homeownership in America.

In July, we entered into another exclusive partnership with the National Association of Real Estate Brokers, an organization focused on equal housing opportunities for African-American and other minority groups. The goal is to help the 93-chapter network better understand the value of private mortgage insurance.

We also continue to pursue cost effective ways to support our small to midsize lending partners including through our enhanced sales team. This team, which assists customers with consultative services by telephone, helped bring on nearly half of the new customers Radian signed in 2014.

While market size in new business volume remain top of mind, our ability to grow our mortgage insurance in force is most important. Radian's persistency, which is the amount of business that remains on our books over a 12-month period, reached 83.1% in the second quarter compared to 80.3% in the second quarter of 2013. Our insurance in force grew 9% from the second quarter of last year, and we once again led our industry as the largest mortgage insurance Company with $165 billion of insurance in force.

Second, our continued success in writing new business improves the credit profile of our portfolio. As you can see on slide 9, the high-quality books of mortgage insurance business written after 2008, including loans completing a HARP refinance, represented 76% of our primary mortgage insurance portfolio as of June 30, 2014. This, again, is one of the key drivers of our future financial results.

THOMSON REUTERS

And the legacy book continues to shrink with the most problematic 2006 and 2007 books now down to less than 12% of the total portfolio. As our legacy portfolio shrinks and improves an important indicator of its resiliency is the fact that approximately 70% of our performing loans from 2005 to 2008 have never been delinquent.

Third, slide 10 shows that for the six months ended June 30, 2014 the earned premiums less incurred losses from our 2009 and later MI vintages were $227 million. This illustrates the steadily increasing positive impact of our business mix and represents impressive increases from the $148 million for the first six months in 2013, and $96 million for the same period in 2012. It is also noteworthy to mention that the 2008 and prior vintages are now positive by $69 million.

Fourth, our total number of primary delinquent loans dropped by 38% year-over-year, as seen on slide 21 of our webcast presentation with the trend continuing in July. Our primary default count decreased to 48,904 loans and our primary default rate, which has been declining steadily since its 2009 peak, fell to 5.8%. This is the lowest rate we've seen since 2007.

In addition, the MI incurred loss ratio was 32% in the quarter representing another positive trend. This compares to a loss ratio of 69% in the second quarter of 2013.

Fifth, we completed our acquisition of Clayton, a leading provider of outsourced mortgage and real estate solutions, in the second quarter. This adds a diversified source of fee-based revenue for Radian, and also broadens our participation in the residential mortgage market value chain with services that complement our MI business.

We plan to leverage the synergies between our two industry-leading businesses providing a competitive advantage for Radian and another way to differentiate ourselves from our mortgage insurance peers. In the third quarter, results of operations for Clayton will be included in our financial results, and we will further direct the Company's progress and business strategy.

We are now looking at opportunities that build on the combined capabilities of Radian and Clayton, and in July, we invested $20 million to capitalize a newly formed wholly-owned Radian Group insurance subsidiary to offer complementary mortgage insurance-related products to industry participants. These products are in the developmental stage today, but we look forward to providing updates on our progress in the coming quarters.

Sixth, as you know, the FHFA released a draft Private Mortgage Insurer Eligibility Requirements, or PMIERs, last month for public comment. These PMIERs were developed by Fannie Mae and Freddie Mac, and are intended to provide revised requirements for private MI companies to be eligible insurers of loans purchased by Fannie and Freddie. The public comment period ends on September 8 and we expect to provide meaningful input on the proposed rules.

We believe that other private MI, the state insurance departments, the mortgage and real estate community and various housing and consumer groups will also provide comments on the rules. Bob will cover this topic in more detail during his remarks, but what is most important to remember is that we and other MI companies have an extended transition period of more than two years to comply with the financial requirements, and we expect to have the ability to fully comply before the transition period ends without a need to raise external capital.

Finally, our success in reducing the exposure in our financial guaranty business continues, with the reduction now at 82% since 2008, including in many of the riskiest segments of the portfolio. While there is risk remaining in our financial guaranty book of business, the credit performance has been generally stable, and we continue to proactively reduce our total exposure which decreased to $20 billion in the quarter.

And as we reported last month, after receiving approval from the New York Department of Financial Services, the Radian Asset paid an extraordinary dividend to Radian Guaranty of $150 million in July. We expect to request an additional extraordinary dividend next year.

