

CONSOLIDATED FINANCIAL STATEMENTS

Midwest Medical Insurance Holding Company and Subsidiaries
Years Ended December 31, 2006 and 2005
With Report of Independent Auditors

Midwest Medical Insurance Holding Company and Subsidiaries

Consolidated Financial Statements

Years Ended December 31, 2006 and 2005

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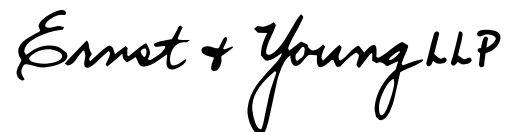
Report of Independent Auditors

The Board of Directors
Midwest Medical Insurance Holding Company
and Subsidiaries

We have audited the accompanying consolidated balance sheets of Midwest Medical Insurance Holding Company and Subsidiaries (the Company) as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in shareholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Midwest Medical Insurance Holding Company and Subsidiaries at December 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.



February 15, 2007

Midwest Medical Insurance Holding Company and Subsidiaries

Consolidated Balance Sheets (In Thousands, Except for Share Amounts)

	December 31	
	2006	2005
Assets		
Investments:		
Available for sale:		
Fixed maturities at fair value (amortized cost: 2006 – \$253,291; 2005 – \$231,763)	\$ 255,011	\$ 233,006
Equity securities at fair value (cost: 2006 – \$33,112; 2005 – \$33,230)	47,436	41,548
Other at fair value (cost: 2006 – \$23,375; 2005 – \$38,491)	37,579	52,899
Trading securities at fair value (cost: 2006 – \$12,512; 2005 – \$12,849)	13,490	12,584
Short-term	61,620	37,570
	415,136	377,607
Cash	4,503	2,830
Accrued investment income	2,787	2,341
Premiums receivable	18,608	15,478
Reinsurance recoverables on paid and unpaid losses	14,636	11,835
Amounts due from reinsurers	3,973	3,430
Deferred income taxes	1,780	2,303
Other assets	12,216	12,568
Total assets	\$ 473,639	\$ 428,392
Liabilities and shareholders' equity		
Liabilities:		
Unpaid losses and loss adjustment expenses	\$ 238,393	\$ 219,912
Unearned premiums	35,812	31,200
Policyholder dividends	3,000	–
Advance premiums	14,626	15,850
Amounts due to reinsurers	88	37
Other liabilities	19,503	20,744
Total liabilities	311,422	287,743
Shareholders' equity:		
Class B Common Stock – authorized, issued, and outstanding, 1 share	1	1
Class C Common Stock – authorized, 300,000 shares; issued and outstanding, 12,257 shares in 2006 and 11,964 shares in 2005; no par value	–	–
Paid-in capital	12,789	12,789
Retained earnings	130,330	112,594
Accumulated other comprehensive income, net of tax:		
Net unrealized appreciation of investments	19,661	15,820
Minimum pension liability	(564)	(555)
Total shareholders' equity	162,217	140,649
Total liabilities and shareholders' equity	\$ 473,639	\$ 428,392

See accompanying notes.

Midwest Medical Insurance Holding Company and Subsidiaries

Consolidated Statements of Income

(In Thousands)

	Year Ended December 31	
	2006	2005
Revenues:		
Net premiums earned	\$ 122,140	\$ 113,141
Net investment income	16,616	13,436
Realized capital gains	10,294	1,822
Other	5,081	4,325
	<u>154,131</u>	<u>132,724</u>
Losses and expenses:		
Losses and loss adjustment expenses	102,416	101,529
Policyholder dividends	5,500	-
Underwriting, acquisition, and insurance expenses	15,894	14,652
Other operating expenses	5,720	6,180
	<u>129,530</u>	<u>122,361</u>
Income before income taxes	24,601	10,363
Income tax expense	6,865	2,662
Net income	<u>\$ 17,736</u>	<u>\$ 7,701</u>

See accompanying notes.

Midwest Medical Insurance Holding Company and Subsidiaries

Consolidated Statements of Changes in Shareholders' Equity (In Thousands)

	Total	Class B Common Stock	Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income
Balance at December 31, 2004	\$ 133,062	\$ 1	\$ 12,789	\$ 104,893	\$ 15,379
Comprehensive income:					
Net income	7,701	-	-	7,701	-
Other comprehensive income:					
Unrealized gains on securities, net of \$521 in taxes	1,013	-	-	-	1,013
Reclassification adjustment for gains included in net income, net of \$619 in taxes	(1,203)	-	-	-	(1,203)
Minimum pension liability, net of \$39 in taxes	76	-	-	-	76
Total comprehensive income	<u>7,587</u>				
Balance at December 31, 2005	140,649	1	12,789	112,594	15,265
Comprehensive income:					
Net income	17,736	-	-	17,736	-
Other comprehensive income:					
Unrealized gains on securities, net of \$6,040 in taxes	10,532	-	-	-	10,532
Reclassification adjustment for gains included in net income, net of \$3,603 in taxes	(6,691)	-	-	-	(6,691)
Minimum pension liability, net of \$(5) in taxes	(9)	-	-	-	(9)
Total comprehensive income	<u>21,568</u>				
Balance at December 31, 2006	<u>\$ 162,217</u>	<u>\$ 1</u>	<u>\$ 12,789</u>	<u>\$ 130,330</u>	<u>\$ 19,097</u>

See accompanying notes.

