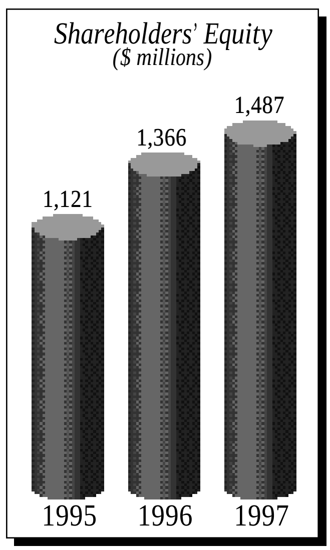
MGIC

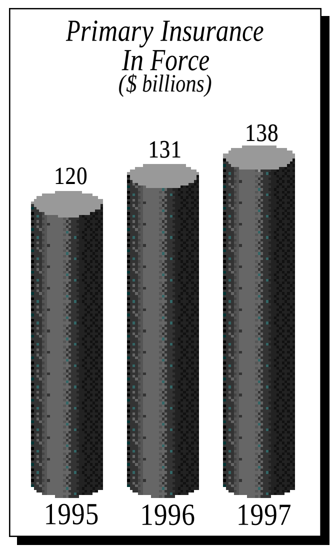
Building an even stronger franchise

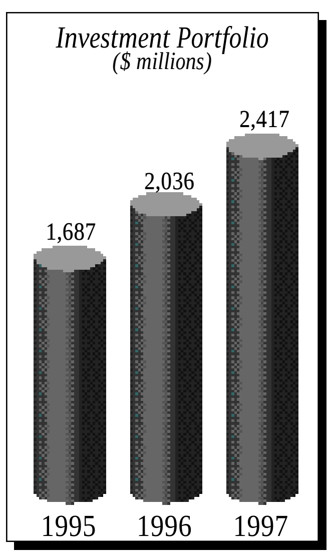
MGIC Investment Corporation • 1997 Annual Report

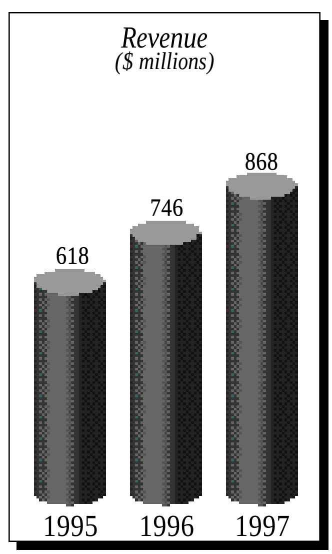
Financial Highlights

	1995	1996	1997
Net income ($ millions)	207.6	258.0	323.8
Earnings per share ($)	1.75	2.17	2.75
Return on equity (%)	21.2	20.7	22.5
New primary insurance written ($ billions)	30.3	32.8	32.2









Fellow Shareholders

The glossy, full-color look of past annual reports is gone. In its place is one in black and white, one that tells the same story, but at a much lower cost. The story is our strong financial performance. In 1997, MGIC Investment Corporation recorded its seventh year of record earnings in seven years as a public company.

The "black and white" of 1997 is that MGIC Investment Corporation earned a record $324 million, an increase of 25 percent. After giving effect to a two-for-one stock split on June 2, earnings per share in 1997 totaled $2.75, an increase of 27 percent. Our strong financial performance can be attributed to another good year for our core business of insuring residential first mortgages. Solid demand for low down payment mortgages, a healthy housing market, low interest rates, and our commitment to building a high-quality book of business in a cost-effective manner helped our principal subsidiary, Mortgage Guaranty Insurance Corporation (MGIC), post stellar results in 1997.

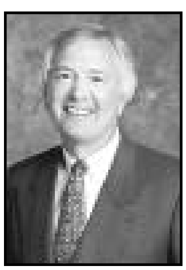
One of the most satisfying elements of our business is that we help families attain homeownership sooner than otherwise possible. Without private mortgage insurance, more than one million families each year would not be able to obtain conventional mortgages. For these families, the American Dream would be just that — a dream. In 1997, MGIC helped some 266,000 families make that dream a reality by insuring $32.2 billion of mortgages, significantly more than any other private mortgage insurer. As a result, at year-end MGIC's insurance-in-force stood at $138.5 billion.

As a customer-focused company, MGIC's goal is to forge long-term relationships with home mortgage lenders. We strive to align our organization with customers' operations so that MGIC is integrated into their processes and procedures. This approach has been fundamental to MGIC's success as the nation's leading private mortgage insurance company. By virtue of our extensive risk management expertise, capital markets support services, training programs, processing and underwriting systems, along with loan scoring technologies, we are well-positioned to continue assisting mortgage lenders as they serve the needs of American home buyers.

Mortgage origination volume in 1998 is expected to exceed 1997 levels. Several factors should fuel this growth. One is continued low interest rates. Another is the steady increase in the homeownership rate, as greater efforts are made to serve the needs of low- and moderate-income home buyers. A third is the growth in demand for housing from the immigrant population. MGIC's leadership role in insuring low down payment mortgages, coupled with our programs designed to meet the needs of the underserved population, positions us well to capitalize on these market opportunities.

Sincerely,

William H. Lacy
President and Chief Executive Officer MGIC Investment Corporation



Curt S. Culver
President and Chief Operating Officer Mortgage Guaranty Insurance Corporation

Shareholder Information

The Annual Meeting
The Annual Meeting of Shareholders of MGIC Investment Corporation will convene at 9 a.m. (CDT) on May 7, 1998 in Vogel Hall, Marcus Center for the Performing Arts, 123 E. State Street, Milwaukee, Wisconsin.

10-K Report
Copies of the Annual Report on Form 10-K, filed with the Securities and Exchange Commission, will be available without charge after March 30, 1998, to shareholders on request from:

Secretary
MGIC Investment Corporation
P.O. Box 488
Milwaukee, WI 53201

Transfer Agent and Registrar

Firstar Trust Company
Corporate Trust Services
1555 North RiverCenter Drive
Suite 301
Milwaukee, Wisconsin 53212
(414) 276-3737
(800) 637-7549

Corporate Headquarters

MGIC Plaza
250 East Kilbourn Avenue
Milwaukee, Wisconsin 53202

Mailing Address

P.O. Box 488
Milwaukee, Wisconsin 53201

Shareholders' Services

(414) 347-6596

MGIC Stock
MGIC Investment Corporation Common Stock is listed on the New York Stock Exchange under the symbol MTG. At December 31, 1997, 113,791,593 shares were outstanding. The following table sets forth for 1996 and 1997 by quarter the high and low sales prices of the Company's common stock on the New York Stock Exchange Composite Tape.

	1996		1997	
Quarters	High	Low	High	Low
1st	$32.6250	$25.2500	$40.7500	$35.3750
2nd	30.7500	25.8125	50.2500	35.2500
3rd	34.7500	26.7500	59.7500	46.1250
4th	38.8750	33.0625	66.9375	55.6250

In 1996 and 1997 the Company declared and paid the following cash dividends:

Quarters	1996	1997
1st	$.020	$.020
2nd	.020	.025
3rd	.020	.025
4th	.020	.025
	$.080	$.095

Dividend and stock price data have been restated to reflect the June 1997 two-for-one stock split.

See Note 10 to the Consolidated Financial Statements for information relating to restrictions on the payment of cash dividends.

As of February 27, 1998, the number of shareholders of record was 364. In addition, there were an estimated 37,000 beneficial owners of shares held by brokers and fiduciaries.

Safe Harbor Statement

The following is a "Safe Harbor" Statement under the Private Securities Litigation Reform Act of 1995:

The statements contained in this 1997 Annual Report that are not historical facts are forward looking statements. Actual results may differ materially from those contemplated by the forward looking statements. These forward looking statements involve risks and uncertainties, including but not limited to, the following risks:

- that demand for housing generally or in MGIC's market segment may be adversely affected by changes in interest rates, adverse economic conditions, or other reasons;

- that government housing policy may change, including changes in Federal Housing Administration loan limits, and changes in the statutory charters and coverage requirements of Freddie Mac and Fannie Mae;
- that MGIC's market share of new insurance written or the amount of new insurance written may be adversely affected as a result of factors affecting housing demand, government housing policy and Freddie Mac and Fannie Mae discussed above; or as a result of underwriting changes by the Company; actions taken by the Company's competitors, including their underwriting criteria, pricing or products offered; decisions by lenders to originate low down payment loans using substitutes for mortgage insurance; or for other reasons;
- that cancellations may increase and persistency may decrease due to refinancings, changes in Freddie Mac or Fannie Mae cancellation policies or legislation regarding mortgage insurance cancellation, or due to other factors; and
- that delinquencies, incurred losses or paid losses may increase as a result of adverse changes in regional or national economies which affect borrowers' incomes or housing values.

Investors are also directed to other risks discussed in documents filed by the Company with the Securities and Exchange Commission.

