

FORM 10-Q

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

(Mark One)

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

For the quarterly period ended September 30, 2004

OR

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

For the transition period from _____ to _____.

Commission file number 0-15341

Donegal Group Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

23-2424711

(I.R.S. Employer
Identification No.)

1195 River Road, P.O. Box 302, Marietta, PA 17547-0302

(Address of principal executive offices) (Zip code)

(717) 426-1931

(Registrant's telephone number, including area code)

Not applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes . No .

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes . No .

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 10,160,174 shares of Class A Common Stock, par value \$0.01 per share, and 3,101,346 shares of Class B Common Stock, par value \$0.01 per share, outstanding on October 28, 2004.

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STATEMENT OF CHIEF FINANCIAL OFFICER PURSUANT TO 18 U.S.C SECTION 1350 OF TITLE 18 OF THE UNITED STATES CODE

Part I. Financial Information**Item 1. Financial Statements.****Donegal Group Inc. and Subsidiaries****Consolidated Balance Sheets**

	September 30, 2004	December 31, 2003
	(Unaudited)	
Assets		
Investments		
Fixed maturities		
Held to maturity, at amortized cost	\$184,315,417	\$113,050,784
Available for sale, at market value	231,412,674	198,433,337
Equity securities, available for sale, at market	44,591,359	31,448,221
Short-term investments, at cost, which approximates market	33,282,316	78,344,125
Total investments	493,601,766	421,276,467
Cash	6,472,502	5,908,521
Accrued investment income	4,787,013	3,752,075
Premiums receivable	43,747,378	29,016,940
Reinsurance receivable	95,687,436	81,009,106
Deferred policy acquisition costs	21,648,892	16,223,765
Deferred federal income taxes	11,133,603	7,032,409
Prepaid reinsurance premiums	38,850,221	30,691,654
Property and equipment, net	5,558,809	4,151,671
Accounts receivable - securities	738,583	1,524,384
Due from affiliate	2,085,587	—
Federal income taxes recoverable	2,023,403	—
Other	2,249,074	1,449,050
Total assets	<u>\$728,584,267</u>	<u>\$602,036,042</u>
Liabilities and Stockholders' Equity		
Liabilities		
Losses and loss expenses	\$265,820,687	\$217,914,057
Unearned premiums	177,070,961	134,028,035
Accrued expenses	11,383,793	7,769,879
Reinsurance balances payable	2,584,722	1,355,796
Federal income taxes payable	—	315,808
Cash dividend declared to stockholders	—	1,378,993
Subordinated debentures	30,929,000	25,774,000
Accounts payable - securities	87,000	2,438,784
Due to affiliate	—	904,452
Drafts payable	1,943,243	—
Other	3,185,545	1,507,006
Total liabilities	<u>493,004,951</u>	<u>393,386,810</u>
Stockholders' Equity		
Preferred stock, \$1.00 par value, authorized 2,000,000 shares; none issued	—	—
Class A common stock, \$.01 par value, authorized 30,000,000 shares, issued 10,226,046 and 9,880,506 shares and outstanding 10,144,522 and 9,798,982 shares	102,260	98,805
Class B common stock, \$.01 par value, authorized 10,000,000 shares, issued 3,141,442 and 3,051,811 shares and outstanding 3,100,680 and 3,011,049 shares	31,415	30,518
Additional paid-in capital	129,165,510	122,744,905
Accumulated other comprehensive income	4,553,312	5,290,923
Retained earnings	102,618,567	81,375,829
Treasury stock	(891,748)	(891,748)
Total stockholders' equity	<u>235,579,316</u>	<u>208,649,232</u>
Total liabilities and stockholders' equity	<u>\$728,584,267</u>	<u>\$602,036,042</u>

See accompanying notes to consolidated financial statements.

Donegal Group Inc. and Subsidiaries**Consolidated Statements of Income**
(Unaudited)

	Nine Months Ended September 30,	
	2004	2003
Revenues:		
Net premiums earned	\$196,156,262	\$146,082,154
Investment income, net of investment expenses	11,640,506	10,006,831
Realized investment gains	1,092,365	494,763
Lease income	662,958	628,749
Service charge income	2,755,645	1,879,643
Other income	—	205,850
Total revenues	<u>212,307,736</u>	<u>159,297,990</u>
Expenses:		
Net losses and loss expenses	122,617,533	94,268,337
Amortization of deferred policy acquisition costs	28,248,000	22,861,000
Other underwriting expenses	31,098,310	21,531,514
Policy dividends	865,756	711,160
Interest	1,114,225	879,496
Other expenses	1,463,149	985,478
Total expenses	<u>185,406,973</u>	<u>141,236,985</u>
Income before income taxes and extraordinary item	26,900,763	18,061,005
Income taxes	7,957,054	4,946,235
Income before extraordinary item	\$ 18,943,709	\$ 13,114,770
Extraordinary gain - unallocated negative goodwill	5,445,670	—
Net income	<u>\$ 24,389,379</u>	<u>\$ 13,114,770</u>
Basic earnings per common share:		
Income before extraordinary item	\$ 1.45	\$ 1.42
Extraordinary item	0.41	—
Net income	<u>\$ 1.86</u>	<u>\$ 1.42</u>
Diluted earnings per common share:		
Income before extraordinary item	\$ 1.39	\$ 1.37
Extraordinary item	0.40	—
Net income	<u>\$ 1.79</u>	<u>\$ 1.37</u>

Consolidated Statements of Comprehensive Income
(Unaudited)

	Nine Months Ended September 30,	
	2004	2003
Net income	\$24,389,379	\$13,114,770
Other comprehensive income (loss), net of tax		
Unrealized gains (losses) on securities:		
Unrealized holding gain (loss) during the period, net of income tax	(27,574)	737,904
Reclassification adjustment, net of income tax	(710,037)	(321,596)
Other comprehensive income (loss)	(737,611)	416,308
Comprehensive income	<u>\$23,651,768</u>	<u>\$13,531,078</u>

See accompanying notes to consolidated financial statements.

