SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 1997

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	23-2424711
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1195 River Road, Marietta, Pennsylvania	17547
(Address of principal executive offices)	(Zip code)

Registrant's telephone number, including area code: (717) 426-1931

Securities registered pursuant to Section 12(b) of the Act: None.

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, $1.00 par value
(Title of class)

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

On March 17, 1998, the aggregate market value (based on the closing sales price on that date) of the voting stock held by non-affiliates of the Registrant was $54,365,781.

Indicate the number of shares outstanding of each of the Registrant's classes of common stock, as of the latest practicable date: 6,057,732 shares of Common Stock outstanding on March 17, 1998.

DOCUMENTS INCORPORATED BY REFERENCE:

1. Portions of the Registrant's annual report to stockholders for the fiscal year ended December 31, 1997 are incorporated by reference into Parts I, II and IV of this report.

2. Portions of the Registrant's proxy statement relating to the annual meeting of stockholders to be held April 16, 1998 are incorporated by reference into Part III of this report.

DONEGAL GROUP INC.

INDEX TO FORM 10-K REPORT

PART I

Item 1 Business.

(a) General Development of Business.

Donegal Group Inc. is a regional insurance holding company formed in August 1986 which is headquartered in Pennsylvania and engages, through its subsidiaries, in the property and casualty insurance business. As used herein, "DGI" or the "Company" refers to Donegal Group Inc. and its subsidiaries, Atlantic States Insurance Company ("Atlantic States"), Southern Insurance Company of Virginia ("Southern"), Delaware Atlantic Insurance Company ("Delaware Atlantic"), Pioneer Insurance Company ("Pioneer") and Atlantic Insurance Services, Inc. ("AIS"). DGI is currently 58.3% owned by Donegal Mutual Insurance Company (the "Mutual Company"). DGI and its subsidiaries and the Mutual Company underwrite a broad line of personal and commercial coverages, consisting of private passenger and commercial automobile, homeowners, commercial multi-peril, workers' compensation and other lines of insurance.

Atlantic States, which DGI organized in September 1986, participates in an underwriting pool whereby it cedes to the Mutual Company the premiums, losses and loss adjustment expenses from all of its insurance business and assumes from the Mutual Company a specified portion of the pooled business, which also includes substantially all of the Mutual Company's property and casualty insurance business. Effective as of October 1, 1986, DGI entered into a pooling agreement with the Mutual Company whereby Atlantic States assumed 35% of the pooled business written or in force on or after October 1, 1986. Pursuant to amendments to the pooling agreement subsequent to October 1, 1986, the Mutual Company, which is solely responsible for any losses in the pooled business with dates of loss on or before the close of business on September 30, 1986, has increased the percentage of retrocessions of the pooled business to Atlantic States. Since January 1, 1996, 65% of the pooled business has been retroceded to Atlantic States. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in Item 7 hereof and Note 2 to the Consolidated Financial Statements incorporated by reference herein.

On December 29, 1988, DGI acquired all of the outstanding capital stock of Southern in exchange for a $3,000,000 equity contribution to Southern. On October 1, 1986, the Mutual Company and Southern's predecessor, Southern Mutual Insurance Company, entered into a reinsurance agreement whereby such predecessor ceded to the Mutual Company 80% of its direct premiums written, less outside reinsurance, and retained 20%. Effective January 1, 1991, this percentage was changed to 50% ceded to the Mutual Company and 50% retained by Southern. Because the Mutual Company places substantially all of the business assumed from Southern in the pool, from which DGI currently has a 65% allocation, DGI's results of operations include approximately 80% of the business written by Southern. See Note 2 to the Consolidated Financial Statements incorporated by reference herein.

In January 1994, DGI organized AIS, which began business in that same month. AIS is an insurance services organization currently providing inspection and policy auditing information on a fee for service basis to its affiliates and the insurance industry.

As of December 31, 1995, the Company acquired all of the outstanding capital stock of Delaware Atlantic pursuant to a Stock Purchase Agreement dated as of December 21, 1995 between the Company and the Mutual Company. As part of this transaction, the Mutual Company entered into an aggregate excess of loss reinsurance agreement with Delaware Atlantic whereby the Mutual Company assumed the risk of any loss from an adverse development in Delaware Atlantic's loss and loss adjustment expense reserve at the end of 1995 compared to the end of 1996 and losses and loss adjustment expenses incurred by Delaware Atlantic during the month of December 1995 and for the 1996 year by reason of the fact that Delaware Atlantic's loss and loss adjustment expense ratio for those periods exceeded the lesser of the loss and loss expense ratios of immediately preceding periods or 60%. This agreement resulted in no additional payment from the Mutual Company to Delaware Atlantic.

On May 3, 1996, the Mutual Company formed Aberdeen Insurance Group, Inc. ("Aberdeen"), which, pursuant to an Asset Purchase Agreement dated July 31, 1996, purchased all of the aggregate excess and surplus lines insurance agency business of Thomas G. Downie Agency, Inc. d/b/a Aberdeen Insurance Group ("Downie Agency") for a purchase price of $100,000. As part of the agreement, Aberdeen acquired, among other things, fixed assets, the right, title and interest in and to the name "Aberdeen Insurance Group," all of Downie Agency's books and records relating to its excess and surplus insurance lines agency business and all intangible property rights and proprietary information of Downie Agency relating to the operation of the excess and surplus lines insurance agency business that was acquired.

Effective July 1, 1996, the Mutual Company entered into retrocessional reinsurance agreements with each of Southern, Delaware Atlantic and Pioneer (individually, an "Affiliate"), whereby the Mutual Company agreed to reinsure each Affiliate in respect of 100% of the net liability that may accrue to such Affiliate from its insurance operations and retrocede 100% of the net liability back to each Affiliate, which the Affiliate assumes.