MGIC Investment Corporation & Subsidiaries – Years Ended December 31, 1997, 1996, 1995, 1994 and 1993

Five-Year Summary of Financial Information

	1997	1996	1995	1994	1993
	(In thousands of dollars, except per share data)				
Summary of Operations					
Premiums:					
Net premiums written	$ 690,248	$ 588,927	$ 480,312	$ 410,296	$ 342,727
Net premiums earned	$ 708,744	$ 617,043	$ 506,500	$ 403,990	$ 299,342
Investment income	123,602	105,355	87,543	75,233	64,689
Realized investment gains, net	3,261	1,220	1,496	336	5,139
Other revenue	32,665	22,013	22,347	22,667	34,347
Total revenues	868,272	745,631	617,886	502,226	403,517
Losses and expenses:					
Losses incurred, net	242,362	234,350	189,982	153,081	107,132
Underwriting and other expenses	157,194	146,483	137,559	136,027	132,057
Interest expense	6,399	3,793	3,821	3,856	3,888
Ceding commission	(3,056)	(4,023)	(4,885)	(7,821)	(14,375)
Total losses and expenses	402,899	380,603	326,477	285,143	228,702
Income before tax	465,373	365,028	291,409	217,083	174,815
Provision for income tax	141,623	107,037	83,844	57,565	47,546
Net income	$ 323,750	$ 257,991	$ 207,565	$ 159,518	$ 127,269
Weighted average common shares outstanding (in thousands) (1)	117,924	119,046	118,567	117,955	117,851
Earnings per share (1) and (2)	$ 2.75	$ 2.17	$ 1.75	$ 1.35	$ 1.08
Dividends per share (1)	$ .095	$ .08	$ .08	$ .08	$ .0725
Balance sheet data					
Total investments	$2,416,740	$2,036,234	$1,687,221	$1,292,960	$1,099,643
Total assets	2,617,687	2,222,315	1,874,719	1,476,266	1,343,205
Loss reserves	598,683	514,042	371,032	274,469	213,600
Long-term notes payable	237,500	–	35,799	36,147	36,459
Shareholders' equity	1,486,782	1,366,115	1,121,392	838,074	712,070
Book value per share	13.07	11.59	9.56	7.18	6.11

(1) In May 1997, the Company declared a two-for-one stock split of the common stock in the form of a 100% stock dividend. The additional shares were issued on June 2, 1997. Prior year shares, dividends per share and earnings per share have been restated to reflect the split.

(2) Diluted earnings per share per Statement of Financial Accounting Standards No. 128, "Earnings Per Share.

A brief description of the Company's business is contained in Note 1 to the Company's Consolidated Financial Statements, page fourteen.

Five-Year Summary of Financial Information

	1997	1996	1995	1994	1993
New primary insurance written ($ millions)	$ 32,250	$ 32,756	$ 30,277	$ 34,419	$ 37,041
New pool risk written ($ million)	394	2	1	27	17
Insurance in force (at year-end) ($ millions)					
Direct primary insurance					
New book*	$ 138,497	$ 131,397	$ 120,341	$ 104,416	$ 85,848
Old book*	4,971	6,505	8,196	9,932	12,737
Direct primary risk					
New book	32,175	29,308	25,502	20,756	16,810
Old book	1,260	1,637	2,055	2,481	3,180
Net primary risk					
New book	31,580	28,565	24,593	19,664	13,971
Old book	789	1,006	390	471	604
Direct pool risk					
New book	590	232	254	295	348
Old book	478	533	638	721	962
Net pool risk					
New book	530	181	186	195	188
Old book	318	349	134	157	211
Primary loans in default ratios					
Policies in force					
New book	1,342,976	1,299,038	1,219,304	1,080,882	921,259
Old book	176,817	223,986	270,800	315,313	386,103
Loans in default					
New book	28,493	25,034	19,980	15,439	13,658
Old book	8,570	10,072	12,354	14,516	16,757
Percentage of loans in default					
New book	2.12%	1.93%	1.64%	1.43%	1.48%
Old book	4.85%	4.50%	4.56%	4.60%	4.34%
Insurance operating ratios (GAAP)					
Loss ratio	34.2%	38.0%	37.5%	37.9%	35.8%
Expense ratio	18.4%	21.6%	24.6%	28.1%	25.7%
Combined ratio	52.6%	59.6%	62.1%	66.0%	61.5%
Risk-to-capital ratios (statutory)					
Combined insurance subsidiaries	16.4:1	18.8:1	19.9:1	20.6:1	18.9:1
MGIC	15.7:1	18.1:1	19.1:1	19.6:1	17.1:1

**The New book consists of insurance written by Mortgage Guaranty Insurance Corporation ("MGIC"), a subsidiary of MGIC Investment Corporation, since March 1, 1985. The Old book consists of insurance written or committed to by Wisconsin Mortgage Assurance Corporation ("WMAC") prior to March 1, 1985. At December 31, 1997 and 1996, MGIC and another subsidiary of MGICInvestment Corporation were reinsurers of, in the aggregate, 65.6% and 64.8%, respectively, of the Old book, and MGIC is the manager of the Old book for WMAC. The Direct information shown above for the Old book represents 100% of the Old book.*

Results of Consolidated Operations

1997 Compared with 1996

Net income for 1997 was $323.8 million, compared with $258.0 million in 1996, an increase of 25%. After giving effect for the Company's two-for-one stock split, effective June 2, 1997, net income per share for 1997 was $2.75, compared with $2.17 in 1996, an increase of 27%.

The amount of new primary insurance written by Mortgage Guaranty Insurance Corporation ("MGIC") during 1997 was $32.2 billion ($6.5 billion, $7.7 billion, $9.1 billion and $8.9 billion during the first through fourth quarters, respectively), compared with $32.8 billion in 1996 ($7.6 billion, $8.9 billion, $8.6 billion and $7.7 billion during the first through fourth quarters, respectively). Refinancing activity accounted for 15% of new primary insurance written in 1997 (17%, 12%, 12% and 20% of new primary insurance written for the first through fourth quarters, respectively), compared to 17% in 1996 (29%, 19%, 10% and 12% of new primary insurance written for the first through fourth quarters, respectively).

The $32.2 billion of new primary insurance written during 1997 was offset by the cancellation of $25.1 billion of insurance in force ($5.1 billion, $6.3 billion, $6.6 billion and $7.1 billion during the first through fourth quarters, respectively), and resulted in a net increase of $7.1 billion in primary insurance in force, compared to new primary insurance written of $32.8 billion, cancellation of $21.7 billion, and a net increase of $11.1 billion in insurance in force during 1996. Direct primary insurance in force was $138.5 billion at December 31, 1997, compared to $131.4 billion at December 31, 1996. In addition to providing direct primary insurance coverage, the Company also insures pools of mortgage loans. The Company's direct pool risk in force at December 31, 1997 was $590.3 million compared to $232.3 million at December 31, 1996 and is expected to increase in 1998 as a result of outstanding commitments to write additional agency pool insurance.

Cancellation activity increased during 1997 due to favorable mortgage interest rates which resulted in a decrease in the MGIC persistency rate (percentage of insurance remaining in force from one year prior) to 80.9% at December 31, 1997, from 82.0% at December 31, 1996. Cancellation activity could increase in 1998 if proposed legislation regarding cancellation of mortgage insurance is enacted. Persistency at March 31, 1998 is expected to decrease compared to December 31, 1997 as a result of favorable mortgage interest rates in January and February 1998.

Net premiums written increased 17% to $690.2 million in 1997, from $588.9 million in 1996. Net premiums earned increased 15% to $708.7 million in 1997, from $617.0 million in 1996. The increases were primarily a result of the growth in insurance in force.

Investment income for 1997 was $123.6 million, an increase of 17% over the $105.4 million in 1996. This increase was primarily the result of an increase in the amortized cost of average investment assets to $2.1 billion for 1997, from $1.8 billion for 1996, an increase of 19%. The increase was partially offset by a decrease in the portfolio's average pre-tax investment yield to 5.8% in 1997 from 5.9% in 1996. The portfolio's average after-tax investment yield was 5.0% for 1997 compared to 5.1% for 1996.

Other revenue was $32.7 million in 1997, compared with $22.0 million in 1996. The increase is primarily the result of $7.1 million of equity earnings from Credit-Based Asset Servicing and Securitization LLC ("C-BASS"), the Company's joint venture with Enhance Financial Services Group Inc. and an increase in fee-based services for underwriting.

Ceding commission for 1997 was $3.1 million, compared to $4.0 million in 1996, a decrease of 23%. The decrease was primarily attributable to reductions in premiums ceded under quota share reinsurance agreements.