Midwest Medical Insurance Holding Company and Subsidiaries

Consolidated Statements of Cash Flows (In Thousands)

	Year Ended December 31	
	2006	2005
Operating activities		
Net income	\$ 17,736	\$ 7,701
Adjustments to reconcile net income to net cash provided by operating activities:		
Increase in accrued investment income	(446)	(379)
Increase in premiums receivable	(3,130)	(4,082)
(Increase) decrease in reinsurance recoverables	(2,801)	3,200
(Increase) decrease in amounts due from reinsurers	(543)	527
Decrease (increase) in other assets	260	(735)
Deferred tax provision	(1,896)	(1,412)
Increase in unpaid losses and loss adjustment expenses	18,481	30,966
Increase in unearned premiums	4,612	4,627
(Decrease) increase in advance premiums	(1,224)	2,244
Increase (decrease) in amounts due to reinsurers	51	(1,680)
Increase in dividends payable to policyholders	3,000	-
(Decrease) increase in other liabilities	(1,177)	8,440
Premium amortization, net of accretion of bond discount	551	1,336
Realized capital gains	(10,294)	(1,822)
Net cash provided by operating activities	23,180	48,931
Investing activities		
Purchases of fixed maturity investments and equity securities	(133,169)	(109,150)
Sales of fixed maturity investments and equity securities	103,180	68,323
Calls and maturities of fixed maturity investments	7,444	7,206
Purchases of other investments	(3,757)	(732)
Sales of other investments	28,331	-
Purchases of trading securities	(5,238)	(4,568)
Sales of trading securities	5,752	3,760
Net purchases of short-term investments	(24,050)	(13,790)
Net cash used in investing activities	(21,507)	(48,951)
Increase (decrease) in cash	1,673	(20)
Cash at beginning of year	2,830	2,850
Cash at end of year	\$ 4,503	\$ 2,830

See accompanying notes.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2006

1. Accounting Policies

Organization and Operations

The consolidated financial statements include the accounts of Midwest Medical Insurance Holding Company (Midwest Holding) and its wholly owned subsidiaries, Midwest Medical Insurance Company (Midwest Medical), MMIC Agency, Inc. (Agency) and MMIC Technology Solutions, Inc. (Solutions). All transactions between Midwest Holding and its subsidiaries have been eliminated in consolidation.

Hereafter, Midwest Holding, Midwest Medical, Agency, and Solutions shall be collectively referred to as the Company unless the reference pertains to a specific entity.

The Company, through its subsidiary Midwest Medical and its predecessors, has been providing professional liability insurance to physicians in the Upper Midwest since October 1980. The current structure of the Company is the result of a reorganization in 1988 followed by two business combinations with other insurers. In 1993, the Company merged with Iowa Physicians Mutual Insurance Trust. In 1996, the Company merged with Medical Liability Mutual Insurance Company of Nebraska.

Agency was incorporated in 1995 and began active operations in January 1999 with the acquisition of a book of business from Johnson-McCann Benefits, Inc. Agency subsequently sold its group insurance book of business back to Johnson-McCann Benefits, Inc. and one other producer, effective December 31, 2003. Prior to the sale, Agency specialized in providing clients with group insurance products such as health, dental, life, disability, and workers' compensation. Agency continues as an intermediary that provides clients with workers' compensation, business owners' protection, and non-standard professional liability insurance products.

During 1997, the Company formed Solutions to develop businesses that would strengthen and promote the independence and interdependencies of physicians, clinics, and hospitals that the Company serves. Solutions currently provides practice enhancement software, technology services and support, and physician office outsourcing services.

Midwest Holding provides management and administrative services to Midwest Medical and Solutions for a fee generally equal to the cost of services provided. Agency operates independently and does not have a management agreement with Midwest Holding.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Accounting Policies (continued)

Midwest Medical provides professional liability insurance primarily to physicians, clinics, hospitals, and healthcare systems in Minnesota, Iowa, Nebraska, North Dakota, South Dakota, and Wisconsin. Insurance policies issued by Midwest Medical are on a “claims made” basis and provide coverage for the policyholder for claims first made against the policyholder and reported to Midwest Medical during the policy period for claims which occurred on or after the retroactive date stated in the policy.

Midwest Medical provides, upon payment of an additional premium, a reporting endorsement which extends the period in which claims otherwise covered by the “claims made” policy may be reported to Midwest Medical. In the event of death or permanent disability of a policyholder, the reporting endorsement is issued without additional premium. Upon retirement, as defined in the policy, a policyholder with at least five years of consecutive coverage with Midwest Medical is eligible for a credit toward the additional premium for the reporting endorsement.

Prior acts coverage may be purchased by policyholders who were previously insured under a “claims made” policy with another professional liability insurer for an additional premium at the option of the insured in lieu of purchasing reporting endorsement coverage from the previous insurer.

Basis of Presentation

The consolidated financial statements have been presented in conformity with accounting principles generally accepted in the United States (U.S. GAAP), which differ in certain respects from statutory accounting practices followed by Midwest Medical in reporting to the Minnesota Department of Commerce (see Note 11).

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses, as well as disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Accounting Policies (continued)

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an Amendment of FASB Statements No 87, 88, 106, and 132(R)* (Statement 158). Statement 158 requires plan sponsors of defined benefit pension and other postretirement benefit plans (collectively, "postretirement benefit plans") to recognize the funded status of their postretirement benefit plans in the statement of financial position, measure the fair value of plan assets and benefit obligations as of the date of the fiscal year-end statement of financial position, and provide additional disclosures. Recognition of the funded status and disclosure provisions of Statement 158 shall be effective for fiscal years ending after June 15, 2007, for a non-public entity. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position shall be effective for fiscal years ending after December 15, 2008, and shall not be applied retrospectively. It is anticipated that the Company will adopt the funded status provisions as of January 1, 2007, and the measurement date provisions as of January 1, 2008. The Company has not yet determined the impact of Statement 158 to the financial statements.