Donegal Group Inc. and Subsidiaries
Consolidated Statements of Income
(Unaudited)

	Three Months Ended September 30,	
	2004	2003
Revenues:		
Net premiums earned	\$67,958,382	\$49,719,584
Investment income, net of investment expenses	4,017,915	3,326,603
Realized investment gains	448,367	408,873
Lease income	223,715	215,017
Service charge income	965,274	615,676
Total revenues	73,613,653	54,285,753
Expenses:		
Net losses and loss expenses	42,285,455	32,759,356
Amortization of deferred policy acquisition costs	9,961,000	7,874,000
Other underwriting expenses	11,941,415	7,239,091
Policy dividends	403,990	242,003
Interest	416,799	357,965
Other expenses	382,066	310,250
Total expenses	65,390,725	48,782,665
Income before income taxes	8,222,928	5,503,088
Income taxes	2,336,042	1,501,703
Net income	\$ 5,886,886	\$ 4,001,385
Net income per common share:		
Basic	\$ 0.44	\$ 0.43
Diluted	\$ 0.43	\$ 0.40

Consolidated Statements of Comprehensive Income
(Unaudited)

	Three Months Ended September 30,	
	2004	2003
Net income	\$5,886,886	\$4,001,385
Other comprehensive income (loss), net of tax		
Unrealized gains (losses) on securities:		
Unrealized holding gain (loss) during the period, net of income tax	3,408,235	(727,636)
Reclassification adjustment, net of income tax	(291,438)	(265,767)
Other comprehensive income (loss)	3,116,797	(993,403)
Comprehensive income	\$9,003,683	\$3,007,982

See accompanying notes to consolidated financial statements.

Donegal Group Inc. and Subsidiaries
Consolidated Statement of Stockholders' Equity
(Unaudited)
Nine Months Ended September 30, 2004

	Class A Shares	Class B Shares	Class A Amount	Class B Amount	Additional Paid-In Capital
Balance, December 31, 2003	9,880,506	3,051,811	\$ 98,805	\$30,518	\$122,744,905
Issuance of common stock	34,418	282	344	3	584,910
Net income					
Cash dividends					
Exercise of stock options	311,122	89,349	3,111	894	4,359,783
Grant of stock options					87,259
Tax benefit on exercise of stock options					1,388,653
Other comprehensive loss					
Balance, September 30, 2004	<u>10,226,046</u>	<u>3,141,442</u>	<u>\$102,260</u>	<u>\$31,415</u>	<u>\$129,165,510</u>

[Additional columns below]

[Continued from above table, first column(s) repeated]

	Accumulated Other Comprehensive Income	Retained Earnings	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2003	\$5,290,923	\$ 81,375,829	\$(891,748)	\$208,649,232
Issuance of common stock				585,257
Net income		24,389,379		24,389,379
Cash dividends		(3,059,382)		(3,059,382)
Exercise of stock options				4,363,788
Grant of stock options		(87,259)		—
Tax benefit on exercise of stock options				1,388,653
Other comprehensive loss	(737,611)			(737,611)
Balance, September 30, 2004	<u>\$4,553,312</u>	<u>\$102,618,567</u>	<u>\$(891,748)</u>	<u>\$235,579,316</u>

See accompanying notes to consolidated financial statements.

Donegal Group Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(Unaudited)

	Nine Months Ended September 30,	
	2004	2003
Cash Flows from Operating Activities:		
Net income	\$ 24,389,379	\$ 13,114,770
Adjustments to reconcile net income to net cash provided by operating activities:		
Extraordinary gain - unallocated negative goodwill	(5,445,670)	—
Depreciation and amortization	2,003,924	1,177,226
Realized investment gains	(1,092,365)	(494,763)
Changes in assets and liabilities:		
Losses and loss expenses	11,984,053	5,960,981
Unearned premiums	22,614,676	14,526,926
Premiums receivable	(6,118,778)	(2,331,847)
Deferred acquisition costs	(5,425,127)	(1,656,205)
Deferred income taxes	(510,529)	(442,847)
Reinsurance receivable	(6,610,893)	431,047
Prepaid reinsurance premiums	(5,501,049)	(4,075,616)
Accrued investment income	(329,011)	262,974
Due from affiliate	(2,990,039)	(1,626,759)
Reinsurance balances payable	291,639	295,114
Current income taxes	(1,224,558)	(1,224,773)
Accrued expenses	376,815	84,523
Drafts payable	(587,683)	—
Other, net	1,805,237	(240,744)
Net adjustments	3,240,642	10,645,237
Net cash provided by operating activities	<u>27,630,021</u>	<u>23,760,007</u>
Cash Flows from Investing Activities:		
Purchase of fixed maturities:		
Held to maturity	(63,631,534)	(47,007,788)
Available for sale	(70,851,891)	(65,381,246)
Purchase of equity securities, available for sale	(22,502,224)	(12,217,011)
Maturity of fixed maturities:		
Held to maturity	18,592,705	18,692,360
Available for sale	46,319,357	67,426,694
Sale of fixed maturities:		
Available for sale	27,813,196	13,819,634
Sale of equity securities, available for sale	11,491,629	9,882,789
Purchase of Le Mars Insurance Company	(11,816,523)	—
Purchase of Peninsula Insurance Group	(21,912,629)	—
Net purchases of property and equipment	(579,325)	(254,418)
Net sales (purchases) of short-term investments	54,345,529	(11,690,409)
Net cash used in investing activities	<u>(32,731,710)</u>	<u>(26,729,395)</u>
Cash Flows from Financing Activities:		
Cash dividends paid	(4,438,375)	(2,870,447)
Issuance of common stock	4,949,045	1,668,647
Issuance of subordinated debentures	5,155,000	15,000,000
Line of credit, net	—	(7,000,000)
Net cash provided by financing activities	<u>5,665,670</u>	<u>6,798,200</u>
Net increase in cash	563,981	3,828,812
Cash at beginning of period	5,908,521	1,124,604
Cash at end of period	<u>\$ 6,472,502</u>	<u>\$ 4,953,416</u>
Cash paid during period - Interest	\$ 1,079,979	\$ 705,515
Net cash paid during period - Taxes	\$ 9,405,000	\$ 6,430,000

See accompanying notes to consolidated financial statements.