Net losses incurred increased 3% to $242.4 million in 1997, from $234.4 million in 1996. Such increase was primarily due to an increase in the primary insurance notice inventory from 25,034 at December 31, 1996 to 28,493 at December 31, 1997, resulting from higher delinquency levels on insurance written in 1994 through 1996, the continued higher level of loss activity in certain high-cost geographic regions, a higher level of defaults which resulted from a higher percentage of the Company's insurance in force reaching its peak claim paying years and an increase in the number of defaults with deeper coverages. Offsetting this increase were favorable developments in prior-year loss reserves resulting from actual claim rates and actual claim amounts being lower than those estimated by the Company when originally establishing the reserve at December 31, 1996. At December 31, 1997, 57% of the insurance in force was written during the last three years, compared to 61% at December 31, 1996. The highest claim frequency years have typically been the third through fifth years after the year of loan origination. However, the pattern of claims frequency for refinance loans may be different from the historical pattern of other loans. A substantial portion of the insurance written in 1992 and 1993 represented insurance on the refinance of mortgage loans originated in earlier years.

Underwriting and other expenses increased 7% in 1997 to $157.2 million from $146.5 million in 1996. This increase in expenses was primarily due to an increase in expenses associated with the fee-based services for underwriting and an increase in premium tax due to higher premiums written.

The consolidated insurance operations loss ratio was 34.2% for 1997 compared to 38.0% for 1996. The consolidated insurance operations expense and combined ratios were 18.4% and 52.6%, respectively, for 1997 compared to 21.6% and 59.6%, respectively, for 1996.

The effective tax rate was 30.4% in 1997, compared with 29.3% in 1996. During both years, the effective tax rate was below the statutory rate of 35%, reflecting the benefits of tax-preferenced investment income. The higher effective tax rate in 1997 resulted from a lower percentage of total income before tax being generated from tax-preferenced investments in 1997.

1996 Compared with 1995

Net income for 1996 was $258.0 million, compared with $207.6 million in 1995, an increase of 24%. After giving effect for the Company's two-for-one stock split, net income per share for 1996 was $2.17, compared with $1.75 in 1995, an increase of 24%.

The amount of new primary insurance written by MGIC during 1996 was $32.8 billion compared with $30.3 billion in 1995 ($6.1 billion, $7.0 billion, $9.0 billion and $8.2 billion during the first through fourth quarters, respectively). Refinancing activity accounted for 17% of new primary insurance written in 1996 compared to 11% in 1995 (7%, 6%, 13% and 17% of new primary insurance written for the first through fourth quarters, respectively).

The $32.8 billion of new primary insurance written during 1996 was offset by the cancellation of $21.7 billion of insurance in force and resulted in a net increase of $11.1 billion in primary insurance in force, compared to new primary insurance written of $30.3 billion, cancellation of $14.4 billion, and a net increase of $15.9 billion in insurance in force during 1995. Direct primary insurance in force was $131.4 billion at December 31, 1996, compared to $120.3 billion at December 31, 1995.

Cancellation activity increased during 1996 due to increased refinancing activity which resulted in a decrease in the MGIC persistency rate (percentage of insurance remaining in force from one year prior) to 82.0% at December 31, 1996, from 86.3% at December 31, 1995.

New insurance written for 1996 reflected an increase in the usage of the monthly premium product to 90% of new insurance written from 83% of new insurance written in 1995. New insurance written for adjustable-rate mortgages decreased to 26% of new insurance written in 1996 from 33% of new insurance written in 1995.

Principally as a result of changes in coverage requirements by the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association which were effective in the first quarter of 1995, new insurance written for mortgages with loan-to-value ("LTV") ratios in excess of 85% but not more than 90% and coverage of 25% was 39% of new insurance written in 1996 compared to 33% in 1995. New insurance written for mortgages with LTV ratios in excess of 90% but not more than 95% and coverage of 30% was 38% of new insurance written in 1996 compared to 34% in 1995.

Net premiums written increased 23% to $588.9 million in 1996, from $480.3 million in 1995. Net premiums earned increased 22% to $617.0 million in 1996, from $506.5 million in 1995. The increases were primarily a result of the growth in insurance in force.

Investment income for 1996 was $105.4 million, an increase of 20% over the $87.5 million in 1995. This increase was primarily the result of an increase in the amortized cost of average investment assets to $1.8 billion for 1996, from $1.5 billion for 1995, an increase of 22%. The increase was partially offset by a decrease in the portfolio's average pre-tax investment yield to 5.9% in 1996 from 6.0% in 1995. The portfolio's average after-tax investment yield was 5.1% for 1996 compared to 5.2% for 1995.

Other revenue was $22.0 million in 1996, compared with $22.3 million in 1995. Other revenue represents activity of the Company's mortgage services operations, primarily contracts with government agencies for premium reconciliation and claim administration and fee-based services for underwriting.

Ceding commission for 1996 was $4.0 million, compared to $4.9 million in 1995, a decrease of 18%. The decrease was primarily attributable to reductions in premiums ceded under quota share reinsurance agreements.

Net losses incurred increased to $234.4 million in 1996, from $190.0 million in 1995, an increase of 23%. Such increase was primarily due to an increase in the notice inventory from 19,980 at December 31, 1995 to 25,034 at December 31, 1996 resulting from an increasing percentage of the Company's insurance in force reaching its peak claim paying years, concern with early loss developments on insurance written in late 1994 and the first half of 1995, the continued high level of loss activity in certain high-cost geographic regions and an increase in claim amounts on defaults with deeper coverages. The increase was partially offset by a redundancy in prior-year loss reserves resulting from actual claim rates and actual claim amounts being lower than those estimated by the Company when originally establishing the reserve at December 31, 1995. At December 31, 1996, 42% of the insurance in force was written during the last two years, compared to 48% at December 31, 1995. The highest claim frequency years have typically been the third through fifth years after the year of loan origination. However, the pattern of claims frequency for refinance loans may be different from the historical pattern of other loans. A substantial portion of the insurance written in 1992 and 1993 represented insurance on the refinance of mortgage loans originated in earlier years.

Underwriting and other expenses increased 6% in 1996 to $146.5 million from $137.6 million in 1995. This increase in expenses was primarily due to an increase associated with the fee-based services for underwriting and an increase in premium tax due to higher premiums written.

The consolidated insurance operations loss ratio was 38.0% for 1996 compared to 37.5% for 1995. The consolidated insurance operations expense and combined ratios were 21.6% and 59.6%, respectively, for 1996 compared to 24.6% and 62.1%, respectively, for 1995.

The effective tax rate was 29.3% in 1996, compared with 28.8% in 1995. During both years, the effective tax rate was below the statutory rate of 35%, reflecting the benefits of tax-preferenced investment income. The higher effective tax rate in 1996 resulted from a lower percentage of total income before tax being generated from tax-preferenced investments in 1996.

Financial Condition

Consolidated total investments were $2.4 billion at December 31, 1997, compared with $2.0 billion at December 31, 1996, an increase of 19%. The increase includes an increase of $66.6 million in unrealized gains on securities marked to market. The Company generated consolidated cash flows from operating activities of $364.0 million during 1997, compared to $367.8 million generated during 1996. The decrease in operating cash flows during 1997 is due primarily to the receipt, in 1996, of $40 million in connection with the assumption by MGIC of reinsurance on mortgage insurance written by Wisconsin Mortgage Assurance Corporation and an increase in losses paid during 1997 offset by an increase in renewal premiums. As of December 31, 1997, the Company had $114.7 million of short-term investments with maturities of 90 days or less, and 72% of the portfolio was invested in tax-preferenced securities. In addition, at December 31, 1997, based on book value, the Company's debt securities were approximately 98% invested in "A" rated and above, readily marketable securities, concentrated in maturities of less than 15 years. At December 31, 1997 the Company had $116.1 million of investments in equity securities compared to $4.0 million at December 31, 1996.

At December 31, 1997, the Company had no derivative financial instruments in its investment portfolio. The Company places its investments in instruments that meet high credit quality standards, as specified in the Company's investment policy guidelines; the policy also limits the amount of credit exposure to any one issue, issuer and type of instrument. At December 31, 1997, the average duration of the Company's investment portfolio was 5.8 years. The effect of a 1% decrease in market interest rates would result in a 5.8% increase in the value of the Company's investment portfolio.

Consolidated loss reserves increased 16% to $598.7 million at December 31, 1997 from $514.0 million at December 31, 1996, reflecting the higher level of defaults as described in the Results of Consolidated Operations (1997 Compared with 1996). Consistent with industry practices, the Company does not establish loss reserves for future claims on insured loans which are not currently in default.

Consolidated unearned premiums decreased $21.0 million from $219.3 million at December 31, 1996, to $198.3 million at December 31, 1997, reflecting the high level of monthly premium policies written in 1997, for which there is no unearned premium. Reinsurance recoverable on unearned premiums decreased $2.5 million to $9.2 million at December 31, 1997 from $11.7 million at December 31, 1996, primarily reflecting the reduction in unearned premiums.