In June 2006, the FASB issued Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes, an Interpretation of FAS 109, Accounting for Income Taxes*, to create a single model to address accounting for uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company will adopt FIN 48 as of January 1, 2007, as required. The cumulative effect of adopting FIN 48 will be recorded in retained earnings and other accounts as applicable. The Company has not determined the effect, if any, the adoption of FIN 48 will have on the Company's financial position and results of operations.

Investments

The principal investment objectives of the Company's portfolio, which support the long-term underwriting operations and enhance the financial strength and stability of the Company, are, in order of emphasis, to provide optimal levels of after-tax income, to conserve principal, to maintain the necessary level of liquidity to meet business needs, and to maximize potential long-term rates of return.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Accounting Policies (continued)

Although management believes the Company has the ability to hold its fixed maturity investment portfolio to maturity, most investments, including fixed maturities, equity securities, and other, are classified as “available for sale,” as management may take advantage of opportunities to increase total return through sales of selected securities in response to changing market conditions. As a result, the Company carries these investments at fair value, with unrealized holding gains and losses reflected as a separate component of accumulated other comprehensive income, net of applicable deferred taxes.

Trading securities consist of fixed maturities and preferred stocks that are convertible into common stock at the option of the Company. Trading securities are carried at fair value with unrealized holding gains and losses reflected as realized gains and losses in the consolidated statements of income.

Fair values for fixed maturity and equity securities are based on quoted market prices, where available. For fixed maturity investments not actively traded, fair values are estimated using values obtained from independent pricing services.

Other investments consist of less than 20% equity interests in an international equity limited partnership and a nontraded real estate investment trust. Other investments also include a municipal bond fund organized as a limited liability company and a loan to a company vendor. The international equity limited partnership is recorded at its net asset value. The real estate investment trust is recorded at the annual appraised value or the initial public offering price prior to an appraised value being established. The municipal bond fund is recorded at fair value based primarily on quoted market prices or independent pricing services, and the vendor loan is recorded at the outstanding principal loan balance.

Short-term investments are principally money market funds, repurchase agreements, and fixed maturities purchased with maturities of less than one year. Short-term investments are recorded at cost, which approximates fair value.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Accounting Policies (continued)

Realized gains and losses on sales of investments are reported on a pretax basis as a component of income and are determined on the specific identification basis. When evidence indicates a decline which is other-than-temporary in the underlying value or earning power of individual investments, such investments are written down to fair value by a charge to income.

Factors that management may consider in determining whether an other-than-temporary condition exists include:

- Whether a market decline is attributable to specific adverse conditions for a particular investment.
- Whether a market decline is attributable to general market conditions that reflect prospects of the economy as a whole or prospects of a particular industry.
- The length of time and the extent to which fair value has been less than amortized cost.
- The financial condition of the issuer.
- The intent and ability of management to retain the investment for a period of time sufficient to allow for prudent anticipation of a recovery in market value.
- Whether dividends have been reduced or eliminated, or scheduled interest payments on debt securities have not been made.

Securities Lending

The Company engages in securities lending through its investment custodian, whereby certain securities are loaned to other institutions for short periods of time. Such securities are in investments on the consolidated balance sheets. The market value of the loaned securities is monitored on a daily basis, with additional collateral obtained or refunded as the market value of the loaned securities fluctuates. Initial collateral, primarily cash, is required at a rate of 102% of the market value of a loaned security. The collateral is deposited by the borrower with the custodian and retained and invested by the custodian according to the terms of the securities lending agreement to generate additional income. The agreement also provides that the custodian will indemnify the Company if the borrower defaults, becomes insolvent, or fails to return the loaned securities. As of December 31, 2006 and 2005, the Company had securities on loan with a

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Accounting Policies (continued)

fair market value of \$18,759,000 and \$15,694,000, which were collateralized by \$19,251,000 and \$16,089,000 of cash, respectively. The fair market value of the collateral was 103% of the fair market value of the securities on loan at December 31, 2006 and 2005. The Company has not replighted the collateral and has restricted access to the collateral.

Losses and Loss Adjustment Expenses

The liability for unpaid losses and loss adjustment expenses represents management's best estimate of the ultimate cost of all such amounts which are unpaid at the balance sheet dates. The liability is based on both case-by-case estimates and statistical analysis and projections using the historical loss experience of Midwest Medical and gives effect to estimates of trends in claim severity and frequency. These estimates are frequently reviewed, and as adjustments become necessary, such adjustments are included in current operations. Midwest Medical believes that the estimate of the liability for losses and loss adjustment expenses is reasonable.

Premiums

Premiums received are recorded as earned ratably over the lives of the policies to which they apply. A portion of premiums received is deferred to recognize Midwest Medical's obligation to provide reporting endorsement coverage without additional premium upon the death, disability, or retirement of policyholders. This amount is recorded as an unearned premium reserve and represents the actuarially determined present value of future benefits to be provided less the present value of future revenues to be received.

Policyholder Dividends

Midwest Medical implemented a policyholder dividend program in 1999. Policyholder dividends are accrued when approved by the Board of Directors and are recorded as a separate component of losses and expenses in the consolidated statements of income.

Dividends are generated from unanticipated profits on prior coverage years. Declared dividends are allocated to policyholders proportionately based on current-year written premium. To receive a dividend, a policyholder is required to have been insured in the applicable coverage year and remain insured throughout the year the dividend is paid. Declared dividends are generally paid in quarterly installments in the year following declaration.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Accounting Policies (continued)

Participating policies represented approximately 98% of total premiums in force and premium income at December 31, 2006 and 2005. Dividends of \$2,500,000 and \$3,000,000 were declared during the year ended December 31, 2006. The dividend declared of \$2,500,000 was also paid in quarterly installments during the year ended December 31, 2006. No dividend was declared or paid during the year ended December 31, 2005.