As of March 31, 1997, the Company acquired all of the outstanding capital stock of Pioneer pursuant to a stock purchase agreement dated as of April 7, 1997 between the Company and the Mutual Company. As part of this transaction, the Mutual Company entered into an aggregate excess of loss reinsurance agreement with Pioneer whereby the Mutual Company assumed the risk of any loss from an adverse development in Pioneer's loss and loss adjustment expense reserve at the end of 1996 compared to the end of 1998 by reason of the fact that Pioneer's loss and loss adjustment expense ratio for those periods exceeded the lesser of the loss and loss expense ratios of immediately preceding periods or 60%. This reinsurance agreement resulted in additional payments of $186,800 from the Mutual Company to Pioneer in 1997.

Unless otherwise stated, all information in this report gives retroactive effect to the four-for-three split of the Company's Common Stock effected through a stock dividend of one share of Common Stock for each three shares outstanding, which was paid on July 15, 1997 to stockholders of record on June 25, 1997.

(b) Financial Information about Industry Segments.

The Company is of the opinion that all of its operations are within one industry segment and that no information as to industry segments is required pursuant to Statement of Financial Accounting Standards No. 14 or Regulation S-K.

(c) Narrative Description of Business.

Relationship with the Mutual Company

DGI's operations are interrelated with the operations of the Mutual Company and, because of the percentage of the pooled business assumed by DGI, DGI's results of operations are largely dependent upon the success of the Mutual Company. In addition, various reinsurance agreements exist between the Company and the Mutual Company. The Mutual Company is responsible for underwriting and marketing the pooled business and provides facilities, employees and services required to conduct the business of DGI on a cost allocated basis. The Mutual Company owned 58.3% of DGI as of March 17, 1998.

Through the pool, DGI writes personal and commercial property and casualty insurance lines, including automobile, homeowners, commercial multi-peril, workers' compensation and other lines of business. The insurance agencies under contract with the Mutual Company serve as representatives for the pool participants.

Under the terms of the intercompany pooling agreement, which took effect on October 1, 1986, Atlantic States cedes to the Mutual Company the premiums, losses and loss expenses on all of its insurance business. Substantially all of the Mutual Company's property and casualty insurance business, including the business reinsured from Southern, written or in force on or after October 1, 1986, is also included in the pooled business. Pursuant to amendments to the pooling agreement subsequent to October 1, 1986, the Mutual Company, which is solely responsible for any losses in the pooled business with dates of loss on or before the close of business on September 30, 1986, has increased the percentage of retrocessions of the pooled business to Atlantic States. Since January 1, 1996, 65% of the pooled business has been retroceded to Atlantic States. All premiums, losses, loss expenses, other underwriting expenses and policy dividends are prorated among the parties on the basis of their participation in the pool. The pooling agreement may be amended or terminated at the end of any calendar year by agreement of the parties. The Company does not intend to terminate its participation in the pooling agreement. The allocations of pool participation percentages between the Mutual Company and Atlantic States are based on the pool participants' relative amounts of capital and surplus and expectations of future relative amounts of capital and surplus. The pooling agreement does not legally discharge Atlantic States from its primary liability for the full amount of the policies ceded. However, it makes the Mutual Company liable to Atlantic States to the extent of the business ceded.

All of DGI's officers are officers of the Mutual Company, and five of DGI's seven directors are directors of the Mutual Company. A Coordinating Committee, which consists of two outside directors from each of DGI and the Mutual Company, none of whom hold seats on both Boards, reviews and approves changes in the pooling agreement and is responsible for matters involving actual or potential conflicts of interest. The decisions of the Coordinating Committee are binding on the two companies. DGI's members must conclude that intercompany transactions are fair and reasonable in order for such transactions to be approved.

The underwriting pool is intended to produce a more uniform and stable underwriting result from year to year for the companies in the pool than they would experience individually and to spread the risk of loss among all the participants. Each company participating in the pool has at its disposal the capacity of the entire pool, rather than being limited to policy exposures of a size commensurate with its own capital and surplus. The additional capacity exists because such policy exposures are spread among the pool participants which each have their own capital and surplus.

In addition to the underwriting pool, through the retrocessional reinsurance agreements with each of Southern, Delaware Atlantic and Pioneer, the Mutual Company agreed to reinsure each Affiliate in respect of 100% of the net liability that may accrue to such Affiliate from its insurance operations and retrocede 100% of the net liability back to each Affiliate, which the Affiliate assumes as part of the retrocession.

DGI's Business Strategy

DGI, in conjunction with the Mutual Company, has multiple strategies which the management of DGI believes have resulted in underwriting results that are favorable when compared to those of the property and casualty insurance industry in general over the past five years. The principal strategies comprise the following:

- A regional company concept designed to provide the advantages of local marketing, underwriting and claims servicing with the economies of scale from centralized accounting, administrative, investment, data processing and other services.

- An underwriting program and product mix designed to produce a Company-wide underwriting profit, i.e., a combined ratio of less than 100%, from careful risk selection and adequate pricing.

- A goal of a closely balanced ratio between commercial business and personal business.

- An agent selection process that focuses on appointing agencies with proven market strategies for the development of profitable business and an agent compensation plan providing for additional commissions based upon premium volume and profitability and the right to participate in the Company's Agency Stock Purchase Plan.

- Gradual expansion into adjacent states, including Indiana, New York, Tennessee and North Carolina.

- A continuing effort to attract and retain qualified employees who receive incentive compensation based upon historical results.

Property and Casualty Insurance Products and Services

The following table indicates the percentage of DGI's net premiums written represented by commercial lines and by personal lines for the years ended December 31, 1997, 1996 and 1995:

	Year Ended December 31,		
	1997	1996	1995
Net Premiums Written:			
Commercial	41.0%	44.3%	45.5%
Personal	59.0%	55.7%	54.5%

The commercial lines consist primarily of automobile, multi-peril and workers' compensation insurance. The personal lines consist primarily of automobile and homeowners insurance. These types of insurance are described in greater detail below:

Commercial

- Commercial automobile -- policies that provide protection against liability for bodily injury and property damage arising from automobile accidents, and provide protection against loss from damage to automobiles owned by the insured.