Consolidated shareholders' equity increased to $1.5 billion at December 31, 1997, from $1.4 billion at December 31, 1996, an increase of 9%. This increase consisted of $323.8 million of net income during 1997, $13.1 million from the reissuance of treasury stock, and an increase in net unrealized gains on investments, net of tax, of $43.3 million, offset by the repurchase of $248.4 million of outstanding common shares and dividends declared of $11.0 million.

Liquidity and Capital Resources

The Company's consolidated sources of funds consist primarily of premiums written and investment income. Funds are applied primarily to the payment of claims and expenses. Approximately 70% of underwriting expenses are personnel-related costs, most of which are considered by the Company to be fixed costs over the short term. Approximately 7% of operating expenses relate to occupancy costs, which are fixed costs. Substantially all of the remaining operating expenses are considered by the Company to be variable in nature, with data processing costs and taxes, licenses and fees representing approximately 4% and 10%, respectively, of total operating expenses. The Company generated positive cash flows of approximately $364.0 million, $367.8 million and $286.5 million in 1997, 1996 and 1995, respectively, as shown on the Consolidated Statement of Cash Flows. Positive cash flows are invested pending future payments of claims and other expenses. Cash-flow shortfalls, if any, could be funded through sales of short-term investments and other investment portfolio securities.

In January 1997, the Company repaid mortgages payable of $35.4 million, which was secured by the home office and substantially all of the furniture and fixtures of the Company.

During 1997, the Company repurchased 4,655,985 shares of its common stock at a cost of approximately $248 million. Funds to repurchase the shares were primarily provided by borrowings under a credit facility evidenced by notes payable. The credit facility provides for up to $250 million of availability which decreases by $25 million each year beginning June 20, 1998 through June 20, 2001. Any outstanding borrowings under the facility mature on June 20, 2002. The Company has the option, on notice to the lenders, to prepay any borrowings subject to certain provisions.

MGIC has a 48% investment in C-BASS and during 1997, guaranteed one-half of a $20 million credit facility for C-BASS. The facility matured in February 1998 and was replaced by a $50 million credit facility, one-half of which was guaranteed by MGIC.

MGIC is the principal insurance subsidiary of the Company. MGIC's risk-to-capital ratio was 15.7:1 at December 31, 1997 compared to 18.1:1 at December 31, 1996. The decrease was due to MGIC's increased policyholders' reserves, partially offset by the additional risk in force of $2.4 billion resulting from the $14.3 billion net addition to insurance in force during 1997.
The Company's combined insurance risk-to-capital ratio was 16.4:1 at December 31, 1997, compared to 18.8:1 at December 31, 1996. The decrease was due to the same reasons as described above.

Year 2000 Issue

Almost all of the Company's computer systems, including all of the systems which are integral to its business, either have been originally developed to be Year 2000 compliant or have been reprogrammed. The Company plans to reprogram the remaining systems and to complete tests of all systems for Year 2000 compliance by the end of 1998. All costs incurred through year end 1997 for systems for Year 2000 compliance have been expensed and were immaterial. The costs of the remaining reprogramming and testing are expected to be immaterial. Some of the Company's computer systems integral to its business interface with computer systems of third parties. Virtually all transactions with systems operated by third parties involve nationally recognized service bureaus, Fannie Mae, Freddie Mac or other companies that were among the top 50 mortgage servicers in 1997. The Company is assuming that these third parties will successfully address Year 2000 compliance for their own systems and is planning to work with many of these third parties in 1998 to coordinate testing of Year 2000 system interfaces. As a result, the Company does not anticipate Year 2000 compliance arising from interfaces with third-party systems will have a material impact on its operations.

Consolidated Statement of Operations

	1997	1996	1995
REVENUES	(In thousands of dollars, except per share data)		
Premiums written:			
Direct	$ 692,134	$ 587,626	$ 492,238
Assumed	11,597	16,912	8,043
Ceded (note 7)	(13,483)	(15,611)	(19,969)
Net premiums written	690,248	588,927	480,312
Decrease in unearned premiums	18,496	28,116	26,188
Net premiums earned (note 7)	708,744	617,043	506,500
Investment income, net of expenses (note 4)	123,602	105,355	87,543
Realized investment gains, net (note 4)	3,261	1,220	1,496
Other revenue	32,665	22,013	22,347
Total revenues	868,272	745,631	617,886
LOSSES AND EXPENSES			
Losses incurred, net (note 7)	242,362	234,350	189,982
Underwriting and other expenses	157,194	146,483	137,559
Interest expense	6,399	3,793	3,821
Ceding commission (note 7)	(3,056)	(4,023)	(4,885)
Total losses and expenses	402,899	380,603	326,477
Income before tax	465,373	365,028	291,409
Provision for income tax (note 9)	141,623	107,037	83,844
Net income	$ 323,750	$ 257,991	$ 207,565
Earnings per share (note 10):			
Basic	$ 2.78	$ 2.19	$ 1.77
Diluted	$ 2.75	$ 2.17	$ 1.75

Consolidated Balance Sheet

	1997	1996
ASSETS	(In thousands of dollars)	
Investment portfolio (note 4):		
Securities, available-for-sale, at market value:		
Fixed maturities	$2,185,954	$1,892,081
Equity securities	116,053	4,039
Short-term investments	114,733	140,114
Total investment portfolio	2,416,740	2,036,234
Cash	4,893	3,861
Accrued investment income	35,485	33,363
Reinsurance recoverable on loss reserves (note 7)	26,415	29,827
Reinsurance recoverable on unearned premiums (note 7)	9,239	11,745
Home office and equipment, net	33,784	35,050
Deferred insurance policy acquisition costs	27,156	31,956
Investment in unconsolidated subsidiary	29,400	14,950
Other assets	34,575	25,329
Total assets	$2,617,687	$2,222,315

LIABILITIES AND SHAREHOLDERS' EQUITY

	1997	1996
Liabilities:		
Loss reserves (notes 6 and 7)	$ 598,683	$ 514,042
Unearned premiums (note 7)	198,305	219,307
Notes payable (note 5)	237,500	35,424
Income taxes payable (note 9)	27,717	23,111
Other liabilities	68,700	64,316
Total liabilities	1,130,905	856,200
Contingencies (note 12)		
Shareholders' equity (note 10):		
Common stock, $1 par value, shares authorized 150,000,000; shares issued 121, 110, 800; outstanding 1997 – 113,791,593; 1996 – 117,900,868	121,111	121,111
Paid-in surplus	218,499	207,984
Treasury stock (shares at cost 1997 – 7,319,207; 1996 – 3,209,932)	(252,942)	(7,073)
Unrealized appreciation in investments, net of tax	83,985	40,685
Retained earnings (note 10)	1,316,129	1,003,408
Total shareholders' equity	1,486,782	1,366,115
Total liabilities and shareholders' equity	$ 2,617,687	$2,222,315

MGIC INVESTMENT CORPORATION & SUBSIDIARIES -
YEARS ENDED DECEMBER 31, 1997, 1996 AND 1995

Consolidated Statement of Shareholder's Equity

	Common stock	Paid-in surplus	Treasury stock	Unrealized appreciation (depreciation) in investments	Retained earnings
			(In thousands of dollars)		
Balance, December 31, 1994	$ 121,111	$ 193,789	$ (9,166)	$ (24,308)	$ 556,648
Net income	–	–	–	–	207,565
Unrealized investment gains, net	–	–	–	79,045	–
Dividends declared	–	–	–	–	(9,371)
Reissuance of treasury stock	–	5,085	994	–	–
Balance, December 31, 1995	121,111	198,874	(8,172)	54,737	754,842
Net income	–	–	–	–	257,991
Unrealized investment losses, net	–	–	–	(14,052)	–
Dividends declared	–	–	–	–	(9,425)
Reissuance of treasury stock	–	9,110	1,099	–	–
Balance, December 31, 1996	121,111	207,984	(7,073)	40,685	1,003,408
Net income	–	–	–	–	323,750
Unrealized investment gains, net	–	–	–	43,300	–
Dividends declared	–	–	–	–	(11,029)
Repurchase of outstanding common shares	–	–	(248,426)	–	–
Reissuance of treasury stock	–	10,515	2,557	–	–
Balance, December 31, 1997	$ 121,111	$ 218,499	$ (252,942)	$ 83,985	$1,316,129