Reinsurance

Midwest Medical purchases reinsurance in order to reduce its liability on individual risks and to enable it to write business at limits it otherwise would be unable to accept. Reinsurance contracts are principally excess-of-loss contracts, which indemnify Midwest Medical for losses in excess of a stated retention up to the contractual limits. Midwest Medical remains obligated for amounts ceded in the event that the reinsurers do not meet their obligations.

Acquisition Costs

The Company's deferred acquisition costs (DACs) represent the costs of acquiring new insurance, principally agent or broker commissions and state premium taxes. DACs are amortized ratably over the lives of the policies to which they apply. The unamortized portion of DACs is reflected on the consolidated balance sheets as a component of other assets.

Other Revenues

Other revenues consist primarily of Agency commission income from insurance carriers and Solutions' technology consulting and software sales and support to healthcare providers. Generally, such revenues are earned as the related services and products are performed or provided.

Income Taxes

The Company files a consolidated tax return with its subsidiaries. Income tax expense is allocated to the subsidiaries based upon separate company taxable income under a tax-sharing agreement. The Company uses the asset and liability method of accounting for income taxes. Deferred income tax assets or liabilities are recognized for the temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and amounts used for income tax purposes.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Accounting Policies (continued)

Reclassifications

Certain amounts in the prior year's financial statements have been reclassified to conform to the current-year presentation.

2. Capital Structure

Midwest Holding has issued two classes of common stock. Each physician insured receives one share of Class C stock at no cost upon commencing coverage with Midwest Medical. Upon termination of insurance coverage, the share of stock is redeemed by the Company. Since the Class C shares have no redemption value, no payment is made to the shareholder upon redemption. Each Class C share entitles the owner to one vote on matters that are subject to shareholder vote or approval. In the event of liquidation, sale, or similar transaction involving Midwest Holding or Midwest Medical, Class C shareholders would participate in the proceeds according to a distribution formula developed by the Board of Directors. This formula takes into account the underwriting risk classification and years of coverage of each shareholder.

Midwest Holding has also issued one share of Class B voting stock that carries with it the right to elect the Board of Directors of Midwest Holding. The Minnesota Medical Association and the Iowa Medical Society currently exercise these voting rights. The Class C shareholders may at any time, by a two-thirds vote, elect to redeem the Class B share at cost.

3. Investments

Components of net investment income are summarized as follows:

	2006	2005
	<i>(In Thousands)</i>	
Fixed maturities	\$ 12,258	\$ 10,702
Equity securities	805	716
Other	3,250	2,600
Trading securities	289	78
Short-term	1,614	835
	18,216	14,931
Investment expenses	(1,600)	(1,495)
	\$ 16,616	\$ 13,436

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Investments (continued)

The cost (amortized cost for fixed maturities) and fair value of available-for-sale investments are as follows:

	December 31, 2006			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
<i>(In Thousands)</i>				
Fixed maturities:				
United States government	\$ 13,767	\$ 67	\$ (67)	\$ 13,767
States, municipalities, and political subdivisions	115,757	1,419	(171)	117,005
Public utilities	1,183	-	(26)	1,157
Industrial and other	38,540	1,400	(337)	39,603
Mortgage-backed securities	84,044	516	(1,081)	83,479
Total	\$ 253,291	\$ 3,402	\$ (1,682)	\$ 255,011
Equity securities:				
Common stock:				
Public utilities	\$ 1,814	\$ 886	\$ -	\$ 2,700
Banks, trusts, and insurance companies	4,649	2,520	-	7,169
Industrial, miscellaneous, and other	26,649	10,925	(7)	37,567
Total	\$ 33,112	\$ 14,331	\$ (7)	\$ 47,436
Other long-term investments:				
Real estate investment trust	\$ 1,770	\$ 128	\$ -	\$ 1,898
International equity limited partnership	18,863	14,044	-	32,907
Municipal bond fund limited liability company	1,772	32	-	1,804
Vendor loan	970	-	-	970
Total	\$ 23,375	\$ 14,204	\$ -	\$ 37,579

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Investments (continued)

	December 31, 2005			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
	<i>(In Thousands)</i>			
Fixed maturities:				
United States government States, municipalities, and political subdivisions	\$ 8,537	\$ 30	\$ (105)	\$ 8,462
Public utilities	98,430	687	(427)	98,690
Industrial and other	2,267	144	(5)	2,406
Mortgage-backed securities	31,783	1,762	(304)	33,241
Total	90,746	422	(961)	90,207
Equity securities:	\$ 231,763	\$ 3,045	\$ (1,802)	\$ 233,006
Common stock:				
Public utilities	\$ 2,468	\$ 480	\$ (9)	\$ 2,939
Banks, trusts, and insurance companies	5,501	1,739	(6)	7,234
Industrial, miscellaneous, and other	25,261	6,224	(110)	31,375
Total	\$ 33,230	\$ 8,443	\$ (125)	\$ 41,548
Other long-term investments:				
Real estate investment trusts	\$ 22,193	\$ 5,657	\$ –	\$ 27,850
International equity limited partnership	16,298	8,751	–	25,049
Total	\$ 38,491	\$ 14,408	\$ –	\$ 52,899

The components of the unrealized appreciation on available-for-sale securities as of December 31 are as follows:

	2006	2005
	<i>(In Thousands)</i>	
Fixed maturities:		
Gross unrealized gains	\$ 3,402	\$ 3,045
Gross unrealized losses	(1,682)	(1,802)
Equity securities:		
Gross unrealized gains	14,331	8,443
Gross unrealized losses	(7)	(125)
Other long-term investments:		
Gross unrealized gains	14,204	14,408
Gross unrealized losses	–	–
Deferred income taxes	30,248	23,969
	(10,587)	(8,149)
	\$ 19,661	\$ 15,820