As we discussed in our call last month, we believe the Radian Asset is a solid over-capitalized Company with strong economic value. We are actively working to monetize or otherwise utilize Radian Asset in a way that will maximize its value consistent with PMIERs. Radian maintains strong Holding Company liquidity of approximately $770 million, and Radian Guaranty's risk-to-capital ratio improved to 18.7 to1 at June 30, 2014.

Now I would like to turn the call over to Bob for details of our financial position.

Bob Quint - *Radian Group Inc - EVP & CFO*

Thanks, S.A. I'll be covering our P&L activity and trends for the second quarter of 2014, our capital and liquidity positions as of quarter end, and some updated expectations regarding the balance of 2014.

We introduced non-GAAP measures in the fourth quarter of 2013 to more closely align with the way we evaluate our business performance, and last quarter we started showing adjusted pretax operating income or loss for segment reporting. Because the Clayton acquisition closed on June 30, only our balance sheet for the second quarter was impacted. Next quarter, our P&L will include a third business segment, mortgage and real estate services, which will contain the results of Clayton.

This quarter we included selected historical Clayton financial results from continuing operations in Exhibit N which displays some important business trends including strong second quarter 2014 revenues, which we expect to continue at similar levels in the second half of the year.

On our June 30 balance sheet, which is Exhibit C, approximately $295 million of goodwill and other intangible assets represents our Clayton investment. The balance of the $312 million purchase price consists of working capital. The $295 million is broken up into $192 million of goodwill and $103 million of identified intangibles. Any amortization of these intangibles will be excluded in our adjusted pretax operating income metric.

Goodwill will be reviewed periodically for impairment, otherwise it will remain as is on the GAAP balance sheet, but is deductible over 15 years for tax purposes. Our EPS calculation for the second quarter includes both the dilutive impact of our 2019 convertible debt which adds 37.7 million shares to our share count, and adds back $5.5 million of interest expense to income for EPS calculation purposes, and additionally, PS dilution relating to our 2017 convertible debt of approximately 7.6 million shares. A table of our fully diluted share count is presented in Exhibit B.

The MI provision for losses was $64 million this quarter compared to $49 million last quarter and $136 million a year ago. Low incurred losses continue to reflect improving default trends, as new primary default totals were 22% better than second quarter of last year, and cure rates have remained fairly high. Many other important trends that we follow, such as claims submitted, and that you can see on slide 24, showed improvements during the quarter.

Favorable reserve development on the existing default line in slide 14 continues to occur because paid claims were less than the amounts reserved for such claims primarily due to curtailments. Similar to last quarter, this favorable movement was only partially offset by default composition changes.

Paid claims for the quarter increased to $240 million, and as we disclosed, would have been approximately $35 million higher had we not entered into the Freddie Mac agreement a year ago. We've nearly completed the process of clearing out the backlog of pending claims, as primary pending claims as of June 30, 2014, were 6,533, down 18% from 7,969 as of March 31. We still expect full-year 2014 claims paid to be between $900 million and $1 billion.

Losses in the Financial Guaranty segment have continued to be modest. In light of the recent developments in Puerto Rico, including the passage of the Debt Enforcement and Recovery Act which impacts public corporations in the Commonwealth, this quarter we increased our GAAP loss reserve on our Puerto Rico Electric Power Authority, or PREPA, exposure by $4.6 million to $4.7 million, representing 21% of our $22.3 million of combined direct and assumed exposure.

We also increased our reserves on our $93 million of senior and subordinate transportation bonds in Puerto Rico by $6.5 million to $7.1 million based on the possibility that the Commonwealth may restructure this debt or use part of the revenues supporting these bonds to further support their GO debt. Our remaining $331 million of Puerto Rico exposure, for which we have not established a reserve, includes $79 million of highway authority bonds which are better secured than the transportation exposure we reserve for, and $233 million of GO and appropriation debt.

The additional reserves booked in the Financial Guaranty segment this quarter were partially offset by favorable reserve developments in both public finance and structured finance reinsurance. Net fair value gains on derivatives for the quarter of $57 million was caused mainly by an improvement in collateral spreads and rating upgrades. Slide 12 depicts our current balance sheet fair value positions along with the expected net credit losses or recoveries on fair valued exposures.