Consolidated Statement of Cash Flows

	1997	1996	1995
	(In thousands of dollars)		
Cash flows from operating activities:			
Net income	$ 323,750	$ 257,991	$ 207,565
Adjustment to reconcile net income to net cash provided by operating activities:			
Amortization of deferred insurance policy acquisition costs	21,373	26,772	29,693
Increase in deferred insurance policy acquisition costs	(16,573)	(20,772)	(24,748)
Depreciation and other amortization	8,187	8,969	8,613
Increase in accrued investment income	(2,122)	(4,150)	(4,876)
Decrease (increase) in reinsurance recoverable on loss reserves	3,412	4,029	(194)
Decrease in reinsurance recoverable on unearned premiums	2,506	3,740	3,791
Increase in loss reserves	84,641	143,010	96,563
Decrease in unearned premiums	(21,002)	(31,856)	(29,980)
Increase in investment in unconsolidated subsidiary	(14,450)	(14,950)	–
Other	(25,761)	(5,021)	110
Net cash provided by operating activities	363,961	367,762	286,537
Cash flows from investing activities:			
Purchase of equity securities	(112,780)	–	–
Purchase of fixed maturities:			
Available-for-sale securities	(685,217)	(1,095,559)	(514,458)
Held-to-maturity securities	–	–	(34,521)
Proceeds from sale of equity securities	10,443	–	–
Proceeds from sale or maturity of fixed maturities:			
Available-for-sale securities	443,551	781,099	166,442
Held-to-maturity securities	–	–	22,615
Net cash used in investing activities	(344,003)	(314,460)	(359,922)
Cash flows from financing activities:			
Dividends paid to shareholders	(11,029)	(9,425)	(9,371)
Increase in notes payable	237,500	–	–
Principal repayments on long-term debt	(35,424)	(375)	(348)
Reissuance of treasury stock	13,072	10,209	6,079
Repurchase of common stock	(248,426)	–	–
Net cash (used in) provided by financing activities	(44,307)	409	(3,640)
Net (decrease) increase in cash and cash equivalents	(24,349)	53,711	(77,025)
Cash and cash equivalents at beginning of year	143,975	90,264	167,289
Cash and cash equivalents at end of year	$ 119,626	$ 143,975	$ 90,264

Notes to Consolidated Financial Statements

1. Nature of business

MGIC Investment Corporation ("Company") is a holding company which, through Mortgage Guaranty Insurance Corporation ("MGIC") and several other subsidiaries, is principally engaged in the mortgage insurance business. The Company provides mortgage insurance to lenders throughout the United States to protect against loss from defaults on low down payment residential mortgage loans. Through certain other non-insurance subsidiaries, the Company also provides various services for the mortgage finance industry, such as contract underwriting, premium reconciliation, claim administration and portfolio analysis.

At December 31, 1997, the Company's direct primary insurance in force (representing the current principal balance of all mortgage loans that are currently insured) and direct primary risk in force was approximately $138.5 billion and $32.2 billion, respectively. In addition to providing direct primary insurance coverage, the Company also insures pools of mortgage loans. The Company's direct pool risk in force at December 31, 1997 was approximately $.6 billion.

The Company's largest shareholder, The Northwestern Mutual Life Insurance Company ("NML"), held approximately 18% of the common stock of the Company at December 31, 1997.

2. Basis of presentation and summary of significant accounting policies

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Principles of consolidation

The consolidated financial statements include the accounts of MGIC Investment Corporation and its wholly-owned subsidiaries. All intercompany transactions have been eliminated. The Company's 48% investment in Credit-Based Asset Servicing and Securitization LLC ("C-BASS"), a joint venture with Enhance Financial Services Group Inc., is accounted for on the equity method and recorded on the balance sheet as investment in unconsolidated subsidiary. The Company's equity earnings from C-BASS are included in other revenue.

Investments

The Company categorizes its investment portfolio according to its ability and intent to hold the investments to maturity. Fixed maturities which are classified as held-to-maturity are stated at amortized cost. Investments which the Company does not have the ability and intent to hold to maturity are considered to be available-for-sale and must be recorded at market and the unrealized gains or losses recognized as an increase or decrease to shareholders' equity. Realized investment gains and losses are reported in income based upon specific identification of securities sold. (See note 4.)

Home office and equipment

Home office and equipment is carried at cost net of depreciation. For financial statement reporting purposes, depreciation is determined on a straight-line basis for the home office, equipment and data processing hardware over estimated lives of 45, 5 and 3 years, respectively. For income tax purposes, the Company uses accelerated depreciation methods.

Home office and equipment is shown net of accumulated depreciation of $40.9 million and $36.1 million at December 31, 1997 and 1996, respectively.

Deferred insurance policy acquisition costs

The cost of acquiring insurance policies, including compensation, premium taxes and other underwriting expenses, is deferred, to the extent recoverable, and amortized as the related premiums are earned. No expenses are deferred on monthly premium policies.

Loss reserves

Reserves are established for reported insurance losses and loss adjustment expenses based on when notices of default on insured mortgage loans are received. Reserves are also established for estimated losses incurred on notices of default not yet reported by the lender. Consistent with industry practices, the Company does not establish loss reserves for future claims on insured loans which are not currently in default. Reserves are established by management using estimated claims rates and claims amounts in estimating the ultimate loss. Amounts for salvage recoverable are considered in the determination of the reserve estimates. Adjustments to reserve estimates are reflected in the financial statements in the years in which the adjustments are made. The liability for reinsurance assumed is based on information provided by the ceding companies. (See note 6.)

Income recognition

The insurance subsidiaries write policies which are guaranteed renewable contracts at the insured's option on a single, annual or monthly premium basis. The insurance subsidiaries have no ability to reunderwrite or reprice these contracts. Premiums written on a single premium basis and an annual premium basis are initially deferred as unearned premium reserve and earned over the policy term. Premiums written on policies covering more than one year are amortized over the policy life in accordance with the expiration of risk. Premiums written on annual policies are earned on a monthly pro rata basis. Premiums written on monthly policies are earned as the premiums are due.

Fee income of the non-insurance subsidiaries is earned as the services are provided.

Income taxes

The Company and its subsidiaries file a consolidated federal income tax return. A formal tax sharing agreement exists between the Company and its subsidiaries. Each subsidiary determines income taxes based upon the utilization of all tax deferral elections available. This assumes Tax and Loss Bonds are purchased and held to the extent they would have been purchased and held on a separate company basis since the tax sharing agreement provides that the redemption or non-purchase of such bonds shall not increase such member's separate taxable income and tax liability on a separate company basis.

Federal tax law permits mortgage guaranty insurance companies to deduct from taxable income, subject to certain limitations, the amounts added to contingency loss reserves. Generally, the amounts so deducted must be included in taxable income in the tenth subsequent year. The deduction is allowed only to the extent that U.S. government non-interest bearing Tax and Loss Bonds are purchased and held in an amount equal to the tax benefit attributable to such deduction. The Company accounts for these purchases as a payment of current federal income taxes.

Deferred income taxes are provided under the liability method which recognizes the future tax effects of temporary differences between amounts reported in the financial statements and the tax bases of these items. The expected tax effects are computed at the current federal tax rate.
(See note 9.)

Benefit plans
The Company has a non-contributory defined benefit pension plan covering substantially all employees. Retirement benefits are based on compensation and years of service. The Company's policy is to fund pension cost as required under the Employee Retirement Income Security Act of 1974.
(See note 8.)

The Company accrues the estimated costs of retiree medical and life benefits over the period during which employees render the service that qualifies them for benefits. The Company offers both medical and dental benefits for retired employees and their spouses. Benefits are generally funded on a pay-as-you-go basis. (See note 8.)

Reinsurance
Loss reserves and unearned premiums are reported before taking credit for amounts ceded under reinsurance treaties. Ceded loss reserves are reflected as "Reinsurance recoverable on loss reserves". Ceded unearned premiums are reflected as "Reinsurance recoverable on unearned premiums". The Company remains contingently liable for all reinsurance ceded. (See note 7.)

Earnings per share
The Company's basic and diluted earnings per share ("EPS") have been calculated in accordance with Statement of Financial Accounting Standards No. 128, Earnings Per Share ("SFAS 128"). The Company's net income is the same for both basic and diluted EPS. Basic EPS is based on the weighted-average number of common shares outstanding. Diluted EPS is based on the weighted-average number of common shares outstanding and common stock equivalents which would arise from the exercise of stock options. The following is a reconciliation of the weighted-average number of shares used for basic EPS and diluted EPS. (See note 10.)

	Year Ended December 31,		
	1997	1996	1995
Weighted-average shares- Basic EPS	116,332	117,787	117,084
Common stock equivalents	1,592	1,259	1,483
Weighted-average shares- Diluted EPS	117,924	119,046	118,567

Earnings per share for 1996 and 1995 has been restated to reflect the provisions of SFAS 128. Previously reported EPS for 1996 and 1995, after adjustment for the stock split (see note 10), equaled diluted EPS under SFAS 128.

Statement of cash flows
For purposes of the consolidated statement of cash flows, the Company considers short-term investments to be cash equivalents, as short-term investments have original maturities of three months or less. Interest paid during 1997, 1996 and 1995 approximates interest expense.

New accounting standard
In June 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 130, Reporting Comprehensive Income ("SFAS 130"), which is effective for fiscal years beginning after December 15, 1997. SFAS 130 establishes standards for the reporting and display of comprehensive income and its components in financial statements. SFAS 130 will not impact the Company's financial position or results of operations.

Reclassifications
Certain reclassifications have been made in the accompanying financial statements to 1996 and 1995 amounts to allow for consistent financial reporting.