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Investments (continued)

The amortized cost and market value of fixed maturities at December 31, 2006, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Market Value
<i>(In Thousands)</i>		
Due in one year or less	\$ 1,255	\$ 1,254
Due after one year through five years	31,891	31,639
Due after five years through ten years	40,805	40,923
Due after ten years	95,296	97,716
Mortgage-backed securities	84,044	83,479
	\$ 253,291	\$ 255,011

Proceeds from sales of available-for-sale investments and the related gross realized gains and losses are as follows:

	Proceeds From Sales	Gross Realized Gains	Gross Realized Losses
<i>(In Thousands)</i>			
Year ended December 31, 2006:			
Fixed maturities	\$ 91,608	\$ 592	\$ (808)
Equity securities	11,572	2,031	(847)
Other	28,331	7,908	-
Year ended December 31, 2005:			
Fixed maturities	\$ 42,656	\$ 387	\$ (642)
Equity securities	25,667	3,689	(1,255)

At December 31, 2006, a fixed maturity investment carried at \$1,966,000 was on deposit with the Minnesota Department of Commerce as required by law.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Investments (continued)

Investments with unrealized losses at December 31, 2006, are summarized as follows:

	<u>Less Than 12 Months</u>		<u>12 Months or Longer</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>
	<i>(In Thousands)</i>					
Fixed maturities:						
United States government States, municipalities, and political subdivisions	\$ 2,922	\$ 8	\$ 3,550	\$ 59	\$ 6,472	\$ 67
Public utilities	18,102	74	8,826	97	26,928	171
Industrial and other	–	–	1,157	26	1,157	26
Mortgage-backed securities	11,431	96	11,655	241	23,086	337
	25,898	214	36,612	867	62,510	1,081
	<u>58,353</u>	<u>392</u>	<u>61,800</u>	<u>1,290</u>	<u>120,153</u>	<u>1,682</u>
Equity securities:						
Common stock:						
Public utilities	–	–	–	–	–	–
Banks, trust, and insurance companies	–	–	–	–	–	–
Industrial, miscellaneous, and other	688	7	–	–	688	7
	<u>688</u>	<u>7</u>	<u>–</u>	<u>–</u>	<u>688</u>	<u>7</u>
Total securities with unrealized loss	<u>\$ 59,041</u>	<u>\$ 399</u>	<u>\$ 61,800</u>	<u>\$ 1,290</u>	<u>\$ 120,841</u>	<u>\$ 1,689</u>

During 2006 and 2005, the Company did not experience any declines in investment values that were deemed other-than-temporary requiring the recognition of realized investment losses.

At December 31, 2006, the Company has 237 securities with unrealized losses, of which 186 are fixed maturity investments and 51 are equity security investments. Only 56 of those positions have had unrealized losses for longer than 12 months. The largest single unrealized loss that is longer than 12 months is \$107,000 on a collateralized mortgage obligation fixed maturity security, which is less than 2% of the holding's cost. The Company believes this is primarily an interest rate-driven temporary impairment. The issuer is current on monthly interest payments, and the Company expects to receive full value at maturity. Based on the Company's review of securities with unrealized losses, none of their declines in investment values were considered other-than-temporary.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Investments (continued)

Net unrealized appreciation of fixed maturities increased (decreased) by \$477,000 and \$(3,330,000) and net unrealized appreciation of equity securities increased by \$6,006,000 and \$46,000 for the years ended December 31, 2006 and 2005, respectively. Net unrealized appreciation of other long-term investments (decreased) increased by \$(204,000) and \$2,996,000 for the years ended December 31, 2006 and 2005, respectively.

Net trading realized gains were \$216,000 and \$269,000 for trading securities for the years ended December 31, 2006 and 2005, respectively. Net mark-to-market realized gains (losses) were \$1,202,000 and \$(626,000) for trading securities for the years ended December 31, 2006 and 2005, respectively.

4. Unpaid Losses and Loss Adjustment Expenses

The reconciliation of the liability for unpaid losses and loss adjustment expenses is as follows:

	2006	2005
	<i>(In Thousands)</i>	
Balance as of January 1, net of reinsurance recoverables	\$ 208,367	\$ 173,896
Incurred related to:		
Current year	101,855	96,800
Prior years	561	4,729
Total incurred	102,416	101,529
Paid related to:		
Current year	4,791	5,154
Prior years	81,068	61,904
Total paid	85,859	67,058
Balance as of December 31, net of reinsurance recoverables	224,924	208,367
Reinsurance recoverables on unpaid losses at December 31	13,469	11,545
Balance as of December 31, gross	\$ 238,393	\$ 219,912

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

4. Unpaid Losses and Loss Adjustment Expenses (continued)

Midwest Medical frequently evaluates emerging trends in the development of loss liabilities. Based on this analysis, management periodically adjusts its estimates of ultimate losses.