DONEGAL GROUP INC. AND SUBSIDIARIES
(Unaudited)
Summary Notes to Consolidated Financial Statements

1 - Organization

We were organized as a regional insurance holding company by Donegal Mutual Insurance Company (the "Mutual Company") on August 26, 1986. We operate predominantly as an underwriter of personal and commercial lines of property and casualty insurance through our subsidiaries. Our personal lines products consist primarily of homeowners and private passenger automobile insurance policies. Our commercial lines products consist primarily of commercial automobile, commercial multiple peril and workers' compensation insurance policies. We distribute our products exclusively through a network of independent insurance agents in the Mid-Atlantic, Midwest and Southeast. Our wholly owned insurance subsidiaries are Atlantic States Insurance Company ("Atlantic States"), Southern Insurance Company of Virginia ("Southern"), and, since January 1, 2004, Le Mars Insurance Company ("Le Mars") and the Peninsula Insurance Group ("Peninsula"), which consists of Peninsula Indemnity Company and The Peninsula Insurance Company. We also own approximately 48% of the outstanding stock of Donegal Financial Services Corporation ("DFSC"), a thrift holding company. The Mutual Company owns the remaining approximately 52% of the outstanding stock of DFSC.

At September 30, 2004, the Mutual Company held approximately 41% of our outstanding Class A common stock and approximately 64% of our outstanding Class B common stock. We refer to the Mutual Company and our insurance subsidiaries as the Donegal Insurance Group.

Atlantic States, our largest subsidiary, and the Mutual Company have a pooling agreement under which both companies are allocated a given percentage of their combined underwriting results, excluding certain reinsurance assumed by the Mutual Company from our insurance subsidiaries. Atlantic States has a 70% share of the results of the pool, and the Mutual Company has a 30% share of the results of the pool.

In addition to the pooling agreement and third-party reinsurance, Atlantic States, Southern and Le Mars have various reinsurance arrangements with the Mutual Company. These agreements include:

- catastrophe reinsurance agreements with Atlantic States, Southern and Le Mars;
- an excess of loss reinsurance agreement with Southern;
- a workers' compensation reallocation agreement with Southern; and
- 100% retrocessional agreements with Southern and Le Mars.

The retrocessional agreements are intended to ensure that Southern and Le Mars receive the same A.M. Best rating, currently A (Excellent), as the Mutual Company. The retrocessional agreements do not otherwise provide for pooling or reinsurance with or by the Mutual Company and do not transfer insurance risk.

In June 2002, the Mutual Company consummated an affiliation with Le Mars. As part of the affiliation, the Mutual Company entered into a management agreement with and made a \$4.0 million surplus note investment in Le Mars. During 2003, Le Mars' board of directors adopted a plan of conversion to convert to a stock insurance company. Following policyholder and regulatory approval of the plan of conversion, we acquired all of the outstanding stock of Le Mars as of January 1, 2004 for approximately \$12.9 million in cash, including payment of the principal amount of the surplus note (\$4.0 million) and accrued interest (\$392,740) to the Mutual Company. The operating results of Le Mars have been included in our consolidated financial statements since January 1, 2004.

The acquisition of Le Mars enables us to conduct our insurance business in four Midwest states. Le Mars, which was organized under the laws of Iowa in 1901, operates as a property and casualty insurer in Iowa, Nebraska, Oklahoma and South Dakota. Personal lines coverages represent a majority of Le Mars' premiums written, with the balance coming from farmowners and mercantile and service businesses. Le

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Mars' largest lines of business are private passenger automobile liability and physical damage; its other principal lines are homeowners and commercial multiple peril. Le Mars had net premiums earned of \$20.5 million in 2002 and \$17.9 million in 2003. Le Mars' surplus and total admitted assets on a statutory basis as of December 31, 2003 were \$12.0 million and \$37.0 million, respectively. The purchase price of Le Mars was based upon an independent valuation as of July 31, 2003. In applying GAAP purchase accounting standards as of January 1, 2004, we recognized an extraordinary gain in the amount of \$5.4 million related to unallocated negative goodwill resulting from this acquisition. A substantial portion of this unallocated negative goodwill was generated by the recognition of anticipated federal income tax benefits that we expect to realize over the allowable twenty-year carryover period by offsetting the net operating loss carryover obtained as part of the acquisition of Le Mars against taxable income generated by our other consolidated affiliates. We have determined that a valuation allowance is required for a portion of the acquired net operating loss carryover, because federal tax laws limit the amount of such carryover that can be utilized. Other factors that generated negative goodwill included favorable operating results and increases in the market values of invested assets in the period between the valuation date and the acquisition date.

As of January 1, 2004, we purchased all of the outstanding stock of Peninsula Indemnity Company and The Peninsula Insurance Company, both of which are organized under Maryland law, with headquarters in Salisbury, Maryland, from Folksamerica Holding Company, Inc. ("Folksamerica"), a part of the White Mountains Insurance Group, Ltd., for a price in cash equal to 107.5% of Peninsula's GAAP stockholders' equity as of the closing of the acquisition, or approximately \$23.4 million. The operating results of Peninsula have been included in our consolidated financial statements since January 1, 2004.

Peninsula expands our presence in existing markets, operating primarily in Maryland, Delaware and Virginia. Peninsula specializes in private passenger automobile coverages and also writes homeowners, commercial multiple peril, workers' compensation and commercial automobile coverages. For the years ended December 31, 2002 and 2003, Peninsula had net premiums earned of \$29.7 million and \$32.7 million, respectively. Peninsula's surplus and total admitted assets on a statutory basis as of December 31, 2003 were \$19.5 million and \$52.6 million, respectively. We recorded goodwill of \$374,968 related to this acquisition, none of which is expected to be deductible for federal income tax purposes. Pursuant to the terms of the purchase agreement with Folksamerica, Folksamerica has guaranteed us against any deficiency in excess of \$1.5 million in the loss and loss expense reserves of Peninsula as of January 1, 2004. Any such deficiency will be based on a final actuarial review of the development of such reserves to be conducted four years after January 1, 2004. The maximum obligation of Folksamerica to us under this guarantee is \$4.0 million.

The following table presents financial information related to the results of operations of Le Mars and Peninsula for the three and nine months ended September 30, 2004. Prior to our acquisition of Le Mars and Peninsula, their quarterly financial statements were prepared in accordance with statutory accounting practices (SAP). Therefore, financial information prepared in accordance with generally accepted accounting principles (GAAP) necessary to prepare supplemental pro forma information was unavailable for the three and nine months ended September 30, 2003.