3. Related party transactions

The Company contracts with Northwestern Mutual Investment Services, Inc., a subsidiary of NML, for investment portfolio management and accounting services. The Company incurred expense of $1.1 million, $.9 million and $.9 million for these services in 1997, 1996 and 1995, respectively.

4. Investments

The following table summarizes the Company's investments at December 31, 1997 and 1996:

	Amortized Cost	Market Value	Financial Statement Value
	(In thousands of dollars)		
At December 31, 1997:			
Securities, available-for-sale:			
Fixed maturities	$2,069,133	$2,185,954	$2,185,954
Equity securities	103,670	116,053	116,053
Short-term investments	114,733	114,733	114,733
Total investment portfolio	$2,287,536	$2,416,740	$2,416,740

	Amortized Cost	Market Value	Financial Statement Value
	(In thousands of dollars)		
At December 31, 1996:			
Securities, available-for-sale:			
Fixed maturities	$1,832,193	$1,892,081	$1,892,081
Equity securities	1,333	4,039	4,039
Short-term investments	140,114	140,114	140,114
Total investment portfolio	$1,973,640	$2,036,234	$2,036,234

The amortized cost and market value of investments at December 31, 1997 are as follows:

December 31, 1997:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
	(In thousands of dollars)			
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 60,972	$ 3,573	$ (2)	$ 64,543
Obligations of states and political subdivisions	1,620,660	102,915	(555)	1,723,020
Corporate securities	487,711	9,984	(42)	497,653
Mortgage-backed securities	437	32	–	469
Debt securities issued by foreign sovereign governments	14,086	916	–	15,002
Total debt securities	2,183,866	117,420	(599)	2,300,687
Equity securities	103,670	14,582	(2,199)	116,053
Total investment portfolio	$ 2,287,536	$ 132,002	$ (2,798)	$2,416,740

The amortized cost and market value of investments at December 31, 1996 are as follows:

December 31, 1996:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 77,498	$ 1,483	$ (345)	$ 78,636
Obligations of states and political subdivisions	1,364,790	57,374	(1,437)	1,420,727
Corporate securities	515,482	3,659	(1,304)	517,837
Mortgage-backed securities	571	33	–	604
Debt securities issued by foreign sovereign governments	13,966	425	–	14,391
Total debt securities	1,972,307	62,974	(3,086)	2,032,195
Equity securities	1,333	2,706	–	4,039
Total investment portfolio	$1,973,640	$ 65,680	$ (3,086)	$ 2,036,234

The amortized cost and market values of debt securities at December 31, 1997, by contractual maturity, are shown below. Debt securities consist of fixed maturities and short-term investments. 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
Due in one year or less	$ 120,796	$ 120,888
Due after one year through five years	215,530	221,781
Due after five years through ten years	948,392	1,005,462
Due after ten years	898,711	952,087
	2,183,429	2,300,218
Mortgage-backed securities	437	469
Total at December 31, 1997	$2,183,866	$ 2,300,687

Net investment income is comprised of the following:

	1997	1996	1995
	(In thousands of dollars)		
Fixed maturities	$ 117,448	$ 99,832	$ 79,328
Equity securities	485	240	240
Short-term investments	6,813	6,223	8,498
Other	65	82	409
Investment income	124,811	106,377	88,475
Investment expenses	(1,209)	(1,022)	(932)
Net investment income	$ 123,602	$ 105,355	$ 87,543

The net realized investment gains (losses) and change in net unrealized appreciation (depreciation) of investments are as follows:

	1997	1996	1995
	(In thousands of dollars)		
Net realized investment gains (losses), on sale of investments:			
Fixed maturities	$ 3,734	$ 1,252	$ 1,502
Equity securities	(472)	(30)	–
Short-term investments	(1)	(2)	(6)
	3,261	1,220	1,496
Change in net unrealized appreciation (depreciation):			
Fixed maturities	56,934	(22,064)	111,359
Equity securities	9,677	233	191
Short-term investments	–	–	898
	66,611	(21,831)	112,448
Net realized investment gains (losses) and change in net unrealized appreciation (depreciation)	$ 69,872	$ (20,611)	$ 113,944

At November 30, 1995, the Company transferred its entire held-to-maturity portfolio with a book value of $557.1 million to the available-for-sale portfolio. This transfer resulted in an increase to shareholders' equity of $30.3 million, net of tax.

The gross realized gains and the gross realized losses on sales of available-for-sale securities were $5.7 million and $2.4 million, respectively in 1997 and $8.6 million and $7.4 million, respectively in 1996. There were no sales or transfers of held-to-maturity securities during 1997, 1996 or 1995 other than the transfer on November 30, 1995 of the entire held-to-maturity portfolio to available-for-sale.

5. Notes payable

In January 1997, the Company repaid mortgages payable of $35.4 million, which were secured by the home office and substantially all of the furniture and fixtures of the Company.

During 1997, the Company repurchased 4,655,985 shares of its outstanding common stock from a financial intermediary at a cost of approximately $248 million. Funds to repurchase the shares were primarily provided by borrowings under a credit facility evidenced by notes payable. The weighted-average interest rate on the notes at December 31, 1997 was 6.01% per annum. The interest rate on borrowings under the facility is variable.

The credit facility provides for up to $250 million of availability which decreases by $25 million each year beginning June 20, 1998 through June 20, 2001. Any outstanding borrowings under the facility mature on June 20, 2002. The Company has the option, on notice to the lenders, to prepay any borrowings subject to certain provisions.

The outstanding balance of the note payable at December 31, 1997 approximates market value.

Under the terms of the credit facility, the Company must maintain shareholders' equity of at least $900 million and MGIC must maintain a claims paying ability rating of AA- or better with Standard & Poor's Corporation ("S&P"). At December 31, 1997, the Company had shareholders' equity of $1,487 million and MGIC had a claims paying ability rating of AA+ from S&P.

During 1997 MGIC guaranteed one half of a $20 million credit facility for C-BASS. The facility matures in February 1998.

6. Loss reserves

Loss reserve activity was as follows

	1997	1996	1995
	(In thousands of dollars)		
Reserve at beginning of year	$ 514,042	$ 371,032	$ 274,469
Less reinsurance recoverable	29,827	33,856	33,662
Net reserve at beginning of year	484,215	337,176	240,807
Reserve transfer (1)	537	35,657	–
Adjusted reserve at beginning of year	484,752	372,833	240,807
Losses incurred:			

Losses and LAE incurred in respect of default notices received in:			
Current year	360,623	312,630	226,439
Prior years (2)	(118,261)	(78,280)	(36,457)
Subtotal	242,362	234,350	189,982
Losses paid:			
Losses and LAE paid in respect of default notices received in:			
Current year	15,257	16,872	14,115
Prior years	139,589	106,096	79,498
Subtotal	154,846	122,968	93,613
Net reserve at end of year	572,268	484,215	337,176
Plus reinsurance recoverables	26,415	29,827	33,856
Reserve at end of year	$ 598,683	$ 514,042	$ 371,032

(1) Received in conjunction with the cancellation of certain reinsurance treaties. (See note 7.)
(2) A negative number for a prior year indicates a redundancy of loss reserves, and a positive number for a prior year indicates a deficiency of loss reserves.

The top half of the table above shows losses incurred on default notices received in the current year and in prior years, respectively. The amount of losses incurred relating to default notices received in the current year represents the estimated amount to be ultimately paid on such default notices. The amount of losses incurred relating to default notices received in prior years represents an adjustment made in the current year for defaults which were included in the loss reserve at the end of the prior year.

Current year losses incurred increased from 1996 to 1997 primarily due to an increase in the primary insurance notice inventory from 25,034 at December 31, 1996 to 28,493 at December 31, 1997 resulting from higher delinquency levels on insurance written in 1994 through 1996, the continued high level of loss activity in certain high cost geographic regions and an increase in the number of claims on defaults with deeper coverages. Offsetting this increase were favorable developments in prior years loss reserves, with the net effect of total losses incurred increasing from $234.4 million in 1996 to $242.4 million in 1997.

The favorable development of the reserves in 1997, 1996 and 1995 is reflected in the prior year line, and results from the actual claim rates and actual claim amounts being lower than those estimated by the Company when originally establishing the reserve at December 31, 1996, 1995 and 1994, respectively.

The lower half of the table above shows the breakdown between claims paid on default notices received in the current year and default notices received in prior years. Since it takes, on average, about twelve months for a default which is not cured to develop into a paid claim, most losses paid relate to default notices received in prior years.

7. Reinsurance

The Company cedes a portion of its business to reinsurers and records assets for reinsurance recoverable on estimated reserves for unpaid losses and unearned premiums. Business written between 1985 and 1993 is ceded under various quota share reinsurance agreements with several reinsurers. The Company receives a ceding commission in connection with this reinsurance. There is no quota share reinsurance on business written subsequent to December 31, 1993.