Based on our projections, we expect to add $157.8 million, or $0.83 per share, to pretax book value from these positions over time as the exposures mature or are otherwise eliminated. That number is derived by taking the net balance sheet liability of $99.1 million and adding the present value of expected credit loss recoveries of $58.7 million. Please note on slide 12, and on Exhibit D, that there's an increase in the present value of net credit losses incurred this quarter of approximately $11 million in the Financial Guaranty segment.

This increase, which does not impact our P&L, only the adjusted pretax operating loss, is primarily due to a deterioration in our internal view of a $377 million second to pay CLO financial guaranty we have talked about in the past. We will only be required to pay if there is a realized loss on the deal and if MBIA Insurance Corp., who is a principal insurer, fails to pay. In order to manage our risk, we've purchased $100 million of default protection on MBIA Insurance Corp. that serves as a meaningful hedge against any potential loss to Radian on the transaction, and which, is factored into our probability weighted loss estimate.

During the second quarter, operating expenses were impacted very modestly by long-term incentive compensation expenses. The variability of this expense relating to stock price performance will be reduced for the next year due to the recent payout of about half of the cash settled awards, and the variability will be substantially eliminated at this time next year when most of the remaining awards are settled.

Other operating expenses this quarter also includes $6.7 million of acquisition expenses relating to the Clayton purchase. We've excluded these acquisition expenses in our measure of adjusted pretax operating income.

The valuation allowance against our deferred tax asset was $886 million this quarter, or approximately $4.64 per share, reduced from year-end primarily due to our pretax income in the first and second quarters. As we make money, we utilize our DTA and reduce the valuation allowance. We still expect to be able to fully recover our valuation allowance by sometime in 2015.

While this is also the timeframe to begin admitting the majority of DTA for statutory purposes, keep in mind that admitted DTA is not an available asset under the proposed PMIERs. As we've said on our PMIERs investor call, we expect to realize much of the DTA over the next two-and-a-half years due to earnings over that time period.

With regard to PMIERs, our first priority is to provide the GSEs and the FHFA with a meaningful set of comments in several areas by September 8. Two primary examples are the onerous requirements for the 2005 to 2008 vintage loans that have made every payment since they were originated many years ago including through the downturn, and the exclusion of unearned premium reserves in the available asset calculation despite the fact that they are liquid and readily available to pay claims. Secondly, we are actively evaluating opportunities to transform the economic value of Radian Asset in a manner that is consistent with the PMIERs framework and are also exploring various mortgage insurance reinsurance possibilities.

Relative returns on our business are clearly lower under the proposed rules, especially for loans with 95 LTVs and higher and FICO scores below 740. However, we believe the current business mix in the current economic environment produces an overall expected unlevered return on our business in the midteens as the rules are currently proposed. Absent pricing increases, any meaningful mix shifts in our business toward higher LTVs and lower average FICO scores would undoubtedly impact these returns in the future.

Most importantly, we remain confident that Radian will meet the financial requirements of the final PMIERs before the two-year transition period is over without the need to raise external capital. I'd now like to turn the call back over to S.A.

S.A. Ibrahim - *Radian Group Inc - CEO*

Thanks, Bob. Once again we are pleased to share with you our solid financial performance in the second quarter and the successful closing of our Clayton acquisition. We believe that there is continued growth and opportunity ahead for us in our mortgage insurance business, and we are fully focused on it, while also positioning Radian to leverage our risk management expertise, as well as our new industry-leading mortgage and real estate services for the next phase in the evolution of the US housing finance markets.

It is important to note that as we face the opportunities and challenges that lie ahead, we do so with the benefit of the growing positive impact from our large profitable post-downturn MI book, continued credit improvement in our legacy MI book, a strongly capitalized Financial Guaranty business, and greater strategic opportunities from the Clayton acquisition. Now, operator, we'd like to open the call to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Jack Micenko with SIG.

Jack Micenko - *Susquehanna Financial Group / SIG - Analyst*

Hi, good morning. Wondering, out of the gate, if you could expand on the new insurance subsidiary and strategy a bit more? What kind of related mortgage insurance products are you targeting?

S.A. Ibrahim - *Radian Group Inc - CEO*

Sure, Jack, this is S.A. Having achieved profitability, having acquired a lot of new customers in our mortgage insurance business, and having closed on the Clayton transaction, we believe we are well-positioned now to explore new opportunities within the space we understand which is in our area of expertise, core expertise, which is the mortgage business.