- Workers' compensation -- policies purchased by employers to provide benefits to employees for injuries sustained during employment. The extent of coverage is established by the workers' compensation laws of each state.

- Commercial multi-peril -- policies that provide protection to businesses against many perils, usually combining liability and physical damage coverages.

Personal

- o Private passenger automobile -- policies that provide protection against liability for bodily injury and property damage arising from automobile accidents, and provide protection against loss from damage to automobiles owned by the insured.

- o Homeowners -- policies that provide coverage for damage to residences and their contents from a broad range of perils, including, fire, lightning, windstorm and theft. These policies also cover liability of the insured arising from injury to other persons or their property while on the insured's property and under other specified conditions.

The following table sets forth the combined ratios of DGI, prepared in accordance with generally accepted accounting principles and statutory accounting principles prescribed or permitted by state insurance authorities. The combined ratio is a traditional measure of underwriting profitability. When the combined ratio is under 100%, underwriting results are generally considered profitable. Conversely, when the combined ratio is over 100%, underwriting results are generally considered unprofitable. The combined ratio does not reflect investment income, federal income taxes or other non-operating income or expense. DGI's operating income depends on income from both underwriting operations and investments.

	Year Ended December 31,		
	1997	1996	1995
GAAP Combined Ratio	97.6%	100.4%	98.6%
Statutory operating ratios:			
Loss ratio	64.0	68.4	66.3
Expense ratio	34.0	31.1	31.9
Dividend ratio	1.2	1.5	1.2
Statutory combined ratio	99.2%	101.0%	99.4%
Industry statutory combined ratio	101.6(1)	107.0(1)	105.0(2)

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(1) Source: A.M. Best Co.
(2) Source: Insurance Information Institute

DGI is required to participate in involuntary insurance programs for automobile insurance, as well as other property and casualty insurance lines, in states in which DGI operates. These programs include joint underwriting associations, assigned risk plans, fair access to insurance requirements ("FAIR") plans, reinsurance facilities and windstorm plans. Legislation establishing these programs requires all companies that write lines covered by these programs to provide coverage (either directly or through reinsurance) for insureds who cannot obtain insurance in the voluntary market. The legislation creating these programs usually allocates a pro rata portion of risks attributable to such insureds to each company on the basis of direct premiums written or the number of automobiles insured. Generally, state law requires participation in such programs as a condition to doing business. The loss ratio on insurance written under involuntary programs has traditionally been greater than the loss ratio on insurance in the voluntary market. The impact of these involuntary programs on DGI has been immaterial.

The following table sets forth the net premiums written and combined ratios by line of insurance for the business of DGI, prepared in accordance with statutory accounting practices prescribed or permitted by state insurance authorities, for the periods indicated.

	Year Ended December 31,		
	1997	1996	1995
	(dollars in thousands)		
Net Premiums Written:			
Commercial:			
Automobile	$ 10,522	$ 10,149	$ 8,306
Workers' compensation	15,590	17,998	17,661
Commercial multi-peril	16,357	17,153	14,775
Other	1,612	3,127	2,813
Total commercial	44,081	48,427	43,555
Personal:			
Automobile	38,989	37,739	32,330
Homeowners	19,939	18,979	15,961
Other	4,597	4,070	3,938
Total personal	63,525	60,788	52,229
Total business	$107,606	$109,215	$95,784
Statutory Combined Ratios:			
Commercial:			
Automobile	89.9%	97.6%	92.9%
Workers compensation	89.5	67.2	77.0
Commercial multi-peril	103.0	106.4	109.3
Other	57.7	42.8	77.2
Total commercial	93.5	86.5	92.9
Personal:			
Automobile	98.7%	100.7%	100.1%
Homeowners	116.4	139.1	119.3
Other	87.6	109.6	108.5
Total personal	103.4	112.7	106.3
Total business	99.2	101.0	99.4%

Property and Casualty Underwriting

The underwriting department is responsible for the establishment of underwriting and risk selection guidelines and criteria for the various insurance products written by DGI. The underwriting department, in conjunction with the marketing representatives, works closely with DGI's independent agents to insure a comprehensive knowledge on the part of the agents of DGI's underwriting requirements and risk selection process.

DGI's underwriting and pricing strategy is designed to produce an underwriting profit resulting in a Company-wide combined ratio below 100%. DGI and the Mutual Company have a conservative underwriting philosophy, which, in the opinion of management, is one of the prime reasons for DGI's favorable loss ratios relative to the property and casualty insurance industry over the last five years.

The underwriting department has over time initiated risk inspection procedures and underwriting analysis on a per risk and class of business basis. It has also automated underwriting processing utilizing technology such as bar coding. Management has established monitoring and auditing processes to verify compliance with underwriting requirements and procedures.

The underwriting department and the research and development section are responsible for the development of new insurance products and enhancements of existing products. Underwriting profitability is enhanced by the creation of niche products focused on classes of business which traditionally have provided underwriting profits.

Marketing

DGI's insurance products, together with the products of the Mutual Company and their respective subsidiaries, are marketed through approximately 2,300 independent insurance agents associated with approximately 700 insurance agencies. Business is written by either DGI or the Mutual Company depending upon geographic location, agency license and product. Management has developed an agency appointment procedure that focuses on appointing agencies with proven marketing strategies for the development of profitable business. DGI regularly evaluates its agency force and continues to strive to obtain and retain a significant position within each agency relative to the amount of business similar to that of DGI placed by the agency with other insurers. DGI and the Mutual Company have developed a successful contingent commission plan for agents under which additional commissions are payable based upon the volume of premiums produced and the profitability of the business of the agency written by DGI and the Mutual Company. Management believes the contingent commission program and the Company's Agency Stock Purchase Plan have enhanced the ability of DGI and the Mutual Company to write profitable business.

DGI has granted certain agents the authority to bind insurance within underwriting and pricing limits specified by DGI without the prior approval of DGI. However, DGI generally reviews all coverages placed by its agents and, subject to applicable insurance regulations, may cancel the coverage if it is inconsistent with DGI's guidelines.