In September 1996, the Company signed an agreement with Wisconsin Mortgage Assurance Corporation (“WMAC”) and a WMAC reinsurer to assume all of the reinsurer’s interest in WMAC mortgage insurance writings, which had been previously ceded to that reinsurer. WMAC wrote mortgage insurance on first mortgages collateralized by one-to-four-family residences until February 28, 1985. Under the agreement, the Company assumed reinsurance on approximately $4.2 billion of WMAC’s insurance in force (representing approximately $1.1 billion of risk in force) committed to, or written, through February 28, 1985. As a result, the amount of WMAC’s insurance in force ceded to the Company increased to approximately $6.2 billion (representing $1.6 billion of risk in force), with the portion of WMAC’s insurance in force reinsured by the Company increasing from approximately 21 percent to approximately 65 percent. The Company received approximately $40 million as payment for its assumption of existing loss and unearned premium reserves related to the insurance in force being assumed from WMAC. In January 1997, the Company signed a similar agreement with WMAC and another WMAC reinsurer. As a result, the portion of WMAC’s insurance in force reinsured by the Company increased slightly to approximately 66 percent at December 31, 1997.

The effect of reinsurance on premiums earned and losses incurred is as follows:

	1997	1996	1995
	(In thousands of dollars)		
Premiums earned:			
Direct	$ 712,069	$ 623,148	$ 522,069
Assumed	12,665	13,245	8,191
Ceded	(15,990)	(19,350)	(23,760)
Net premiums earned	$ 708,744	$ 617,043	$ 506,500
Losses incurred:			
Direct	$ 247,137	$ 226,702	$ 197,490
Assumed	3,683	17,073	7,108
Ceded	(8,458)	(9,425)	(14,616)
Net losses incurred	$ 242,362	$ 234,350	$ 189,982

8. Benefit plans

The components of the net periodic pension cost of the Company's defined benefit pension plan are as follows:

	1997	1996	1995
	(In thousands of dollars)		
Service cost	$ 3,569	$ 3,378	$ 3,118
Interest on projected benefit obligation	3,169	2,777	2,255
Actual return on plan assets	(8,865)	(5,235)	(7,532)
Net amortization and deferral	5,356	2,179	5,375
Net periodic pension cost	$ 3,229	$ 3,099	$ 3,216

The following lists the funded status of the pension plan as of December 31, 1997 and 1996:

	1997	1996
	(In thousands of dollars)	
Actuarial present value of benefit obligations:		
Vested	$ 39,470	$ 31,654
Non-vested	2,032	1,266
Accumulated benefit obligation	$ 41,502	$ 32,920
Projected benefit obligation	$ 51,190	$ 42,845
Net assets available for benefits	57,577	46,256
Projected benefit obligation less than plan assets	6,387	3,411
Unrecognized net asset	4,664	1,583
Pension asset	$ 1,723	$ 1,828

The discount rate used in determining the actuarial present value of the projected benefit obligation was 7 1/2% for 1997 and 1996. The discount rate used in determining the pension expense was 7 1/2% for 1997, 1996 and 1995. The expected long term rate of return on plan assets was 7 1/2% for 1997, 1996 and 1995, and the assumed rate of compensation increase was 6% for 1997, 1996 and 1995. Plan assets consist of fixed maturities and equity securities.

The components of the net periodic postretirement benefit cost of the Company's non-pension postretirement benefit plans are as follows:

	1997	1996	1995
	(In thousands of dollars)		
Service cost	$ 1,379	$ 1,208	$ 1,220
Interest cost on projected benefit obligation	1,268	1,171	1,019
Actual return on plan assets	(1,270)	(791)	(806)
Net amortization and deferral	1,226	933	1,131
Net periodic postretirement benefit cost	$ 2,603	$ 2,521	$ 2,564

The Company's liability for the unfunded accumulated postretirement benefit obligation as of December 31, 1997 and 1996, is as follows:

	1997	1996
	(In thousands of dollars)	
Actuarial present value of accumulated postretirement benefit obligation:		
Retirees	$ 3,812	$ 3,869
Active employees eligible to retire	2,415	1,936
Active employees ineligible to retire	13,137	12,010
Total accumulated postretirement benefit obligation	19,364	17,815
Fair value of assets	(8,632)	(6,248)
Unrecognized transition obligation	(7,949)	(8,479)
Unrecognized net gain relating to plan and discount rate changes	3,753	2,185
Accrued postretirement liability	$ 6,536	$ 5,273

The Company is amortizing the unrecognized transition obligation over 20 years. The discount rate used in determining the accumulated postretirement benefit obligation was 7 1/2% for 1997 and 1996. The expected long term rate of return on plan assets was 7 1/2% for 1997, 1996 and 1995. The assumed health care cost trend rate used in measuring the accumulated postretirement benefit obligation is 8.5% reduced over a period of 4 years to 6%. The effect of a 1% increase in the health care trend rate assumption would result in an increase of 21% in the accumulated postretirement benefit obligation from $19.4 million to approximately $23.4 million.

The Company has a profit sharing and 401(k) savings plan for employees. At the discretion of the Board of Directors, the Company may make a profit sharing contribution of up to 5% of each participant's compensation. The Company provides a matching 401(k) savings contribution on employees' before-tax contributions at a rate of 80% of the first $1,000 contributed and 40% of the next $2,000 contributed. Profit sharing costs and the Company's matching contributions to the 401(k) savings plan were $3.8 million, $3.6 million and $3.6 million in 1997, 1996 and 1995, respectively.

9. Income taxes

The components of the net deferred tax liability as of December 31, 1997 and 1996 are as follows:

	1997	1996
	(In thousands of dollars)	
Unearned premium reserves	$ (18,337)	$ (19,571)
Deferred policy acquisition costs	9,504	11,184
Loss reserves	(6,622)	1,559
Unrealized appreciation in investments	45,221	21,908
Other	(3,957)	(3,901)
Net deferred tax liability	$ 25,809	$ 11,179

At December 31, 1997, gross deferred tax assets and liabilities amounted to $56.8 million and $82.6 million, respectively. Management believes that all gross deferred tax assets at December 31, 1997 are fully realizable and no valuation reserve has been established.

The following summarizes the components of the provision for income tax:

	1997	1996	1995
	(In thousands of dollars)		
Federal:			
Current	$ 147,983	$ 116,160	$ 87,627
Deferred	(7,833)	(10,325)	(5,117)
State	1,473	1,202	1,334
Total provision	$ 141,623	$ 107,037	$ 83,844

The Company purchased $133.8 million, $93.6 million and $72.0 million of non-interest bearing U.S. Government Tax and Loss Bonds as a payment of current taxes in 1997, 1996 and 1995, respectively. The Company paid $12.5 million, $10.3 million and $8.5 million in estimated federal income taxes in 1997, 1996 and 1995, respectively. The Company also paid in 1997 $4.8 million in federal income taxes relating to assessments for 1991 and 1992.

The reconciliation of the provisions for income taxes computed at the federal tax rate of 35% to the reported provision for income taxes is as follows:

	1997	1996	1995
	(In thousands of dollars)		
Tax provision computed at federal tax rate	$ 162,881	$ 127,760	$ 101,993
(Decrease) increase in tax provision resulting from:			
Tax exempt municipal bond interest	(24,926)	(22,114)	(18,955)
Other, net	3,668	1,391	806
Total income tax provision	$ 141,623	$ 107,037	$ 83,844

The Internal Revenue Service ("IRS") is presently examining the Company's income tax returns for 1993 and 1994. The Company has received proposed tax assessments and remitted payments relating to 1991 and 1992. Management believes that no material issues remain outstanding for any tax returns for years prior to those currently under examination.

In examinations through 1988 the IRS had proposed to delay the deduction for loss reserves on mortgage loans in default until the lender takes title to the mortgaged property. In August 1992, this issue was decided in favor of another private mortgage insurer by the Court of Appeals for the federal circuit applicable to the Company. However, the IRS has continued to pursue this position with other private mortgage insurers in other circuits.

Management believes that adequate provision has been made in the financial statements for any amounts which may become due with respect to the open years.

10. Shareholders' equity and dividend restrictions

The Company's insurance subsidiaries are subject to statutory regulations as to maintenance of policyholders' surplus and payment of dividends. The maximum amount of dividends that the insurance subsidiaries may pay in any twelve-month period without regulatory approval by the Office of the Commissioner of Insurance of the State of Wisconsin ("OCI") is the lesser of adjusted statutory net income or 10% of statutory policyholders' surplus as of the preceding calendar year end. Adjusted statutory net income is defined for this purpose to be the greater of statutory net income, net of realized investment gains, for the calendar year preceding the date of the dividend or statutory net income, net of realized investment gains, for the three calendar years preceding the date of the dividend less dividends paid within the first two of the preceding three calendar years. In 1998, MGIC can pay $33.3 million of dividends and the other insurance subsidiaries of the Company can pay $2.5 million of dividends without such regulatory approval.