And in that light, as we look at some of these opportunities, and we believe there several available to us, we recently capitalized the subsidiary in order to get it licensed. I'd like to defer talking about any specifics on the products at this stage because we've got a lot of opportunities available to us, and that is a good thing, and we will give you more details as we continue to make progress.

Jack Micenko - *Susquehanna Financial Group / SIG - Analyst*

Okay. And then, I guess earlier this week Padilla down in Puerto Rico moved the San Juan subway out the highway transportation authority. Given it was losing about $50 million a year, on that, I think, a $350 million debt service, it seems like it is a good news development given your exposure. I guess, are my numbers right? Am I thinking about this the right way? Was this development in your reserve methodology? Just some thoughts around that development?

Derek Brummer - *Radian Group Inc - EVP & Chief Risk Officer*

This is Derek. That's factored in. We do view that as a positive development. That being said, and we made a distinction this quarter, as Bob pointed out, in terms of our exposure to highway and transportation authority between the highway bonds and the transportation bonds. The view being that highway bonds have generally stronger security structure.

Obviously, getting rid of that negative drag is a positive for all the credits. We still think that overall the Commonwealth has signaled pretty clearly that they are going to protect their own ability to pay back their bonds, and potentially at the expense, or at least from their perspective, stop subsidizing the public corporations. As a result, we think that creates risk for all of our public corporations exposure. That being said, that certainly is a positive development, and then looking at the public corporations, certainly PREPA stands out as the one that's most materially at risk, and we have around $22 million of exposure to that.

Jack Micenko - *Susquehanna Financial Group / SIG - Analyst*

All right, okay. And then, just real quick, last question, really good July results. I guess, the growth in NIW was surprising. It seems maybe like the spring season maybe got pushed out a month or two, just curious your observations on the new business volume side coming in a little bit better than June? And then, obviously, credit trends really good too, cured default well above prior July numbers, any specifics there? I know month-to-month numbers can move around a bit on the credit side, but just some thoughts on July?

Derek Brummer - *Radian Group Inc - EVP & Chief Risk Officer*

This is Derek. From a credit perspective, it has been a trend we've been seeing in terms of cure rates. So if you look on a year-over-year basis, cure rates have been trending up, and so July, I think, is really just a continuation of that trend we've been seeing.

S.A. Ibrahim - *Radian Group Inc - CEO*

And Teresa has a comment on NIW.

Teresa Bryce Bazemore - *Radian Group Inc - President Radian Guaranty Inc.*

And with respect to NIW, your right, it was a slower first quarter, and we continue to see, as we were in the middle of that quarter, the commits go up and then the NIW in the following months go up. So we've been very pleased with the amount of NIW [would ride] over the quarter and how that's continuing to trend.

Jack Micenko - *Susquehanna Financial Group / SIG - Analyst*

All right. Thank you very much.

Operator

Bose George with KBW.

Bose George - *Keefe, Bruyette & Woods - Analyst*

Good morning. Just first a question on the increase in book value. I was just trying to bridge the increase of -- part was the capital raise, part was the earnings. Was there some also change in the financial guaranty liability?

Bob Quint - *Radian Group Inc - EVP & CFO*

A little bit, Bose, but, no, that's reflected in the earnings. So it is going to be the earnings and it is going to be essentially the Clayton book value which we raised capital -- we raised capital during the quarter, some of that was debt but sum was equity, which is going to increase our book value.

Bose George - *Keefe, Bruyette & Woods - Analyst*

Okay, great. And then, just switching to the financial guaranty business and your plans there. If you are able to get substantial dividends out of that, is that preferable to selling all or part of that business?

Bob Quint - *Radian Group Inc - EVP & CFO*

We want to maximize the economic value. So, obviously, dividends are great because that brings the liquidity to the MI Company, but in terms of the options we have available to us, that's one, and there are many others, but the object is clear to maximize the value that we think is there. We think it is a very strong, over capitalized Company and we are going to do what we can to maximize value.

Bose George - *Keefe, Bruyette & Woods - Analyst*

Thanks, and then, actually one last one on the FHA. They started the HAWK program recently where they are offering discounts to borrowers who take counseling. Do you think that will have much traction in terms of loans that could be in the MI market, or is it different cohortive borrowers?

Teresa Bryce Bazemore - *Radian Group Inc - President Radian Guaranty Inc.*

Yes, we've taken a look at that, and we don't think that that's going to have much of an impact on the business that we see. If you take a look even that the pricing benefits that those borrowers get, it doesn't -- it sort of closes the GAAP a little bit, but there still is an advantage in terms of getting conventional with private MI, so we just don't think that there is going to be much of an impact there.