DGI believes that its regional structure enables it to compete effectively with large national companies. This regional structure permits DGI to take advantage of its knowledge of local operating territories and the opportunity to form strong, long-term relationships with the agents that represent DGI and the Mutual Company.

DGI and the Mutual Company have developed comprehensive growth strategies for each of the commercial and personal lines of insurance business. DGI has focused on the small- to medium-sized commercial insurance markets, which have traditionally been a stable and profitable segment of the property and casualty insurance business. Commercial lines marketing is characterized by account selling, in which multiple lines of insurance are offered to a single policyholder.

DGI believes that competitive and comprehensive products targeted to selected classes of personal lines business, along with excellent service to agents and policyholders, will provide growth with profitability. As is customary in the industry, insureds are encouraged to place both their homeowners and personal automobile insurance with DGI or the Mutual Company and are offered a discount for doing so.

Claims

The claims department develops and implements policies and procedures for the establishment of claim reserves and the timely resolution and payment of claims. The management and staff of the department resolve policy coverage issues, manage and process reinsurance recoveries and handle salvage and subrogation matters.

Insurance claims are normally investigated and adjusted by internal claims adjusters and supervisory personnel. Independent adjusters are employed as needed to handle claims in territories in which the volume of claims is not sufficient to justify hiring internal claims adjusters. The litigation and personal injury sections manage all claims litigation, and all claims above $25,000 require home office review and settlement authorization.

Field office staffs are supported by home office technical, litigation, material damage, subrogation and medical audit personnel who provide specialized claims support. An investigative unit attempts to prevent fraud and abuse and to control losses.

Liabilities for Losses and Loss Expenses

Liabilities for losses and loss expenses are estimates at a given point in time of what the insurer expects to pay to claimants, based on facts and circumstances then known, and it can be expected that the ultimate liability will exceed or be less than such estimates. Liabilities are based on estimates of future trends and claims severity, judicial theories of liability and other factors. However, during the loss adjustment period, additional facts regarding individual claims may become known, and consequently it often becomes necessary to refine and adjust the estimates of liability. Any adjustments are reflected in operating results in the year in which the changes are made.

DGI maintains liabilities for the eventual payment of losses and loss expenses with respect to both reported and unreported claims. Liabilities for loss expenses are intended to cover the ultimate costs of settling all losses, including investigation and litigation costs from such losses. The amount of liability for reported losses is primarily based upon a case-by-case evaluation of the type of risk involved and knowledge of the circumstances surrounding each claim and the insurance policy provisions relating to the type of loss. The amount of liability for unreported claims and loss expenses is determined on the basis of historical information by line of insurance. Inflation is implicitly provided for in the reserving function through analysis of costs, trends and reviews of historical reserving results. Liabilities are closely monitored and are recomputed periodically by the Company and the Mutual Company using new information on reported claims and a variety of statistical techniques. Liabilities for losses are not discounted.

The establishment of appropriate liabilities is an inherently uncertain process, and there can be no assurance that the ultimate liability will not exceed DGI's loss and loss expenses and have an adverse effect on DGI's results of operations and financial condition. As is the case for virtually all property and casualty insurance companies, DGI has found it necessary in the past to revise in non-material amounts estimated future liabilities for losses and loss expenses, and further adjustments could be required in the future. However, on the basis of DGI's internal procedures, which analyze, among other things, DGI's experience with similar cases and historical trends such as reserving patterns, loss payments, pending levels of unpaid claims and product mix, as well as court decisions, economic conditions and public attitudes, management of DGI believes that adequate provision has been made for DGI's liability for loss and loss expenses.

Differences between liabilities reported in DGI's financial statements prepared on the basis of generally accepted accounting principles and financial statements prepared on a statutory accounting basis result from reducing statutory liabilities for anticipated salvage and subrogation recoveries. These differences amounted to $6,155,467, $5,170,486 and $4,103,285 at December 31, 1997, 1996 and 1995, respectively.

The following tables set forth a reconciliation of the beginning and ending net liability for unpaid losses and loss expenses for the periods indicated on a GAAP basis for the Company.

	Year Ended December 31,		
	1997	1996	1995
		(in thousands)	
Net liability for unpaid losses and loss expenses at beginning of year	$75,428	$71,155	$63,317
Provision for net losses and loss expenses for claims incurred in the current year	69,040	73,212	61,163
Increase (decrease) in provision for estimated net losses and loss expenses for claims incurred in prior years	(1,384)	(2,791)	(3,093)
Total incurred	67,656	70,421	58,070
Net losses and loss payments for claims incurred during:			
The current year	39,133	42,669	30,832
Prior years	26,477	23,479	19,400
Total paid	65,610	66,148	50,232
Net liability for unpaid losses and loss expenses at end of year	$77,474	$75,428	$71,155

The following table sets forth the development of the liability for net unpaid losses and loss expenses for DGI on a GAAP basis from 1987 (the first full year of DGI's operations) to 1997, with supplemental loss data for 1997 and 1996.

"Net liability at end of year for unpaid losses and loss expenses" sets forth the estimated liability for net unpaid losses and loss expenses recorded at the balance sheet date for each of the indicated years. This liability represents the estimated amount of net losses and loss expenses for claims arising in the current and all prior years that are unpaid at the balance sheet date including losses incurred but not reported.

The "Liability reestimated as of" portion of the table shows the reestimated amount of the previously recorded liability based on experience for each succeeding year. The estimate is increased or decreased as payments are made and more information becomes known about the severity of the remaining unpaid claims. For example, the 1990 liability has developed an excess after seven years, in that reestimated net losses and loss expenses are expected to be less than the estimated liability initially established in 1990 of $31,898 by $2,481.

The "Cumulative deficiency (excess)" shows the cumulative deficiency or excess at December 31, 1997 of the liability estimate shown on the top line of the corresponding column. An excess in liability means that the liability established in prior years exceeded actual net losses and loss expenses or were reevaluated at less than the original amount. A deficiency in liability means that the liability established in prior years was less than actual net losses and loss expenses or were reevaluated at more than the original amount.