Certain of the Company's non-insurance subsidiaries also have requirements as to maintenance of net worth. These restrictions could also affect the Company's ability to pay dividends. In 1997, 1996 and 1995, the Company paid dividends of $11.0 million, $9.4 million and $9.4 million, respectively, or $.095 per share in 1997 and $.08 per share in 1996 and 1995. In 1998, the Company can pay dividends of $25.9 million from its own funds and funds available from the non-insurance subsidiaries.

The principles used in determining statutory financial amounts differ from generally accepted accounting principles ("GAAP"), primarily for the following reasons:

> Under statutory accounting practices, mortgage guaranty insurance companies are required to maintain contingency loss reserves equal to 50% of premiums earned. Such amounts cannot be withdrawn for a period of ten years except as permitted by insurance regulations. Contingency loss reserves are not reflected as liabilities under GAAP.

Under statutory accounting practices, insurance policy acquisition costs are charged against operations in the year incurred. Under GAAP, these costs are deferred and amortized as the related premiums are earned commensurate with the expiration of risk.

Statutory financial statements only include a provision for current income taxes due, and purchases of Tax and Loss Bonds are accounted for as investments. GAAP financial statements provide for deferred income taxes, and purchases of Tax and Loss Bonds are recorded as payments of current income taxes.

Under statutory accounting practices, fixed maturity investments are valued at amortized cost. Under GAAP, those investments which the Company does not have the ability and intent to hold to maturity are considered to be available-for-sale and are recorded at market, with the unrealized gain or loss recognized, net of tax, as an increase or decrease to shareholders' equity.

The statutory net income, equity and the contingency reserve liability of the insurance subsidiaries (excluding the non-insurance companies) are as follows:

Year Ended December 31,	Net Income	Equity	Contingency Reserve
	(In thousands of dollars)		
1997	$ 144,963	$ 394,274	$ 1,625,810
1996	67,094	274,118	1,317,438
1995	38,975	229,305	1,030,232

The differences between the statutory net income and equity presented above for the insurance subsidiaries and the consolidated net income and equity presented on a GAAP basis primarily represent the differences between GAAP and statutory accounting practices.

The Company has two stock option plans which permit certain officers and employees to purchase common stock at specified prices. A summary of activity in the stock option plans during 1995, 1996 and 1997 is as follows:

	Average Exercise Price	Shares Subject to Option
Outstanding, December 31, 1994	$ 8.50	3,739,200
Granted	18.08	66,666
Exercised	4.49	(450,780)
Canceled	15.31	(42,520)
Outstanding, December 31, 1995	9.15	3,312,566
Granted	30.57	61,334
Exercised	4.80	(636,654)
Canceled	15.41	(132,620)
Outstanding, December 31, 1996	10.40	2,604,626
Granted	37.04	1,592,000
Exercised	9.08	(532,332)
Canceled	31.19	(29,420)
Outstanding, December 31, 1997	$ 22.09	3,634,874

The exercise price of the options granted in 1996 and 1997 was equal to the market value of the stock on the date of grant. The options are exercisable between one and ten years after the date of grant. At December 31, 1997, 3,722,757 shares were available for future grant under the stock option plans.

The Company adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation ("SFAS 123"). Had compensation cost for the Company's stock option plans been determined based on the fair value method described by SFAS 123, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below (in thousands, except per share data):

	Year Ended December 31, 1997	1996	1995
Net income	$ 320,416	$ 257,807	$ 207,483
Earnings per share:			
Basic	$ 2.75	$ 2.19	$ 1.77
Diluted	$ 2.72	$ 2.17	$ 1.75

The fair value of these options was estimated at grant date using the Black-Scholes option pricing model with the following weighted-average assumptions for each year:

	Year Ended December 31, 1997	1996	1995
Risk free interest rate	6.44%	6.73%	6.73%
Expected life	6.88 years	5.63 years	5.63 years
Expected volatility	28.07%	28.60%	28.60%
Expected dividend yield	0.16%	0.21%	0.21%

The following is a summary of stock options outstanding at December 31, 1997:

	Options Outstanding			Options Exercisable	
Exercise Price Range	Shares	Remaining Average Life (yrs.)	Average Exercise Price	Shares	Average Exercise Price
$2.50 - $3.45	842,200	2.8	$ 3.28	842,200	$ 3.28
$9.63 - $20.88	1,163,540	5.8	15.10	686,854	14.68
$26.69 - $36.44	1,589,134	9.0	36.22	11,022	30.30
$60.25	40,000	10.0	60.25	–	–
Total	3,634,874	6.6	$ 22.09	1,540,076	$ 8.56

At December 31, 1996 and 1995, option shares of 1,683,700 and 1,674,744 were exercisable at an average exercise price of $7.12 and $5.21, respectively. The Company also granted an immaterial amount of equity instruments other than options during 1996 and 1997.

On June 2, 1997 the Company effected a two-for-one stock split of the Company's common stock in the form of a 100% stock dividend.

Per share and certain equity amounts set forth in the accompanying financial statements and notes have been adjusted to take into account the stock split.

11. Leases

The Company leases certain office space as well as data processing equipment and autos under operating leases that expire during the next five years. Generally, all rental payments are fixed.

Total rental expense under operating leases was $5.3 million, $5.1 million and $4.5 million in 1997, 1996 and 1995, respectively.

At December 31, 1997, minimum future operating lease payments are as follows (in thousands of dollars):

1998	$ 4,324
1999	3,153
2000	1,714
2001	872
2002	309
Total	$ 10,372

12. Contingencies

The Company is involved in litigation in the ordinary course of business. In the opinion of management, the ultimate disposition of the pending litigation will not have a material adverse effect on the financial position of the Company.

MGIC is a defendant in a lawsuit commenced by a borrower challenging the necessity of maintaining mortgage insurance in certain circumstances, primarily when the loan-to-value ratio is below 80%. The lawsuit purports to be brought on behalf of a class of borrowers. This case appears to be based to some degree upon guidelines issued by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association to their respective mortgage servicers under which the mortgage servicers may be required in certain circumstances to cancel borrower-purchased insurance upon the borrower's request. The plaintiff alleges that MGIC has a common law duty to inform a borrower that the insurance may be canceled in these circumstances. The relief sought is equitable relief as well as the return of premiums paid after the insurance was cancelable under the applicable guidelines. The Company believes that MGIC has a meritorious defense to this action in that, in the absence of a specific statute (no statutory duty other than under a general consumer fraud statute is alleged), there appears to be no legal authority requiring a mortgage insurer to inform a borrower that insurance may be canceled. Summary judgment was granted to MGIC in another case involving similar issues. Similar cases are pending against other mortgage insurers, mortgage lenders and mortgage loan servicers.

See note 9 for a description of federal income tax contingencies.

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Curt S. Culver

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J. Michael Lauer

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Jeffrey H. Lane
General Counsel and Secretary

Russell E. Van Hooser

Vice Presidents
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Treasurer

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Report of Independent Accountants

To the Board of Directors & Shareholders of
MGIC Investment Corporation

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of operations, of shareholders' equity and of cash flows present fairly, in all material respects, the financial position of MGIC Investment Corporation and Subsidiaries (the "Company") at December 31, 1997 and 1996, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1997, in conformity with generally accepted accounting principles. 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 of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit 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 the opinion expressed above.

Price Waterhouse LLP

Milwaukee, Wisconsin
January 7, 1998

Unaudited quarterly financial data

1997	Quarter First	Second	Third	Fourth	1997 Year
	(In thousands of dollars, except per share data)				
Net premiums written	$ 155,606	$ 170,916	$ 184,003	$ 179,723	$ 690,248
Net premiums earned	170,292	173,479	180,542	184,431	708,744
Investment income, net of expenses	29,508	30,372	31,548	32,174	123,602
Losses incurred, net	63,194	58,251	60,785	60,132	242,362
Underwriting and other expenses	38,213	37,920	39,907	41,154	157,194
Net income	72,436	80,615	84,175	86,524	323,750
Earnings per share (a), (b):					
Basic	.61	.68	.73	.76	2.78
Diluted	.61	.67	.72	.75	2.75

1996	Quarter First	Second	Third	Fourth	1996 Year
	(In thousands of dollars, except per share data)				
Net premiums written	$ 123,528	$ 141,584	$ 158,532	$ 165,283	$ 588,927
Net premiums earned	144,640	150,727	156,779	164,897	617,043
Investment income, net of expenses	24,261	25,191	26,926	28,977	105,355
Losses incurred, net	56,837	56,889	60,247	60,377	234,350
Underwriting and other expenses	35,704	37,626	36,401	36,752	146,483
Net income	58,460	62,650	65,785	71,096	257,991
Earnings per share (a), (b):					
Basic	.50	.53	.56	.60	2.19
Diluted	.49	.53	.55	.60	2.17

(a) Due to the use of weighted-average shares outstanding when calculating earnings per share, the sum of the quarterly per share data may not equal the per share data for the year.

(b) Amounts have been restated to reflect the provisions of SFAS 128.