Bose George - *Keefe, Bruyette & Woods - Analyst*

Okay, great, thank you.

Operator

Eric Beardsley with Goldman Sachs.

Eric Beardsley - *Goldman Sachs - Analyst*

Hi, thank you. Just on the actions you might take to mitigate the proposed requirements, would you anticipate doing anything prior to the final rules being issued?

Bob Quint - *Radian Group Inc - EVP & CFO*

It is possible, Eric. I think we want to wait and see what the final rules say, and I think most of our actions will be based on that. But there are certain things that could be done before hand that would be positive regardless of the outcome. So I would say it is possible, although we are certainly going to wait until the final rules are out before we take some of the action.

Eric Beardsley - *Goldman Sachs - Analyst*

Okay. Just on the Financial Guaranty, the present value of net credit losses. Could you just walk through what the future P&L impact looks and how that ultimately comes in?

Bob Quint - *Radian Group Inc - EVP & CFO*

Most of it -- most of what is sitting there is this recovery that we expect to get down the road, so that's why the number, it is a present value recovery. There's a little bit of expected losses, which would be cash losses, that we expect, and we talked a little bit about the one transaction that was

THOMSON REUTERS

impacted this quarter. But on a net basis, it is a recovery, so we expect cash to come back over time. This goes through the P&L in the fair value line, so that's why we -- if there's ever a change to that line that's meaningful in terms of losses or recoveries we would talk about it like we did this quarter on the one transaction.

Eric Beardsley - *Goldman Sachs - Analyst*

Got it. In terms of the one transaction, would you need to set aside provisions for that, or you are just going to treat that with the hedges and derivatives?

Bob Quint - *Radian Group Inc - EVP & CFO*

It is going to go through the fair value line, any of the P&L, but the hedge we bought was really to mitigate any potential loss, so we feel like we are well-positioned as the second to pay with that hedge in play.

Eric Beardsley - *Goldman Sachs - Analyst*

All right, great, thank you.

Operator

Sean Dargan with Macquarie.

Sean Dargan - *Macquarie Research - Analyst*

Thank you. Looking at the disclosure you provided in Exhibit N around Clayton, so should we assume that second quarter run rate gross profit on services is something that we can pencil in for operating earnings above and beyond what you would report in MI and FG?

Bob Quint - *Radian Group Inc - EVP & CFO*

If you look back, and we gave you several quarters to look at, you can see the gross profit moves within a band, so I think that's a fair -- I wouldn't look necessarily at one specific quarter, but that's -- you have a range of where the gross profit is and often it is going to be related to the size of the revenues. Now what we did say was quarter two was a strong revenue quarter and we do expect the rest of the year to be similar to quarter two.

You can also see that the revenues can jump around because this business, unlike the MI business which is based on the in-force, this is business based on assignments and sometimes things are going to come in more sporadically in terms of revenue, either a securitization, or a contract with a counter party or a customer. So I think you're going to see some levels of jumping around in terms of the revenues and the gross profit within this band, but not exactly what it was in the second quarter necessarily.

Sean Dargan - *Macquarie Research - Analyst*

Got you. And can I just ask about the rationale from excluding amortization of intangibles from operating earnings? Is that -- in my mind, that something that should be included?

Bob Quint - *Radian Group Inc - EVP & CFO*

Yes, that's fine, you can evaluate it the way you would like. The rules that we follow are really that we would have a non-GAAP measure when we, the management, are evaluating the business a certain way, and that's the way we evaluate the business based on the operating performance and we view that amortization of intangibles as not something that we are going to evaluate the business based on. Obviously, it is a part of the P&L, and that's (inaudible) to the way companies like that are typically evaluated when they stand alone.

Sean Dargan - *Macquarie Research - Analyst*

So is this like EBITDA, this gross profit?

Bob Quint - *Radian Group Inc - EVP & CFO*

It is akin to that. Obviously, it is not exactly that, but if you think in those terms, that's kind of the way a company, a service kind of company, would be evaluated, and it will be the way that management will be evaluating the operating performance of Clayton.

Sean Dargan - *Macquarie Research - Analyst*

All right, got it, thank you. And can you disclose maybe the assumed loss severity in PREPA that's baked into your current reserves?