The "Cumulative amount of liability paid through" portion of the table shows the cumulative net losses and loss expense payments made in succeeding years for net losses incurred prior to the balance sheet date. For example, the 1990 column indicates that as of December 31, 1997, payments equal to $28,627 of the currently reestimated ultimate liability for net losses and loss expenses of $29,417 had been made.

	Year Ended December 31					
	1987	1988	1989	1990	1991	1992
	(in thousands)					
Net liability at end of year for unpaid losses and loss expenses	$11,878	$20,734	$27,767	$31,898	$36,194	$44,339
Net liability reestimated as of:						
One year later	12,678	21,598	29,175	32,923	37,514	45,408
Two years later	12,949	20,475	28,861	33,550	37,765	42,752
Three years later	12,692	19,823	28,545	32,803	35,446	40,693
Four years later	12,160	19,296	27,717	31,004	33,931	38,375
Five years later	11,799	18,796	26,759	30,041	32,907	37,096
Six years later	11,857	18,457	26,180	29,595	32,234	
Seven years later	11,782	18,189	25,971	29,417		
Eight years later	11,722	18,117	25,828			
Nine years later	11,655	18,050				
Ten years later	11,611					
Cumulative deficiency (excess)	$ (267)	$(2,684)	$(1,939)	$(2,481)	$(3,960)	$(7,243)
Cumulative amount of liability paid through:						
One year later	$ 5,891	$ 8,855	$11,401	$13,003	$13,519	16,579
Two years later	8,472	12,280	17,421	19,795	20,942	24,546
Three years later	9,988	14,912	20,986	24,178	25,308	29,385
Four years later	10,774	16,292	23,268	26,413	27,826	32,925
Five years later	11,209	17,201	24,331	27,439	29,605	34,757
Six years later	11,388	17,706	24,909	28,157	30,719	
Seven years later	11,484	17,782	25,280	28,627		
Eight years later	11,544	17,884	25,599			
Nine years later	11,563	17,986				
Ten years later	11,594					

	Year Ended December 31				
	1993	1994	1995	1996	1997
	(in thousands)				
Net liability at end of year for unpaid losses and loss expenses	$ 52,790	$63,317	$71,155	$75,428	$77,474
Net liability reestimated as of:					
One year later	50,583	60,227	68,348	74,044	
Two years later	48,132	56,656	66,520		
Three years later	44,956	54,571			
Four years later	42,157				
Five years later					
Six years later					
Seven years later					
Eight years later					
Nine years later					
Ten years later					
Cumulative deficiency (excess)	$(10,633)	$(8,746)	$(4,635)	$(1,384)	
Cumulative amount of liability paid through:					
One year later	16,126	19,401	23,479	26,477	
Two years later	25,393	30,354	37,078		
Three years later	32,079	38,684			
Four years later	36,726				
Five years later					
Six years later					
Seven years later					
Eight years later					
Nine years later					
Ten years later					

	Year Ended December 31					
	1992	1993	1994	1995	1996	1997
	(in thousands)					
Gross liability at end of year	$57,777	$70,093	$88,484	$98,894	$114,622	$118,112
Reinsurance recoverable	13,438	17,303	25,167	27,739	39,194	40,638
Net liability at end of year	44,339	52,790	63,317	71,155	75,428	77,474
Gross reestimated liability -- latest	59,122	58,183	78,823	93,611	113,559	
Reestimated recoverable -- latest	22,026	16,026	24,252	27,091	39,515	
Net reestimated liability -- latest	37,096	42,157	54,571	66,520	74,044	
Gross cumulative deficiency (excess)	1,345	(11,910)	(9,661)	(5,283)	(1,063)	

Reinsurance

DGI and the Mutual Company use several different reinsurers, all of which have a Best rating of A- or better or, with respect to foreign reinsurers, have a financial condition which, in the opinion of management, is equivalent to a company with at least an A- rating.

The external reinsurance purchased by DGI and the Mutual Company includes "excess treaty reinsurance" under which losses are automatically reinsured over a set retention ($250,000 for 1997) and "catastrophic reinsurance" under which the reinsured recovers 90% of an accumulation of many losses resulting from a single event, including natural disasters (for 1997, $3,000,000 retention), DGI's principal reinsurance agreement, other than that with the Mutual Company, is an excess of loss treaty in which the reinsurers are Continental Casualty Company, Employers Reinsurance Corporation and Dorinco Reinsurance Company. Reinsurance is also purchased on an individual policy basis to reinsure losses that may occur from large risks, specific risk types or specific locations. The amount of coverage provided under each of these types of reinsurance depends upon the amount, nature, size and location of the risk being reinsured. For property insurance, excess of loss treaties provide for coverage up to $1,000,000. For liability insurance, excess of loss treaties provide for coverage up to $30,000,000. Property catastrophe contracts provide coverage up to $50,000,000 resulting from one event. On both property and casualty insurance, DGI and the Mutual Company purchase facultative reinsurance to cover exposures from losses that exceed the limits provided by their respective treaty reinsurance. In addition, the Company and the Mutual Company maintain various reinsurance agreements between themselves in addition to the pooling agreement. Atlantic States and the Mutual Company have a catastrophe reinsurance agreement which limits the maximum liability for losses from any one catastrophe occurrence to $400,000 for Atlantic States and $700,000 for a catastrophe involving more than one of the Company's subsidiaries. Southern and the Mutual Company have an excess of loss reinsurance agreement in which the Mutual Company assumes up to $150,000 of losses in excess of $100,000. Southern and the Mutual Company also have a catastrophe reinsurance agreement which limits Southern's liability to $300,000 from any one catastrophe occurrence. Delaware Atlantic and the Mutual Company have an excess of loss reinsurance agreement in which the Mutual Company assumes up to $200,000 for losses in excess of $50,000. Delaware Atlantic and the Mutual Company also have a catastrophe reinsurance agreement which limits Delaware Atlantic's liability to $300,000 from any one catastrophe occurrence. Delaware Atlantic and the Mutual Company also have a reinsurance agreement whereby Delaware Atlantic cedes 70% of its workers' compensation business to the Mutual Company. Pioneer and the Mutual Company have an excess of loss reinsurance agreement in which the Mutual Company assumes up to $200,000 for losses in excess of $50,000. Each of Southern, Delaware Atlantic and Pioneer also have a retrocessional reinsurance agreement with the Mutual Company whereby the Mutual Company indemnifies each of these companies in respect of 100% of the net liability that may accrue to such companies from its insurance operations and retrocedes 100% of the net liability back to each such company, which each such company assumes as part of the retrocession.