5. Segment Information

The Company is organized along four main product and service groups. Management and administrative services provided by Midwest Holding are the Management business segment. Professional liability insurance provided by Midwest Medical is the Insurance business segment. Technology-based products and services provided by Solutions are the Technology business segment. Property and casualty insurance intermediary services provided by Agency are the Agency business segment. The business and accounting policies of the reportable segments are described in Note 1 to the consolidated financial statements. Management evaluates the performance of each business segment based primarily on profit or loss from operations. With the exception of the international equity limited partnership and any foreign stocks and bonds held as investments by Midwest Medical, all business transactions are conducted in the United States. The following financial information summarizes the results of operations and total assets reported by the business segments for the years ended 2006 and 2005.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

5. Segment Information (continued)

	2006					
	Management	Insurance	Technology	Agency	Eliminations ⁽¹⁾	Consolidated
	<i>(In Thousands)</i>					
Revenues:						
External customers	\$ –	\$ 122,140	\$ 3,981	\$ 425	\$ –	\$ 126,546
Intersegment	19,740	–	130	–	(19,870)	–
Net investment income	418	16,810	16	3	(631)	16,616
Other ⁽²⁾	24	10,253	–	333	359	10,969
	<u>20,182</u>	<u>149,203</u>	<u>4,127</u>	<u>761</u>	<u>(20,142)</u>	<u>154,131</u>
Total expenses	<u>21,123</u>	<u>123,810</u>	<u>4,507</u>	<u>232</u>	<u>(20,142)</u>	<u>129,530</u>
(Loss) income before tax	(941)	25,393	(380)	529	–	24,601
Income tax (benefit) expense	(364)	7,186	(145)	188	–	6,865
Net (loss) income	<u>\$ (577)</u>	<u>\$ 18,207</u>	<u>\$ (235)</u>	<u>\$ 341</u>	<u>\$ –</u>	<u>\$ 17,736</u>
Total assets	<u>\$ 173,448</u>	<u>\$ 472,108</u>	<u>\$ 1,041</u>	<u>\$ 1,078</u>	<u>\$ (174,036)</u>	<u>\$ 473,639</u>

⁽¹⁾Intersegment eliminations for revenues and expenses are primarily for management and administrative services provided by Midwest Holding. Eliminations for assets consist primarily of investments in wholly owned subsidiaries, intersegment receivables for management fees, and reclassifications between assets and liabilities primarily for taxes.

⁽²⁾Other revenues consist primarily of net realized capital gains and a gain adjustment on an asset sale by Agency.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

5. Segment Information (continued)

	2005						Consolidated
	Management	Insurance	Technology	Agency	Eliminations ⁽¹⁾		
	<i>(In Thousands)</i>						
Revenues:							
External customers	\$ –	\$ 113,141	\$ 3,075	\$ 491	\$ –	\$ 116,707	
Intersegment	18,824	–	153	–	(18,977)	–	
Net investment income	621	13,707	11	2	(905)	13,436	
Other ⁽²⁾	17	1,787	–	184	593	2,581	
	19,462	128,635	3,239	677	(19,289)	132,724	
Total expenses	20,173	116,180	5,019	278	(19,289)	122,361	
(Loss) income before tax	(711)	12,455	(1,780)	399	–	10,363	
Income tax (benefit) expense	(37)	3,166	(603)	136	–	2,662	
Net (loss) income	\$ (674)	\$ 9,289	\$ (1,177)	\$ 263	\$ –	\$ 7,701	
Total assets	\$ 151,193	\$ 425,091	\$ 1,391	\$ 1,560	\$ (150,843)	\$ 428,392	

⁽¹⁾Intersegment eliminations for revenues and expenses are primarily for management and administrative services provided by Midwest Holding. Eliminations for assets consist primarily of investments in wholly owned subsidiaries, intersegment receivables for management fees, and reclassifications between assets and liabilities primarily for taxes.

⁽²⁾Other revenues consist primarily of net realized capital gains and a gain adjustment on an asset sale by Agency.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Income Taxes

Components of income tax expense are as follows:

	2006	2005
	<i>(In Thousands)</i>	
Current provision	\$ 8,761	\$ 4,074
Deferred tax provision	(1,896)	(1,412)
	\$ 6,865	\$ 2,662

The Company's income taxes differ from the federal statutory rate applied to income before tax as follows:

	2006	2005
	<i>(In Thousands)</i>	
Income before tax at the federal statutory rate (35% – 2006; 34% – 2005)	\$ 8,610	\$ 3,523
Tax-exempt income (net of proration adjustment)	(1,388)	(846)
Dividends received deductions (net of proration adjustment)	(185)	(163)
Nondeductible expenses	65	49
State income taxes, net of federal tax benefit	13	5
Expense for prior-year income taxes	52	76
Effect of change in tax rate	(302)	–
Other	–	18
	\$ 6,865	\$ 2,662

The Company made income tax payments of \$2,482,000 and \$1,482,000 in 2006 and 2005, respectively. At December 31, 2006 and 2005, amounts due from subsidiaries for income taxes were \$5,453,000 and \$2,147,000, respectively.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Income Taxes (continued)

The components of the net deferred income tax asset as of December 31 are as follows:

	2006	2005
	<i>(In Thousands)</i>	
Deferred tax assets:		
Unpaid losses and loss adjustment expenses	\$ 5,947	\$ 5,497
Liabilities not currently deductible	3,441	3,104
Unearned and advanced premiums	3,050	2,692
Minimum pension liability	304	286
Other	1,643	1,580
	14,385	13,159
Deferred tax liabilities:		
Unrealized gains	(10,587)	(8,149)
Other	(2,018)	(2,707)
	(12,605)	(10,856)
	\$ 1,780	\$ 2,303

The Company is required to establish a valuation allowance for any portion of the deferred income tax assets that management believes will not be realized. In the opinion of management, it is more likely than not that the Company will realize the benefit of the deferred income tax assets, and therefore, no valuation allowance has been established.