Derek Brummer - *Radian Group Inc - EVP & Chief Risk Officer*

In terms of PREPA, looking at that, we use a probability weighted analysis. Generally, the range we are looking at in terms of losses is between 10% and 35%.

Sean Dargan - *Macquarie Research - Analyst*

Okay, thank you. Just one last question. Is there any concerted effort between you and your competitors in the US mortgage insurance organization to, I guess, present the united front during the comment period with PMIERs?

Teresa Bryce Bazemore - *Radian Group Inc - President Radian Guaranty Inc.*

Well, I think there's certainly a common view on many of the issues that we will be commenting on in the PMIERs, and we've also had a number of calls, and we will have some additional calls with the GSEs and the FHSA to discuss certain topics that we commonly have sort of have concerns with.

Sean Dargan - *Macquarie Research - Analyst*

Okay, but do you find yourself in agreement with some of your newer competitors, or do you feel that they are working against your interest?

Teresa Bryce Bazemore - *Radian Group Inc - President Radian Guaranty Inc.*

I think that we find that some of the newer competitors also are concerned about some of the same issues, but I think, certainly, those of us who have legacy business who have a historical view and data around some of these issues I think have more of a view on what the impact might be going forward. And a lot of what we will be commenting on is related to whether or not the historical data and experience support, what is presented or proposed in those requirements.

Sean Dargan - *Macquarie Research - Analyst*

Okay, great, thank you.

Operator

Mark DeVries with Barclays.

Mark DeVries - *Barclays Capital - Analyst*

Yes, thanks. With your loss ratio already now at more normalized levels, and your legacy book still showing credit improvement, where do you think the loss ratio can end up?

Bob Quint - *Radian Group Inc - EVP & CFO*

It is conceivable that it comes down from here. Certainly, we are adding really, really high-quality business and the recently written vintages look like they are going to have a better than expected, really superlative loss ratios attached to them. So conceivably the loss ratios can go down into the 20s.

Mark DeVries - *Barclays Capital - Analyst*

Okay, what's the lowest loss ratio you have had historically?

Bob Quint - *Radian Group Inc - EVP & CFO*

Going back, it was probably in the 30s, but it was probably not a book of business that contained the high quality that this one does, so it is not really a totally fair comparison. And then, of course, the date you start writing business you are going to have loss ratios that are very, very low until the loss curve kind of catches up, but on a normalized basis, we had loss ratios in the low 30s, I believe.

Mark DeVries - *Barclays Capital - Analyst*

Okay. Is there any room to bring the expense ratio down here, or are you kind of running at normal levels?

Bob Quint - *Radian Group Inc - EVP & CFO*

I think we are running at relatively normal levels. We've had a little bit of noise in there due to the variability, which we try to point out every quarter. The growth of the book, and hence the growth of the revenues, impacts the expense ratio, as well. But we've said, I think, that we believe a normalized expense ratio is in the 20% to 25% range. And if we grow the book, and are successful in growing the book, we can get to the lower end of that.

Mark DeVries - *Barclays Capital - Analyst*

That's great. Have you commented yet on if the PMIERs are implemented as proposed, and you don't do any additional reinsurance, how much of the value from Radian Asset you would need to extract to meet your required asset test?

Bob Quint - *Radian Group Inc - EVP & CFO*

I think we've put the numbers out there, so they are pretty evident in terms of the needs, or certainly the range, and I think that, again, we believe the Financial Guarantee value is there, and if we can capture a substantial portion of that that's our goal. And, regardless, I think the ability for us to meet the financial requirement, we are confident in that because there are other options, reinsurance options, and things like that. So we don't need a certain number to get there, but we are, obviously, trying to maximize value and we believe we can because it is a very strong company.

Mark DeVries - *Barclays Capital - Analyst*

Okay. Do you have a sense for how much you could get potentially through the issuance of surplus notes?

Bob Quint - *Radian Group Inc - EVP & CFO*

Not specific numbers, but we do -- the concept of surplus note, which I think we raised on our other call, is certainly one that could be pursued and makes sense in the context of the PMIERs, but we don't really have numbers out there. Something like that would need the department's approval and things like that, so that would have to be worked through them.

Mark DeVries - *Barclays Capital - Analyst*

Okay. And just one last question. Have you commented yet on how much of a buffer over your required assets you would want to get to by the end of 2016?