Competition

The property and casualty insurance industry is highly competitive on the basis of both price and service. There are numerous companies competing for this business in the geographic areas where the Company operates, many of which are substantially larger and have greater financial resources than DGI, and no single company dominates. In addition, because the insurance products of DGI and the Mutual Company are marketed exclusively through independent insurance agencies, most of which represent more than one company, DGI faces competition to retain qualified independent agencies, as well as competition within agencies.

Investments

DGI's return on invested assets is an important element of its financial results. Currently, the investment objective is to maintain a widely diversified fixed maturities portfolio structured to maximize after-tax investment income while minimizing credit risk through investments in high quality instruments. At December 31, 1997, all debt securities were rated investment grade with the exception of one unrated obligation of $250,000, and the investment portfolio did not contain any mortgage loans or any non-performing assets.

The following table shows the composition of the debt securities investment portfolio (at carrying value), excluding short-term investments, by rating as of December 31, 1997:

	December 31, 1997	
Rating(1)	Amount	Percent
	(dollars in thousands)	
U.S. Treasury and U.S. agency securities(2)	$ 94,301	53.9%
Aaa or AAA	45,392	25.9
Aa or AA	25,380	14.5
A	9,796	5.6
BBB	98	0.1
Not rated(3)	10	--
Total	$174,977	100.0%

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(1) Ratings assigned by Moody's Investors Services, Inc. or Standard & Poor's Corporation.

(2) Includes mortgage-backed securities of $12,445.

(3) Represents one unrated obligation of The Lancaster County Hospital Authority Mennonite Home Project, which management of DGI believes to be equivalent to investment grade securities with respect to repayment risk.

DGI invests in both taxable and tax-exempt securities as part of its strategy to maximize after-tax income. Such strategy considers, among other factors, the alternative minimum tax. Tax-exempt securities made up approximately 34.3%, 36.4% and 37.8% of the total investment portfolio at December 31, 1997, 1996 and 1995, respectively.

The following table shows the classification of the investments (at carrying value) of DGI and its subsidiaries at December 31, 1997, 1996 and 1995.

	December 31,					
	1997		1996		1995	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
	(dollars in thousands)					
Fixed maturities(1):						
Held to maturity:						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 41,450	20.2%	$ 38,647	20.1%	$ 20,580	12.2%
Obligations of states and political subdivisions	57,621	28.1	57,095	29.6	53,186	31.6
Corporate securities	7,250	3.5	5,917	3.1	4,266	2.6
Mortgage-backed securities	10,925	5.4	12,680	6.6	16,655	9.9
Total held to maturity	117,246	57.2	114,339	59.4	94,687	56.3
Available for sale:						
U.S. treasury securities and obligations of U.S. government corporations and agencies	40,197	19.6	35,507	18.4	37,775	22.5
Obligations of states and political subdivisions	12,762	6.2	12,987	6.8	10,427	6.2
Corporate securities	3,252	1.6	3,436	1.8	4,711	2.8
Mortgage-backed securities	1,520	0.8	1,606	0.8	2,265	1.3
Total available for sale	57,731	28.2	53,536	27.8	55,178	32.8
Total fixed maturities	174,977	85.4	167,875	87.2	149,865	89.1
Equity securities(2)	7,275	3.5	3,143	1.6	3,272	1.9
Short-term investments(3)	22,713	11.1	21,471	11.2	15,079	9.0
Total investments	$204,965	100.0%	$192,489	100.0%	$168,216	100.0%

(1) The Company accounts for its investments in accordance with Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting For Certain Investments in Debt and Equity Securities." See Notes 1 and 3 to the Consolidated Financial Statements incorporated by reference herein. Fixed maturities held to maturity are valued at amortized cost; those fixed maturities available for sale are valued at fair value. Total fair value of fixed maturities held to maturity was $120,882,886 at December 31, 1997. The amortized cost of fixed maturities available for sale was $56,922,342 at December 31, 1997.

(2) Equity securities are valued at fair value. Total cost of equity securities was $6,551,020 at December 31, 1997, $2,774,946 at December 31, 1996 and $2,959,087 at December 31, 1995.

(3) Short-term investments are valued at cost, which approximates market.

The following table sets forth the maturities (at carrying value) in the fixed maturity and short-term investment portfolio at December 31, 1997, December 31, 1996 and December 31, 1995.

	December 31,					
	1997		1996		1995	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
			(dollars in thousands)			
Due in:(1)						
One year or less	36,013	18.2%	$ 34,836	18.4%	$ 35,374	21.5%
Over one year through three years .	30,910	15.6	26,392	13.9	21,184	12.8
Over three years through five years ..	20,303	10.3	21,163	11.2	10,537	6.4
Over five years through ten years ...	65,122	32.9	45,370	24.0	36,620	22.2
Over ten years through fifteen years	32,384	16.4	46,248	24.4	40,123	24.3
Over fifteen years ...	513	0.3	1,051	0.6	2,185	1.3
Mortgage-backed securities	12,445	6.3	14,286	7.5	18,921	11.5
	$197,690	100.0%	$189,346	100.0%	$164,944	100.0%

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(1) Based on stated maturity dates with no prepayment assumptions. Actual maturities will differ because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

As shown above, the Company held investments in mortgage-backed securities having a carrying value of $12,445,321 at December 31, 1997. Included in these investments are collateralized mortgage obligations ("CMOs") with a carrying value of $11,931,721 at December 31, 1997. The Company has attempted to reduce the prepayment risks associated with mortgage-backed securities by investing approximately 99%, as of December 31, 1997, of the Company's holdings of CMOs in planned amortization and very accurately defined tranches. Such investments are designed to alleviate the risk of prepayment by providing predictable principal prepayment schedules within a designated range of prepayments. If principal is repaid earlier than originally anticipated, investment yields may decrease due to reinvestment of the proceeds at lower current interest rates and capital gains or losses may be realized since the book value of securities purchased at premiums or discounts may be different from the prepayment amount.