	Three Months Ended September 30, 2004		Nine Months Ended September 30, 2004	
	Le Mars	Peninsula	Le Mars	Peninsula
	(\$ in thousands, except per share data)			
Total revenues	\$4,872	\$9,262	\$13,258	\$26,177
Income before extraordinary item	1,047	1,106	2,214	3,035
Net income	1,047	1,106	2,214	3,035
Basic earnings per share	0.08	0.08	0.17	0.23
Diluted earnings per share	0.08	0.08	0.16	0.22

2 - Basis of Presentation

The financial information for the interim periods included herein is unaudited; however, such information reflects all adjustments, consisting only of normal recurring adjustments, that, in the opinion of

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management, are necessary for a fair presentation of our financial position, results of operations and cash flows for the interim periods included herein. Our results of operations for the three and nine months ended September 30, 2004 are not necessarily indicative of our results of operations to be expected for the twelve months ending December 31, 2004.

These interim financial statements should be read in conjunction with the financial statements and notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2003.

3 - Earnings Per Share

The computation of basic and diluted earnings per share is as follows:

	Basic	Effect of Stock Options	Diluted
Three Months Ended September 30:			
2004			
Net income	\$ 5,886,886	\$ —	\$ 5,886,886
Weighted average shares outstanding	13,230,009	424,772	13,654,781
Earnings per common share:			
Net income	\$ 0.44	\$ (0.01)	\$ 0.43
2003			
Net income	\$ 4,001,385	\$ —	\$ 4,001,385
Weighted average shares outstanding	9,315,339	590,153	9,905,492
Earnings per common share:			
Net income	\$ 0.43	\$ (0.03)	\$ 0.40
Nine Months Ended September 30:			
2004			
Income before extraordinary item	\$18,943,709	\$ —	\$18,943,709
Extraordinary item	5,445,670	—	5,445,670
Net income	\$24,389,379	\$ —	\$24,389,379
Weighted average shares outstanding	13,086,199	509,149	13,595,348
Earnings per common share:			
Income before extraordinary item	\$ 1.45	\$ (0.06)	\$ 1.39
Extraordinary item	0.41	(0.01)	0.40
Net income	\$ 1.86	\$ (0.07)	\$ 1.79
2003			
Income before extraordinary item	\$13,114,770	\$ —	\$13,114,770
Extraordinary item	—	—	—
Net income	\$13,114,770	\$ —	\$13,114,770
Weighted average shares outstanding	9,265,308	325,501	9,590,809
Earnings per common share:			
Income before extraordinary item	\$ 1.42	\$ (0.05)	\$ 1.37
Extraordinary item	—	—	—
Net income	\$ 1.42	\$ (0.05)	\$ 1.37

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The following options to purchase shares of Class A common stock were not included in the computation of diluted earnings per share because the exercise price of the options was greater than the average market price during the relevant period:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Number of shares	22,000	5,000	22,000	5,000
Number of shares	<u>22,000</u>	<u>5,000</u>	<u>22,000</u>	<u>5,000</u>

4 - Segment Information

We evaluate the performance of our personal lines and commercial lines segments based upon underwriting results as determined under SAP, which is used by management to measure performance for our total business. Financial data by segment is as follows:

	Three Months Ended September 30,	
	2004	2003
	(\$ in thousands)	
Revenues:		
Premiums earned:		
Commercial lines	\$25,564	\$18,024
Personal lines	42,742	31,695
Net SAP premiums earned	68,306	49,719
GAAP adjustments	(348)	—
Net GAAP premiums earned	67,958	49,719
Net investment income	4,018	3,327
Realized investment gains	448	409
Other	1,190	831
Total revenues	<u>\$73,614</u>	<u>\$54,286</u>
Income before income taxes:		
Underwriting income:		
Commercial lines	\$ 2,917	\$ 1,967
Personal lines	(75)	(985)
SAP underwriting income	2,842	982
GAAP adjustments	525	623
GAAP underwriting income	3,367	1,605
Net investment income	4,018	3,327
Realized investment gains	448	409
Other	390	162
Income before income taxes	<u>\$ 8,223</u>	<u>\$ 5,503</u>

	Nine Months Ended September 30,	
	2004	2003
	(\$ in thousands)	
Revenues:		
Premiums earned:		
Commercial lines	\$ 73,026	\$ 52,667
Personal lines	126,190	93,415
Net SAP premiums earned	199,216	146,082
GAAP adjustments	(3,060)	—
Net GAAP premiums earned	196,156	146,082
Net investment income	11,641	10,007
Realized investment gains	1,092	495
Other	3,419	2,714
Total revenues	<u>\$212,308</u>	<u>\$159,298</u>

	Nine Months Ended September 30,	
	2004	2003
(\$ in thousands)		
Income before income taxes and extraordinary item:		
Underwriting income:		
Commercial lines	\$ 8,010	\$ 6,222
Personal lines	2,959	(794)
SAP underwriting income	10,969	5,428
GAAP adjustments	2,358	1,282
GAAP underwriting income	13,327	6,710
Net investment income	11,641	10,007
Realized investment gains	1,092	495
Other	841	849
Income before income taxes and extraordinary item	<u>\$26,901</u>	<u>\$18,061</u>

5- Subordinated Debentures

On May 15, 2003, we received \$15.0 million in net proceeds from the issuance of subordinated debentures. The debentures mature on May 15, 2033 and are callable at our option, at par, after five years. The debentures carry an interest rate equal to the three-month LIBOR rate plus 4.10%, which is adjustable quarterly. At September 30, 2004, the interest rate on the debentures was 5.81%.

On October 29, 2003, we received \$10.0 million in net proceeds from the issuance of subordinated debentures. The debentures mature on October 29, 2033 and are callable at our option, at par, after five years. The debentures carry an interest rate equal to the three-month LIBOR rate plus 3.85%, which is adjustable quarterly. At September 30, 2004, the interest rate on the debentures was 5.52%.

On May 24, 2004, we received \$5.0 million in net proceeds from the issuance of subordinated debentures. The debentures mature on May 24, 2034 and are callable at our option, at par, after five years. The debentures carry an interest rate equal to the three-month LIBOR rate plus 3.85%, which is adjustable quarterly. At September 30, 2004, the interest rate on the debentures was 5.59%.

6- Stock — Based Compensation Plans

We account for stock-based compensation plans under the provisions of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. During 2001, we adopted an Equity Incentive Plan for key employees that made 1,500,000 shares of Class A common stock available. The plan provides for the granting of awards by our board of directors in the form of stock options, stock appreciation rights, restricted stock or any combination of the above. During 2001, we also adopted an Equity Incentive Plan for Directors that made 200,000 shares of Class A common stock available. Awards may be made in the form of stock options, and the plan further provides for the issuance of 175 shares of restricted stock to each director on the first business day of January in each year. No stock-based employee compensation is reflected in income, except for expense associated with restricted stock issued, as all options granted under those plans had an exercise price equal to, or greater than, the market value of the underlying common stock on the date of the grant. The following table illustrates the effect on net income and earnings per share as if we had applied the provisions of Statement of Financial Accounting Standards (SFAS) No. 123 (as amended by SFAS No. 148), "Accounting for Stock-Based Compensation."