7. Reinsurance

To reduce overall risk, including exposure to large losses, Midwest Medical participates in various reinsurance programs. Midwest Medical would only become liable for losses in excess of its retention limits in the event that any reinsuring company were unable to meet its obligations under the existing agreement. Management is not aware of any such default at December 31, 2006. Midwest Medical evaluates the financial condition of its reinsurers and monitors concentration of credit risk arising from similar geographic regions, activities, or economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer insolvencies. At December 31, 2006 and 2005, reinsurance recoverables on paid and unpaid losses of \$5,584,000 and \$3,418,000, respectively, are associated with a single reinsurer, Hannover Rückversicherungs AG. In 2006 and 2005, Midwest Medical also holds collateral under related reinsurance agreements in the form of letters of credit totaling \$9,505,000 and \$11,224,000, respectively, which can be drawn upon in the event the applicable reinsuring company is unable to pay its obligation to Midwest Medical.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Reinsurance (continued)

Midwest Medical is authorized to issue policies with limits not to exceed \$15,000,000 for each claim and \$17,000,000 in the aggregate under each policy. Limits in excess of \$15,000,000 for each claim and \$17,000,000 annual aggregate are available to physicians, clinics, and hospitals through reinsurance placed on a facultative basis by Midwest Medical. For the 2006 policy year, Midwest Medical's reinsurance program consists of two separate contracts: "aggregate stop loss" and "excess of loss." Under the aggregate stop loss contract (ASL), Midwest Medical retains the first \$2,000,000 of each claim and the premiums are based on a flat rate and could be subject to a favorable adjustment through a "no paid ceded loss bonus" provision at the time of the commutation of this contract. Midwest Medical is liable for the sum of all losses up to 90% of its net written premium under this contract. The reinsurers are then liable for the sum of all losses in excess of Midwest Medical's retention, but the liability of the reinsurers under this contract shall not exceed 15% of Midwest Medical's net written premium or \$20,000,000, whichever is less. Under the excess of loss contract, Midwest Medical acts as an intermediary and cedes the full amount of the risk for policies with limits in excess of \$2,000,000 for each claim and \$4,000,000 in the aggregate up to \$15,000,000 for each claim and \$17,000,000 in the aggregate. The reinsurance premium for the excess of loss contract is a percentage of the preceding layer of coverage gross of any ceding commission paid by the reinsurers to Midwest Medical.

The reinsurance program for the 2005 policy year was the same as the 2006 policy year, with the exception that Midwest Medical was liable for the sum of all losses up to 92% of its net written premium under the ASL contract. The reinsurers were then liable for the sum of all losses in excess of Midwest Medical's retention, but the liability of the reinsurers under the 2005 ASL contract was not to exceed 13% of Midwest Medical's net written premium or \$20,000,000, whichever was less.

For the 2004 and prior policy years, Midwest Medical's reinsurance program is structured in two components: "basic" and "excess." Under the basic component, Midwest Medical generally retains the first \$1,000,000 of each claim and reinsures the next \$1,000,000 through a treaty under which premiums are based on a flat rate and could be subject to adjustment through a profit sharing provision. Under the excess component, Midwest Medical acts as an intermediary and cedes the full amount of the risk for policies with limits in excess of \$2,000,000 for each claim and \$4,000,000 in the aggregate up to \$12,000,000 for each claim and \$14,000,000 in the aggregate. The reinsurance premium for the excess of loss contract is a percentage of the preceding layer of coverage gross of any ceding commission paid by the reinsurers to Midwest Medical.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Reinsurance (continued)

The effect of reinsurance on premiums written and earned for 2006 and 2005 is as follows:

	2006		2005	
	Written	Earned	Written	Earned
	<i>(In Thousands)</i>		<i>(In Thousands)</i>	
Current year:				
Direct	\$ 144,105	\$ 139,494	\$ 133,795	\$ 129,167
Ceded – ASL	(4,103)	(3,987)	(3,486)	(2,972)
Ceded – basic	(4)	(7)	(293)	(1,865)
Ceded – excess	(13,657)	(13,227)	(11,593)	(11,063)
	126,341	122,273	118,423	113,267
Prior years:				
Ceded	(133)	(133)	(126)	(126)
Net	\$ 126,208	\$ 122,140	\$ 118,297	\$ 113,141

Losses and loss adjustment expenses incurred are net of applicable reinsurance of \$18,184,000 and \$8,569,000 for the years ended December 31, 2006 and 2005, respectively.

8. Benefit Plans

The Company sponsors a number of postretirement and deferred compensation benefit plans. The principal plans are discussed below; other such plans are not significant individually or in the aggregate.

Employees of Midwest Holding are covered by a noncontributory defined contribution pension plan. Contributions to the plan are based upon each covered employee's salary. Employees at Midwest Holding are also covered by a 401(k) plan that provides a 50% match on employee contributions subject to certain limitations. Total contributions charged to expense for the years ended December 31, 2006 and 2005, were \$1,032,000 and \$980,000, respectively.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Benefit Plans (continued)

Midwest Holding provides an unfunded Deferred Compensation Plan (DCP), which is a nonqualified, voluntary plan that provides eligible key management employees of Midwest Holding the opportunity to defer pretax dollars. Benefits provided by the DCP are supplemental to Midwest Holding's other benefit plans. The liability recognized in the consolidated balance sheets at December 31, 2006 and 2005, related to this plan was \$1,603,000 and \$1,377,000, respectively.

Midwest Holding provides an unfunded Supplemental Executive Retirement Plan (SERP), which is a non-qualified, defined benefit pension plan covering certain Midwest Holding officers. At least annually, an outside actuary is engaged to assist management in evaluating plan assumptions and to calculate the plan's pension cost and benefit obligation.