Investment results of DGI and its subsidiaries for the years ended December 31, 1997, 1996 and 1995 are shown in the following table:

	Year Ended December 31,		
	1997	1996	1995
	(dollars in thousands)		
Invested assets(1)	$202,283	$183,401	$161,901
Investment income(2)	11,507	10,799	9,714
Average yield	5.7%	5.9%	6.0%

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(1) Average of the aggregate invested amounts at the beginning and end of the period, including cash.

(2) Investment income is net of investment expenses and does not include realized investment gains or losses or provision for income taxes.

A.M. Best Rating

In 1997, the Best rating of the Mutual Company, Atlantic States, Southern, Delaware Atlantic and Pioneer was "A", based upon their respective current financial conditions and historical statutory results of operations. Management believes that this Best rating is an important factor in marketing DGI's products to its agents and customers. Best's ratings are industry ratings based on a comparative analysis of the financial condition and operating performance of insurance companies as determined by their publicly available reports. Best's classifications are A++ and A+ (Superior), A and A- (Excellent), B++ and B+ (Very Good), B and B- (Good), C++ and C+ (Fair), C and C- (Marginal), D (below minimum standards) and E and F (Liquidation). Best's ratings are based upon factors relevant to policyholders and are not directed toward the protection of investors. According to Best, an "excellent" rating is assigned to those companies which, in Best's opinion, have achieved excellent overall performance when compared to the norms of the property and casualty insurance industry and have generally demonstrated a strong ability to meet policyholder and other contractual obligations.

Regulation

Insurance companies are subject to supervision and regulation in the states in which they transact business. Such supervision and regulation relates to numerous aspects of an insurance company's business and financial condition. The primary purpose of such supervision and regulation is the protection of policyholders. The extent of such regulation varies, but generally derives from state statutes which delegate regulatory, supervisory and administrative authority to state insurance departments. Accordingly, the authority of the state insurance departments includes the establishment of standards of solvency which must be met and maintained by insurers, the licensing to do business of insurers and agents, the nature of and limitations on investments, premium rates for property and casualty insurance, the provisions which insurers must make for current losses and future liabilities, the deposit of securities for the benefit of policyholders, the approval of policy forms, notice requirements for the cancellation of policies and the approval of certain changes in control. State insurance departments also conduct periodic examinations of the affairs of insurance companies and require the filing of annual and other reports relating to the financial condition of insurance companies.

In addition to state-imposed insurance laws and regulations, in December 1993 the National Association of Insurance Commissioners (the "NAIC") adopted a risk-based capital system for assessing the adequacy of statutory capital and surplus which augments the states' current fixed dollar minimum capital requirements for insurance companies. At December 31, 1997, DGI exceeded the required levels of capital. There can be no assurance that the capital requirements applicable to DGI's business will not increase in the future.

The states in which Atlantic States (Pennsylvania, Maryland and Delaware), the Mutual Company (Pennsylvania, Ohio, Maryland, New York, Virginia, Delaware and North Carolina), Southern (Virginia and Pennsylvania), Delaware Atlantic (Delaware, Maryland and Pennsylvania) and Pioneer (Ohio and Pennsylvania) do business have guaranty fund laws under which insurers doing business in such states can be assessed on the basis of premiums written by the insurer in that state in order to fund policyholder liabilities of insolvent insurance companies. Under these laws in general, an insurer is subject to assessment, depending upon its market share of a given line of business, to assist in the payment of policyholder claims against insolvent insurers. The Mutual Company, Atlantic States, Southern, Delaware Atlantic and Pioneer have made accruals for their portion of assessments related to such insolvencies based upon the most current information furnished by the guaranty associations. During the five years ended December 31, 1997, the amount of such insolvency assessments paid by Atlantic States, Southern, the Mutual Company, Delaware Atlantic and Pioneer was not material.

The property and casualty insurance industry has recently received a considerable amount of publicity because of rising insurance costs and the unavailability of insurance. New regulations and legislation are being proposed to limit damage awards, to control plaintiffs' counsel fees, to bring the industry under regulation by the federal government and to control premiums, policy terminations and other policy terms. It is not possible to predict whether, in what form or in what jurisdictions any of these proposals might be adopted or the effect thereof, if any, on the Company.

Most states have enacted legislation that regulates insurance holding company systems. Each insurance company in the holding company system is required to register with the insurance supervisory agency of its state of domicile and furnish information concerning the operations of companies within the holding company system that may materially affect the operations, management or financial condition of the insurers within the system. Pursuant to these laws, the respective insurance departments may examine the Mutual Company, the Company and their respective insurance subsidiaries at any time, require disclosure of material transactions by the holding company and require prior notice or prior approval of certain transactions, such as "extraordinary dividends" from the insurance subsidiaries to the holding company.

All transactions within the holding company system affecting the Mutual Company and the Company's insurance subsidiaries must be fair and equitable. Approval of the applicable insurance commissioner is required prior to consummation of transactions affecting the control of an insurer. In some states, including Pennsylvania, the acquisition of 10% or more of the outstanding capital stock of an insurer or its holding company is presumed to be a change in control. These laws also require notice to the applicable insurance commissioner of certain material transactions between an insurer and any person in its holding company system and, in some states, certain of such transactions cannot be consummated without the prior approval of the applicable insurance commissioner.