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
(\$ in thousands, except per share data)				
Net income, as reported	\$5,887	\$4,001	\$24,389	\$13,115
Less:				
Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(92)	(127)	(305)	(231)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
	(\$ in thousands, except per share data)			
Pro forma net income	\$5,795	\$3,874	\$24,084	\$12,884
Basic earnings per share:				
As reported	\$ 0.44	\$ 0.43	\$ 1.86	\$ 1.42
Pro forma	\$ 0.44	\$ 0.42	\$ 1.84	\$ 1.39
Diluted earnings per share:				
As reported	\$ 0.43	\$ 0.40	\$ 1.79	\$ 1.37
Pro forma	\$ 0.42	\$ 0.39	\$ 1.77	\$ 1.34

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Results of Operations - Three Months Ended September 30, 2004 Compared to Three Months Ended September 30, 2003

Net Premiums Written. Net premiums written for the three months ended September 30, 2004 were \$71.1 million, an increase of \$18.1 million, or 34.1%, over the comparable period in 2003. The acquisition of Le Mars and Peninsula as of January 1, 2004 accounted for approximately \$14.1 million of net premiums written in the third quarter of 2004, or approximately 77.9% of the increase from the comparable period in 2003. Commercial lines net premiums written increased \$6.4 million, or 35.2%, in the third quarter of 2004 compared to the comparable period in 2003. Personal lines net premiums written increased \$11.6 million, or 33.5%, in the third quarter of 2004 compared to the comparable period in 2003. We have also benefited during these periods from premium increases by our insurance subsidiaries that have resulted from rate filings approved by insurance regulatory authorities. These increases related primarily to private passenger automobile, commercial multiple peril, workers' compensation and homeowners lines of business realized in most of the states in which we operate. In addition to the acquisitions and pricing increases, we have also benefited from organic growth in most of the states in which we operate.

Net Premiums Earned. Net premiums earned increased to \$68.0 million for the third quarter of 2004, an increase of \$18.2 million, or 36.7%, over the third quarter of 2003. Premiums are earned, or recognized as revenue, over the terms of our policies, which are one year or less in duration. Therefore, increases or decreases in net premiums earned will generally reflect increases or decreases in net premiums written in the preceding twelve-month period compared to the comparable period one year earlier. Earned premiums have grown during the 2004 period due to the acquisition of Le Mars and Peninsula as well as due to the increase in written premiums in the past year. Net premiums earned and amortization of deferred policy acquisition costs decreased \$347,662 during the third quarter of 2004 because of the application of purchase accounting methodology in the acquisition of Le Mars and Peninsula. Acquired deferred acquisition costs were netted from unearned premiums as of January 1, 2004. Since these costs were incurred prior to January 1, 2004, they were netted from the associated deferred revenues in estimating the fair value of the unearned premiums assumed in the acquisitions. As a result, the normal amortization of these costs was shown as a reduction of net premiums earned in the three months ended September 30, 2004. The amortization of deferred acquisition costs was correspondingly reduced, so that there was no impact on net income for the period.

Investment Income. For the three months ended September 30, 2004, our net investment income increased 20.8% to \$4.0 million, compared to \$3.3 million for the comparable period one year ago. An increase in average invested assets from \$359.9 million in the third quarter of 2003 to \$487.6 million in the third quarter of 2004 was offset by a decrease in the annualized average return on investments from 3.7% for the third quarter of 2003 to 3.3% for the third quarter of 2004. The decrease in our annualized average return reflects higher levels of short-term investments in our investment portfolio during the third quarter of 2004 compared to the comparable period a year earlier and a declining interest rate environment in both periods.

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Net Realized Investment Gains/Losses. Net realized investment gains in the third quarter of 2004 were \$448,367, compared to \$408,873 for the comparable period in 2003. No impairment charges were recognized in either period. The net realized investment gains and losses in both periods resulted from normal turnover within our investment portfolio.

Losses and Loss Expenses. Our loss ratio, which is the ratio of incurred losses and loss expenses to premiums earned, in the third quarter of 2004 was 62.2%, compared to 65.9% in the third quarter of 2003. The commercial lines loss ratio improved to 56.1% in the third quarter of 2004, compared to 58.9% in the third quarter of 2003 due to favorable experience in our commercial multiple peril line of business. The personal lines loss ratio decreased from 70.3% in the third quarter of 2003 to 66.2% in the third quarter of 2004, primarily due to a decrease in our homeowners loss ratio. Loss ratios in both periods were impacted by severe weather events. Cumulative property losses from severe weather events totaled approximately \$3.2 million for the third quarter of 2004, compared to \$1.0 million for the third quarter of 2003. Our loss ratios were also impacted in the third quarter of 2004 by the reduction in earned premiums during the third quarter of 2004 related to the application of purchase accounting methodology in the acquisition of Le Mars and Peninsula discussed above.

Underwriting Expenses. Our expense ratio, which is the ratio of policy acquisition costs and other underwriting expenses to premiums earned, for the third quarter of 2004 was 32.2%, compared to 30.4% in the third quarter of 2003. The increase in the third quarter of 2004 expense ratio reflects increased underwriting-based incentive costs, offset by a decrease in expenses related to the application of purchase accounting methodology in the acquisition of Le Mars and Peninsula discussed above. The acquired deferred acquisition costs were netted from unearned premiums as of the purchase date and, as a result, the amortization of these costs was shown as a reduction of earned premiums instead of being shown as a component of expenses in the three months ended September 30, 2004.

Combined Ratio. The combined ratio was 95.0% and 96.8% for the three months ended September 30, 2004 and 2003, respectively. The combined ratio represents the sum of the loss ratio, expense ratio and dividend ratio, which is the ratio of workers' compensation policy dividends incurred to premiums earned. The improvement in the combined ratio was largely attributable to the decrease in the loss ratio for the 2004 period compared to the 2003 period.

Interest Expense. Interest expense for the third quarter of 2004 was \$416,799, compared to \$357,965 for the third quarter of 2003, and reflected an increase in interest expense related to the issuance of \$15.5 million of subordinated debentures in October 2003 and May 2004, offset by the fact that no borrowings were outstanding under our line of credit for the 2004 period compared to average borrowings of \$12.8 million for the 2003 period.