Bob Quint - *Radian Group Inc - EVP & CFO*

We really haven't said. Obviously, that's going to depend on the way the market moves and how we are doing in terms of our results. And so, surely, you would want some sort of cushion and be able to absorb some growth without having to manage that number so closely. But we haven't really said in terms of a specific amount.

Mark DeVries - *Barclays Capital - Analyst*

Okay, thank you.

Operator

Geoffrey Dunn with Dowling.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

Thanks, good morning. First, Bob, could you comment as to the type of entity that you have invested in in July? Is it established as a regulated mortgage insurance entity or a different type of structure?

Bob Quint - *Radian Group Inc - EVP & CFO*

It is a credit insurer, Geoff, so it can certainly do mortgage insurance-related products, but the specific licensing is a credit insurer.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

Okay, and then, I couldn't keep up typing, could you just review the details of the [up G] you are reserving again, the PREPA shift and the transportation shift?

Bob Quint - *Radian Group Inc - EVP & CFO*

Just the numbers?

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

Yes, please.

Derek Brummer - *Radian Group Inc - EVP & Chief Risk Officer*

Sure. I can do that, Geoff. It is Derek. In terms of the PREPA exposure, we made an increase in reserves of $6.5 million, so bringing that up to $7.1 million. I'm sorry, PREPA upright was from 4.6 to 4.7. In terms of the highway and transportation authority, the increase was $6.5 million to $7.1 million.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

And then, in terms of the PMIERs, you have a reinsurance or capture option coming up, I believe, December 31. Conceivably, you may make a decision on that before we get the finalized version. How are you thinking about that opportunity? And in your previous conference call where you discussed PMIERs, was your commentary assuming your recapture abilities, or assuming that that reinsurance stays outstanding?

Bob Quint - *Radian Group Inc - EVP & CFO*

We have the option. It is nice to have the option, so we will make that decision when the time comes. The business is performing really, really well, so it is profitable. So recapture would certainly be, from an economic standpoint, would be where we would lean. However, in light of PMIERs, recapturing would require us to have more assets, so we will make that decision. But I think it terms of performance, you would lean toward recapturing, and we will have to see where we stand in terms of required assets versus available assets and make that decision.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

Okay, so at this point, it really comes down to the line of whether or not for the 2014 recapture, whether or not you have the rules finalized and valuation of the cost capital at that point, et cetera?

Bob Quint - *Radian Group Inc - EVP & CFO*

Yes, somewhat, Geoff, but I think there are other ways. Conceivably, we could recapture and then do something else in terms of reinsurance that is more efficient and less costly that would do the same in terms of the impact on required assets, so that could be something we do.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

Okay. And then, last question, in terms of the traditional loss development curves where we see peak incurred year three, four, paids, four, five, do you think those traditional curves are holding for your 2009 and after books? Or are those books developing a little bit more slowly? What do you think the experience has been, so we can look at your disclosure and get a feel for what is a seasoned loss ratio versus non?

Derek Brummer - *Radian Group Inc - EVP & Chief Risk Officer*

Sure, this is Derek. Those books are, obviously, developing slowly. If you look at in terms of where they are from a default and loss rate, they are historically extremely low. From a development standpoint, we would say they are probably developing a bit slower.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

Any idea to extend -- are we looking at peak five six on incurreds versus three, four?

Derek Brummer - *Radian Group Inc - EVP & Chief Risk Officer*

Yes, I think peak -- maybe put it a year, a year-and-a-half out forward from what you traditionally have seen. So maybe you're looking at five-and-a-half, six years.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

Okay. Great, thank you very much.

Operator

Douglas Harter with Credit Suisse.

Douglas Harter - *Credit Suisse - Analyst*

Thanks. When we are thinking about the cash flow generation of Clayton, is that gross profit number a good approximation of the cash flow that could be generated?

Bob Quint - *Radian Group Inc - EVP & CFO*

It is not, Doug, because there's going to be expenses associated with the Company. So I think next quarter you will get a much better view of what the cash flow will be. I think with this quarter we really just wanted to show the revenue trends and the gross profit percentage, but, of course, there are operating expenses and there will be interest expense associated with the debt that we incurred. So I think you will get a much better view next quarter.

Douglas Harter - *Credit Suisse - Analyst*

Great, and then, I guess, when we're thinking, should we look back to the net income and the amortization expenses that you gave, I guess, the last quarter as the terms of cash generation?