Midwest Holding uses a December 31 measurement date for the SERP. The following table summarizes the benefit obligation and plan asset activity for the SERP:

	2006	2005
	<i>(In Thousands)</i>	
Change in projected benefit obligation:		
Benefit obligation at beginning of year	\$ 8,562	\$ 8,109
Service cost	176	126
Interest cost	505	478
Actuarial gain	129	180
Benefits paid	(297)	(331)
Benefit obligation at measurement date	\$ 9,075	\$ 8,562
Change in plan assets:		
Fair value of plan assets at beginning of year	\$ —	\$ —
Actual return on plan assets	—	—
Employer contributions	297	331
Benefits paid	(297)	(331)
Fair value of plan assets at measurement date	\$ —	\$ —
Funded status:		
Funded status at measurement date	\$ (9,075)	\$ (8,562)
Unrecognized prior service cost	411	502
Unrecognized net actuarial loss	785	706
Net amount recognized	\$ (7,879)	\$ (7,354)
Amounts recognized in the consolidated financial statements:		
Accrued benefit liability	\$ (6,600)	\$ (6,011)
Minimum pension liability	(1,279)	(1,343)
Net amount recognized	\$ (7,879)	\$ (7,354)
Accumulated benefit obligation	\$ 7,879	\$ 7,354

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Benefit Plans (continued)

The following discloses the minimum pension liability adjustment included in “accumulated other comprehensive income, net of tax” under shareholders’ equity in the consolidated balance sheets at December 31, 2006 and 2005:

	2006	2005
	<i>(In Thousands)</i>	
Minimum pension liability	\$ (1,279)	\$ (1,343)
Intangible asset – unrecognized prior service cost	411	502
Deferred tax benefit	304	286
Accumulated other comprehensive loss, net of tax – minimum pension liability	\$ (564)	\$ (555)

The following discloses the net periodic benefit costs of the SERP:

	2006	2005
	<i>(In Thousands)</i>	
Service cost	\$ 176	\$ 126
Interest cost	505	478
Amortization of prior service cost	91	91
Amortization of net loss	115	128
Net periodic benefit cost	\$ 887	\$ 823

The following discloses the assumptions used in the measurement of the SERP pension costs and benefit obligations:

	2006	2005
Discount rate in determining benefit obligations	6.00%	6.00%
Rate of increase in future compensation	5.00%	5.00%
Expected long-term rate of return on plan assets	N/A	N/A

Although the SERP is technically unfunded and therefore does not have plan assets, Midwest Holding invests in specified assets that are designed to coordinate with the projected obligation under the SERP. Midwest Holding expects to contribute cash of \$316,000 to the SERP to fund anticipated withdrawals in 2007.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Benefit Plans (continued)

The following benefit payments are expected to be paid from the SERP (in thousands):

2007	\$	316
2008		313
2009		455
2010		452
2011		461
2012–2016		3,179
Total	\$	<u>5,176</u>

9. Leases

The Company leases office space and equipment under lease agreements that expire at various intervals over the next five years and are subject to renewal options at market rates prevailing at the time of renewal. Rental expense for all leases was \$1,178,000 and \$1,177,000 for 2006 and 2005, respectively. At December 31, 2006, future minimum payments under noncancelable leases are as follows (in thousands):

2007	\$	770
2008		773
2009		676
2010		513
2011		11
Thereafter		–
	\$	<u>2,743</u>

10. Commitment and Contingencies

The Company is named as a defendant in various legal actions arising principally from claims made under insurance policies and contracts. Those actions are considered by Midwest Medical in estimating the loss and loss adjustment expense reserves. Management believes the resolution of those actions will not have a material effect on the Company's financial position or results of operations.

11. Reconciliation With Statutory Accounting Principles

U.S. GAAP differ in certain respects from the accounting practices prescribed or permitted by insurance regulatory authorities (statutory basis).

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Reconciliation With Statutory Accounting Principles (continued)

The following is a reconciliation of net income and shareholder equity under U.S. GAAP with that reported for Midwest Medical on a statutory basis:

	Net Income	
	Year Ended December 31	
	2006	2005
	<i>(In Thousands)</i>	
On the basis of U.S. GAAP, Midwest Medical only	\$ 18,207	\$ 9,289
(Deductions) additions:		
Deferred acquisition costs	(218)	(282)
Deferred income taxes	(1,483)	(1,235)
Mark-to-market realized (gain) loss on trading securities, net of tax	(625)	205
Prescribed investment value differences	(123)	-
On the basis of statutory accounting principles	<u>\$ 15,758</u>	<u>\$ 7,977</u>
	Shareholder Equity	
	December 31	
	2006	2005
	<i>(In Thousands)</i>	
On the basis of U.S. GAAP, Midwest Medical only	\$ 160,416	\$ 139,872
(Deductions) additions:		
Deferred acquisition costs	(1,551)	(1,332)
Deferred income taxes	1,141	876
Mark-to-market realized gain on trading securities, net of tax	(992)	(250)
Net unrealized gain on fixed maturities	(1,720)	(1,243)
Prescribed investment value differences	(4)	(72)
Other	(105)	(40)
On the basis of statutory accounting principles	<u>\$ 157,185</u>	<u>\$ 137,811</u>

Under Minnesota insurance statutes, Midwest Medical is required to maintain statutory surplus in excess of ten times its per risk reinsurance retention limit. Since Midwest Medical limited its retention to \$2,000,000 on any single risk, the minimum statutory surplus level was \$20,000,000 for 2006.

Midwest Medical Insurance Holding Company and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Reconciliation With Statutory Accounting Principles (continued)

Dividends that exceed the greater of 10% of Midwest Medical's prior year-end policyholder surplus or Midwest Medical's prior-year net income excluding realized capital gains are considered extraordinary under Minnesota insurance statutes. Payment of extraordinary dividends is subject to the approval of the Commissioner of the Minnesota Department of Commerce. At December 31, 2006, the maximum dividend that may be paid by Midwest Medical in 2007 without regulatory approval is approximately \$15,719,000. Midwest Medical paid cash dividends to Midwest Holding of \$1,500,000 in 2006 and 2005.