Income Taxes. Income tax expense was \$2.3 million for the third quarter of 2004, representing an effective tax rate of 28.4%, compared to \$1.5 million for the third quarter of 2003, representing an effective tax rate of 27.3%. The change in effective tax rates is due to tax-exempt interest income representing a smaller proportion of net income before taxes in the 2004 period compared to the 2003 period.

Net Income and Earnings Per Share. Our net income for the third quarter of 2004 was \$5.9 million, or \$.43 per share on a diluted basis, an increase of 47.1% over the net income of \$4.0 million, or \$.40 per share on a diluted basis, reported for the third quarter of 2003. Cumulative property losses from severe weather events reduced net income by approximately \$2.1 million, or \$.15 per share on a diluted basis, for the third quarter of 2004, compared to \$650,000, or \$.07 per share on a diluted basis, for the third quarter of 2003. Our fully diluted shares outstanding for the third quarter of 2004 increased to 13.7 million, compared to 9.9 million for the third quarter of 2003, due primarily to a public stock offering of 3.45 million shares of Class A common stock that was completed in December 2003.

Results of Operations - Nine Months Ended September 30, 2004 Compared to Nine Months Ended September 30, 2003

Net Premiums Written. Net premiums written for the nine months ended September 30, 2004 were \$213.3 million, an increase of \$56.8 million, or 36.2%, over the comparable period in 2003. The acquisition of Le Mars and Peninsula as of January 1, 2004 accounted for approximately \$43.2 million of net premiums written in 2004, or approximately 76.1% of the increase from the comparable period in 2003. Commercial lines net premiums written increased \$23.2 million, or 40.1%, in the first nine months of 2004 compared to

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the comparable period in 2003. Personal lines net premiums written increased \$33.5 million, or 34.0%, in the first nine months of 2004 compared to the comparable period in 2003. We have also benefited during these periods from premium increases by our insurance subsidiaries that have resulted from rate filings approved by insurance regulatory authorities. These increases related primarily to private passenger automobile, commercial multiple peril, workers' compensation and homeowners lines of business realized in most of the states in which we operate. In addition to the acquisitions and pricing increases, we have also benefited from organic growth in most of the states in which we operate.

Net Premiums Earned. Net premiums earned increased to \$196.2 million for the first nine months of 2004, an increase of \$50.1 million, or 34.3%, over the first nine months of 2003. Premiums are earned, or recognized as revenue, over the terms of our policies, which are one year or less in duration. Therefore, increases or decreases in net premiums earned will generally reflect increases or decreases in net premiums written in the preceding twelve-month period compared to the comparable period one year earlier. Earned premiums have grown during the 2004 period due to the acquisition of Le Mars and Peninsula as well as due to the increase in written premiums in the past year. Net premiums earned and amortization of deferred policy acquisition costs decreased \$3.1 million during the first nine months of 2004 because of the application of purchase accounting methodology in the acquisition of Le Mars and Peninsula. Acquired deferred acquisition costs were netted from unearned premiums as of January 1, 2004. Since these costs were incurred prior to January 1, 2004, they were netted from the associated deferred revenues in estimating the fair value of the unearned premiums assumed in the acquisitions. As a result, the normal amortization of these costs was shown as a reduction of net premiums earned in the first nine months of 2004. The amortization of deferred acquisition costs was correspondingly reduced, so that there was no impact on net income for the nine months ended September 30, 2004.

Investment Income. For the nine months ended September 30, 2004, our net investment income increased 16.3% to \$11.6 million, compared to \$10.0 million for the comparable period one year ago. An increase in average invested assets from \$345.3 million in the first nine months of 2003 to \$457.4 million in the first nine months of 2004 was offset by a decrease in the annualized average return on investments from 3.9% for the first nine months of 2003 to 3.4% for the first nine months of 2004. The decrease in our annualized average return reflects higher levels of short-term investments in our investment portfolio during the first nine months of 2004 compared to the comparable period a year earlier and a declining interest rate environment in both periods.

Net Realized Investment Gains/Losses. Net realized investment gains in the first nine months of 2004 were \$1.1 million, compared to \$494,763 for the comparable period in 2003. Impairment charges of \$6,650 were recognized in the first nine months of 2004, compared to impairment charges of \$255,874 recognized in the first nine months of 2003. The impairment charges for both periods were the result of declines in the market value of equity securities that we determined to be other than temporary. The remaining net realized investment gains and losses in both periods resulted from normal turnover within our investment portfolio.

Losses and Loss Expenses. Our loss ratio, which is the ratio of incurred losses and loss expenses to premiums earned, in the first nine months of 2004 was 62.5%, compared to 64.5% in the first nine months of 2003. The commercial lines loss ratio increased to 56.7% in the first nine months of 2004, compared to 56.2% in the first nine months of 2003. The personal lines loss ratio improved from 69.2% in the first nine months of 2003 to 66.1% in the first nine months of 2004. Increases in our workers' compensation and commercial automobile loss ratios were offset by favorable experience in our commercial multiple peril, personal automobile and homeowners lines of business. Our loss ratios were also impacted in the first nine months of 2004 by the reduction in earned premiums during the first nine months of 2004 related to the application of purchase accounting methodology in the acquisition of Le Mars and Peninsula discussed above.

Underwriting Expenses. Our expense ratio, which is the ratio of policy acquisition costs and other underwriting expenses to premiums earned, for the first nine months of 2004 was 30.3%, compared to 30.4% for the first nine months of 2003. The improvement in our expense ratio reflects a decrease in expenses during the first nine months of 2004 related to the application of purchase accounting methodology in the acquisition of Le Mars and Peninsula discussed above, offset by increased underwriting-based incentive costs. The acquired deferred acquisition costs were netted from unearned premiums as of January 1, 2004 and, as a result, the amortization of these costs was shown as a reduction of earned premiums instead of being shown as a component of expenses in the first nine months of 2004.

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Combined Ratio. The combined ratio was 93.2% and 95.4% for the nine months ended September 30, 2004 and 2003, respectively. The combined ratio represents the sum of the loss ratio, expense ratio and dividend ratio, which is the ratio of workers' compensation policy dividends incurred to premiums earned. The improvement in the combined ratio was largely attributable to the decrease in the loss ratio for the 2004 period compared to the 2003 period.