Bob Quint - *Radian Group Inc - EVP & CFO*

We did that for that reason, to give you an idea of what they were generating. But, again, I think next quarter as we report the results within our consolidated results you will get a much clearer view of the expected cash flow to Group, which we've said, and continue to say, we expect to be modest.

Douglas Harter - *Credit Suisse - Analyst*

Got it, thank you, Bob.

Operator

Chris Gamaitoni with Autonomous.

Chris Gamaitoni - *Autonomous Research LLP - Analyst*

Good morning, thanks for taking my call. Bob, thanks for clarification on the returns in the midteens. I just wanted to clarify, is that an unlevered return?

Bob Quint - *Radian Group Inc - EVP & CFO*

It is, yes.

Chris Gamaitoni - *Autonomous Research LLP - Analyst*

And I assume that's just on the capital at the mortgage insurance subsidiary?

Bob Quint - *Radian Group Inc - EVP & CFO*

Yes, the capital required to be held against the business.

Chris Gamaitoni - *Autonomous Research LLP - Analyst*

Sure. What's the -- assuming your higher quality business of the current mix, what are the over-the-run loss ratios implied in that?

Bob Quint - *Radian Group Inc - EVP & CFO*

They are going to be pretty low because in the current environment we are really looking at the more recent books of business that we're probably looking at the lower 20s, or high teens, lower 20s.

Chris Gamaitoni - *Autonomous Research LLP - Analyst*

Okay, I come up with the same numbers. And just as far as your provisioning on early stage, I saw the reserve for delinquent went from about $10,200 to $9,800 in the quarter. What stage are we at in moving back to normalcy for what the early stage delinquency reserving was compared to pre-crisis levels?

Derek Brummer - *Radian Group Inc - EVP & Chief Risk Officer*

I think in -- this is Derek -- in terms of development it is drifting back. The thing that you should also keep in mind, though, in terms of the incremental defaults that are moving into that, that is still predominantly from the legacy book. So I still think about 75% that are moving in are still from the legacy book.

I think you'd move to a more normalized level when you see a transition over time away from the legacy book. And so I think it is just gradually quarter-over-quarter transitioning back. I wouldn't say it is there yet, we continue to watch the developments, and we will make any adjustments that we think are warranted.

Chris Gamaitoni - *Autonomous Research LLP - Analyst*

Could you give a sense of what this quarter's, the expectation of [lifetime] defaults was versus what you might've seen historically? From the development, the new developments?

Derek Brummer - *Radian Group Inc - EVP & Chief Risk Officer*

In terms of lifetime defaults? In terms of, obviously, the new book that you are seeing transition in terms of development over time, as Bob indicated, the loss ratios on that we would see historically at extremely low levels. In terms of what is baked in -- in terms of our projections -- we are still looking at, on a net basis, a little over 20%.

Chris Gamaitoni - *Autonomous Research LLP - Analyst*

Okay, perfect. Did you get any thoughts or color for the rest of the year for NIW?

Teresa Bryce Bazemore - *Radian Group Inc - President Radian Guaranty Inc.*

Yes. We took a look at it and, obviously, the mortgage market as a whole is down a bit from what we thought as we were coming into the year. But given what we've seen over the last few months and where things are trending, we still believe that NIW will be somewhere between 35 and 40.

Chris Gamaitoni - *Autonomous Research LLP - Analyst*

Perfect. Thank you so much.

Teresa Bryce Bazemore - *Radian Group Inc - President Radian Guaranty Inc.*

Sure.

Operator

And we do have a follow-up from Bose George with KBW.

Bose George - *Keefe, Bruyette & Woods - Analyst*

Thanks. I wanted to make sure, wanted to go back to your comment on the returns on new business assuming PMIERs. Did you say that's the midteens return assuming the current book of business under PMIERs?

Bob Quint - *Radian Group Inc - EVP & CFO*

The current mix that we are writing today which is the really high quality.

Bose George - *Keefe, Bruyette & Woods - Analyst*

Okay, great, just wanted to make sure I heard that right. Thanks.

Operator

Thank you, and we have no further questions in queue. So please go ahead with any closing remarks.

S.A. Ibrahim - *Radian Group Inc - CEO*

I'd like to thank you all for participating in our call, and look forward to seeing you again at the next quarter call. Thanks.

Operator

Thank you. And, ladies and gentlemen, that does conclude our conference for today. Thank you for your participation and for using AT&T Executive Teleconference. You may now disconnect.