Interest Expense. Interest expense for the first nine months of 2004 was \$1.1 million, compared to \$879,496 for the first nine months of 2003, and reflected an increase in interest expense related to the additional issuance of \$15.5 million of subordinated debentures in October 2003 and May 2004, offset by the fact that no borrowings were outstanding under our line of credit for the 2004 period compared to average borrowings of \$17.1 million for the 2003 period.

Income Taxes. Income tax expense was \$8.0 million for the first nine months of 2004, representing an effective tax rate of 29.6%, compared to \$4.9 million for the first nine months of 2003, representing an effective tax rate of 27.4%. The change in effective tax rates is due to tax-exempt interest income representing a smaller proportion of net income before taxes in the 2004 period compared to the 2003 period.

Net Income and Earnings Per Share. Our net income for the first nine months of 2004 was \$24.4 million, or \$1.79 per share on a diluted basis. The first nine months of 2004 net income included an extraordinary gain of \$5.4 million related to unallocated negative goodwill associated with the Le Mars acquisition. Income before this extraordinary item was \$18.9 million, or \$1.39 per share on a diluted basis, an increase of 44.4% over the net income of \$13.1 million, or \$1.37 per share on a diluted basis, reported for the first nine months of 2003. Our fully diluted shares outstanding for the first nine months of 2004 increased to 13.6 million, compared to 9.6 million for the first nine months of 2003, due primarily to a public stock offering of 3.45 million shares of Class A common stock that was completed in December 2003.

Liquidity and Capital Resources

Liquidity is a measure of an entity's ability to secure enough cash to meet its contractual obligations and operating needs as they arise. Our major sources of funds from operations are the net cash flows generated from our insurance subsidiaries' underwriting results, investment income and maturing investments.

We generate sufficient net positive cash flow from our operations to fund our commitments and build our investment portfolio, thereby increasing future investment returns. We maintain a high degree of liquidity in our investment portfolio in the form of readily marketable fixed maturities, equity securities and short-term investments. Net cash flows provided by operating activities in the first nine months of 2004 and 2003 were \$27.6 million and \$23.8 million, respectively.

On May 15, 2003, we received \$15.0 million in net proceeds from the issuance of subordinated debentures. The debentures mature on May 15, 2033 and are callable at our option, at par, after five years. The debentures carry an interest rate equal to the three-month LIBOR rate plus 4.10%, which is adjustable quarterly. At September 30, 2004, the interest rate on the debentures was 5.81%.

On October 29, 2003, we received \$10.0 million in net proceeds from the issuance of subordinated debentures. The debentures mature on October 29, 2033 and are callable at our option, at par, after five years. The debentures carry an interest rate equal to the three-month LIBOR rate plus 3.85%, which is adjustable quarterly. At September 30, 2004, the interest rate on the debentures was 5.52%.

On November 25, 2003, we entered into a credit agreement with Manufacturers and Traders Trust Company ("M&T") relating to a four-year \$35.0 million unsecured, revolving line of credit. As of September 30, 2004, we may borrow up to \$35.0 million at interest rates equal to M&T's current prime rate or the then current LIBOR rate plus between 1.50% and 1.75%, depending on our leverage ratio. In addition, we pay a fee of 0.15% per annum on the loan commitment amount, regardless of usage. The agreement requires our compliance with certain covenants, which include minimum levels of our net worth, leverage ratio and statutory surplus and A.M. Best ratings of our insurance subsidiaries. As of September 30, 2004, there were no borrowings outstanding under the credit agreement, and we were in compliance with all requirements of the credit agreement.

On May 26, 2004, we received \$5.0 million in net proceeds from the issuance of subordinated

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debentures. The debentures mature on May 26, 2034 and are callable at our option, at par, after five years. The debentures carry an interest rate equal to the three-month LIBOR rate plus 3.85%, which is adjustable quarterly. At September 30, 2004, the interest rate on the debentures was 5.59%.

The following table shows our significant contractual obligations as of September 30, 2004.

(\$ in thousands)	Total	2004	2005	2006	2007	2008	After 2008
Subordinated debentures	\$30,929	\$—	\$—	\$—	\$—	\$—	\$30,929
Total contractual obligations	<u>\$30,929</u>	<u>\$—</u>	<u>\$—</u>	<u>\$—</u>	<u>\$—</u>	<u>\$—</u>	<u>\$30,929</u>

On October 21, 2004, we declared regular quarterly cash dividends of 12 cents per share for our Class A common stock and 10.5 cents per share for our Class B common stock, payable November 15, 2004 to stockholders of record as of the close of business on November 1, 2004. There are no regulatory restrictions on the payment of dividends to our stockholders, although there are state law restrictions on the payment of dividends from our insurance subsidiaries to us. Our insurance subsidiaries are required by law to maintain certain minimum surplus on a statutory basis, and are subject to regulations under which payment of dividends from statutory surplus is restricted and may require prior approval of the applicable domiciliary insurance regulatory authorities. Our insurance subsidiaries are subject to risk-based capital (RBC) requirements. At December 31, 2003, our insurance subsidiaries' capital levels were each substantially above RBC requirements. At January 1, 2004, amounts available for distribution as dividends to us from our insurance subsidiaries without prior approval of their domiciliary insurance regulatory authorities were \$13.3 million from Atlantic States, \$4.1 from Southern, \$1.2 million from Le Mars and \$1.9 million from Peninsula, all of which remained available at September 30, 2004.

As of September 30, 2004, we had no material commitments for capital expenditures.

Equity Price Risk

Our portfolio of marketable equity securities, which is carried on our consolidated balance sheets at estimated fair value, has exposure to the risk of loss resulting from an adverse change in prices. We manage this risk by performing an analysis of prospective investments and through regular reviews of our portfolio by our investment staff.

Credit Risk

Our portfolio of fixed-maturity securities and, to a lesser extent, short-term investments is subject to credit risk. This risk is defined as the potential loss in market value resulting from adverse changes in the borrower's ability to repay the debt. We manage this risk by performing an analysis of prospective investments and through regular reviews of our portfolio by our investment staff. We also limit the amount that any one security can constitute of our total investment portfolio.

We provide property and liability insurance coverages through independent insurance agencies located throughout our operating area. The majority of this business is billed directly to the insured, although a portion of our commercial business is billed through our agents who are extended credit in the normal course of business.

Because the pooling agreement does not relieve Atlantic States of primary liability as the originating insurer, we are subject to a concentration of credit risk arising from business ceded to the Mutual Company. Our insurance subsidiaries maintain reinsurance agreements in place with the Mutual Company and with a number of other major unaffiliated authorized reinsurers.

Impact of Inflation

Property and casualty insurance premium rates are established before the amount of losses and loss settlement expenses, or the extent to which inflation may impact such expenses, are known. Consequently, we attempt, in establishing rates, to anticipate the potential impact of inflation.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

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Our market risk generally represents the risk of gain or loss that may result from the potential change in the fair value of our investment portfolio as a result of fluctuations in prices and interest rates and, to a lesser extent, our debt obligations. We attempt to manage our interest rate risk by maintaining an appropriate relationship between the average duration of the investment portfolio and the approximate duration of our liabilities, i.e., policy claims and debt obligations.

We have maintained approximately the same duration of our investment portfolio to our liabilities from December 31, 2003 to September 30, 2004. In addition, we have maintained approximately the same investment mix during this period.

There have been no material changes to our quantitative or qualitative market risk exposure from December 31, 2003 through September 30, 2004.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

We conducted an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this report. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures are effective to ensure that information we (including our consolidated subsidiaries) are required to disclose in our periodic filings with the Securities and Exchange Commission is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms.

Changes in Internal Control Over Financial Reporting

There has been no change in our internal control over financial reporting during the quarter covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995

Certain forward-looking statements contained herein involve risks and uncertainties. These statements include certain discussions relating to underwriting, premium and investment income volume, business strategies and our business activities during 2004 and beyond. In some cases, you can identify forward-looking statements by terms such as "may," "will," "should," "could," "would," "expect," "plan," "intend," "anticipate," "believe," "estimate," "project," "predict," "potential" and similar expressions. These forward-looking statements reflect our current views about future events, are based on assumptions and are subject to known and unknown risks and uncertainties that may cause our actual results to differ materially from those anticipated by these forward-looking statements. Many of the factors that will determine future events or our future results of operations are beyond our ability to control or predict.

Part II. Other Information**Item 1. Legal Proceedings.**

None.

Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities.

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
Month #1	Class A - None	Class A - None	Class A - None	Class A - None
July 1-31, 2004	Class B - 666(1)	Class B - \$20.61	Class B - None	Class B - None
Month #2	Class A - 18,175(2)	Class A - \$20.78	Class A - None	
Aug. 1-31, 2004	Class B - 21,500(3)	Class B - \$19.06	Class B - 21,500	(3)
Month #3	Class A - None	Class A - None	Class A - None	
Sept. 1-30, 2004	Class B - 18,169(3)	Class B - \$18.87	Class B - 18,169	(3)
	Class A - 18,175	Class A - \$20.78	Class A - None	
Total	Class B - 40,335	Class B - \$19.00	Class B - 39,669	(3)

- (1) These shares were purchased by the Mutual Company in privately negotiated non-market transactions directly with its employees. These purchases were not pursuant to a publicly announced plan or program.
- (2) These shares were purchased by the Mutual Company through its participation in our Dividend Reinvestment and Stock Purchase Plan. These purchases were not pursuant to a publicly announced plan or program.
- (3) These shares were purchased by the Mutual Company pursuant to its announcement on August 17, 2004, that it will, at its discretion, purchase shares of our Class A common stock and Class B common stock at market prices prevailing from time to time in the open market subject to the provisions of SEC Rule 10b-18 and in privately negotiated transactions. Such announcement did not stipulate a maximum number of shares that may be purchased under this program.

Item 3. Defaults upon Senior Securities.

None.

Item 4. Submission of Matters to a Vote of Security Holders.

None.

Item 5. Other Information.

None.

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits

<u>Exhibit No.</u>	<u>Description</u>
Exhibit 31.1	Certification of Chief Executive Officer
Exhibit 31.2	Certification of Chief Financial Officer
Exhibit 32.1	Statement of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 of Title 18 of the United States Code
Exhibit 32.2	Statement of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 of Title 18 of the United States Code

(b) Reports on Form 8-K:

On August 17, 2004, we filed a report on Form 8-K including as an exhibit a press release announcing that the Mutual Company will, at its discretion, purchase shares of our Class A common stock and Class B common stock at market prices prevailing from time to time in the open market subject to the provisions of SEC Rule 10b-18 and in privately negotiated transactions.

On July 20, 2004, we filed a report on Form 8-K including as an exhibit our second quarter 2004 earnings press release.

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DONEGAL GROUP INC.

October 29, 2004

By: /s/ Donald H. Nikolaus

Donald H. Nikolaus, President
and Chief Executive Officer

October 29, 2004

By: /s/ Ralph G. Spontak

Ralph G. Spontak, Senior Vice President,
Chief Financial Officer and Secretary

I, Donald H. Nikolaus, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Donegal Group Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:

- (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
- (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
- (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

- (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting that are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: October 29, 2004

/s/ Donald H. Nikolaus

Donald H. Nikolaus
President and Chief Executive Officer

I, Ralph G. Spontak, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Donegal Group Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:

- (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
- (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
- (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

- (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting that are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: October 29, 2004

/s/ Ralph G. Spontak

Ralph G. Spontak
Senior Vice President and Chief Financial Officer

Exhibit 32.1

Statement of Chief Executive Officer
Pursuant to Section 1350 of Title 18 of the United States Code

Pursuant to Section 1350 of Title 18 of the United States Code, the undersigned, Donald H. Nikolaus, the President and Chief Executive Officer of Donegal Group Inc., hereby certifies that, to the best of his knowledge:

1. Our Form 10-Q Quarterly Report for the period ended September 30, 2004 (the "Report") fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, our financial condition and results of operations.

Dated: October 29, 2004

/s/ Donald H. Nikolaus

Donald H. Nikolaus, President
and Chief Executive Officer

Exhibit 32.2

Statement of Chief Financial Officer

Pursuant to Section 1350 of Title 18 of the United States Code

Pursuant to Section 1350 of Title 18 of the United States Code, the undersigned, Ralph G. Spontak, the Senior Vice President and Chief Financial Officer of Donegal Group Inc., hereby certifies that, to the best of his knowledge:

1. Our Form 10-Q Quarterly Report for the period ended September 30, 2004 (the "Report") fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, our financial condition and results of operations.

Dated: October 29, 2004

/s/ Ralph G. Spontak

Ralph G. Spontak,
Senior Vice President
and Chief Financial Officer