The Company's insurance subsidiaries are restricted by the insurance laws of their respective states of domicile as to the amount of dividends or other distributions they may pay to the Company without the prior approval of the respective state regulatory authorities. Generally, the maximum amount that may be paid by an insurance subsidiary during any year after notice to, but without prior approval of, the insurance commissioners of these states is limited to a stated percentage of that subsidiary's statutory capital and surplus as of a certain date, or the net income or net investment income not including realized capital gains of the subsidiary for the preceding year. As of December 31, 1997, amounts available for payment of dividends in 1997 without the prior approval of the various insurance commissioners were $7,349,284 from Atlantic States, $703,727 from Southern, $1,070,463 from Delaware Atlantic and $542,799 from Pioneer. See Note 11 to the Consolidated Financial Statements incorporated by reference herein.

The Mutual Company

The Mutual Company, which was organized in 1889, has a Best rating of A (Excellent). At December 31, 1997, the Mutual Company had admitted assets of $185 million and policyholders' surplus of $101 million. At December 31, 1997, the Mutual Company had no debt and, of its total liabilities of $83 million, reserves for net losses and loss expenses accounted for $46 million and unearned premiums accounted for $21 million. Of the Mutual Company's investment portfolio of $138 million at December 31, 1997, investment-grade bonds accounted for $42 million, cash and short-term investments accounted for $7 million and mortgages accounted for $7 million. At December 31, 1997, the Mutual Company owned 3,512,356 shares of the Company's Common Stock, which were carried on the Mutual Company's books at $78 million. The foregoing financial information is presented on the statutory basis of accounting.

Employees

As of December 31, 1997, the Mutual Company had 376 employees. The Mutual Company's employees provide a variety of services to DGI, Atlantic States, Delaware Atlantic, Southern and Pioneer as well as to the Mutual Company and its subsidiaries.

Item 2. Properties.

DGI shares headquarters with the Mutual Company in a building owned by the Mutual Company. The Mutual Company charges DGI for an appropriate portion of the building expenses under an intercompany allocation agreement which is consistent with the terms of the pooling agreement. The headquarters of the Mutual Company have approximately 140,000 square feet of office space. Southern has a facility of approximately 10,000 square feet in Glen Allen, Virginia which it owns. Delaware Atlantic has a facility of approximately 2,800 square feet in Wilmington, Delaware which it leases. Pioneer has a facility of approximately 8,000 square feet in Greenville, Ohio which it owns.

Item 3. Legal Proceedings.

DGI is a party to numerous lawsuits arising in the ordinary course of its insurance business. DGI believes that the resolution of these lawsuits will not have a material adverse effect on its financial condition or results of operations.

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

No matter was submitted to a vote of holders of the Company's Common Stock during the fourth quarter of 1997.

Executive Officers of the Company

Name	Age	Position
Donald H. Nikolaus	55	President and Chief Executive Officer since 1981
Ralph G. Spontak	45	Senior Vice President since 1991; Chief Financial Officer and Vice President since 1983; Secretary since 1988
Cyril J. Greenya	53	Senior Vice President - Commercial Underwriting since 1997; Vice President - Commercial Underwriting for five years prior thereto; Manager - Commercial Underwriting for nine years prior thereto
Frank J. Wood	64	Senior Vice President - Marketing since 1997; Vice-President - Marketing for nine years prior thereto; Manager - Marketing for one year prior thereto
James B. Price	62	Senior Vice President - Claims since 1997; Vice President - Claims for 25 years prior thereto
Robert G. Shenk	45	Senior Vice President - Claims since 1997; Vice President - Claims for five years prior thereto
William H. Shupert	71	Senior Vice President - Underwriting since 1991; Vice President - Underwriting for 18 years prior thereto
Daniel J. Wagner	37	Treasurer since 1993; Controller for five years prior thereto

PART II

Item 5. Market for the Registrant's Common Equity and Related Stockholder Matters.

The answer to this Item is incorporated in part by reference to page 29 of the Company's Annual Report to Stockholders for the year ended December 31, 1997, which is included as Exhibit (13) to this Form 10-K Report. As of March 17, 1998, the Company had approximately 480 holders of record of its Common Stock. The Company declared dividends of $.33 per share in 1996 and $.39 per share in 1997.

Item 6. Selected Financial Data.

The answer to this Item is incorporated by reference to page 1 of the Company's Annual Report to Stockholders for the year ended December 31, 1997, which is included as Exhibit (13) to this Form 10-K Report.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The answer to this Item is incorporated by reference to pages 10 through 12 of the Company's Annual Report to Stockholders for the year ended December 31, 1997, which is included as Exhibit (13) to this Form 10-K Report.

Item 8. Financial Statements and Supplementary Data.

The answer to this Item is incorporated by reference to pages 13 through 26 of the Company's Annual Report to Stockholders for the year ended December 31, 1997, which is included as Exhibit (13) to this Form 10-K Report.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

PART III

Item 10. Directors and Executive Officers of the Company.

The answer to this Item with respect to the Company's directors is incorporated by reference to pages 5 through 8 of the Company's proxy statement relating to the Company's annual meeting of stockholders to be held April 16, 1998. The response to this Item with respect to the Company's executive officers is incorporated by reference to Part I of this Form 10-K Report.

Item 11. Executive Compensation.

The answer to this Item is incorporated by reference to pages 9 through 14 of the Company's proxy statement relating to the Company's annual meeting of stockholders to be held April 16, 1998, except for the Compensation Committee Report and the Performance Graph, which are not incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management.

The answer to this Item is incorporated by reference to pages 2 through 3 of the Company's proxy statement relating to the Company's annual meeting of stockholders to be held April 16, 1998.

Item 13. Certain Relationships and Related Transactions.

The answer to this Item is incorporated by reference to pages 3 through 5 and page 14 of the Company's proxy statement relating to the Company's annual meeting of stockholders to be held April 16, 1998.

PART IV

Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K.

(a) Financial statements, financial statement schedules and exhibits filed:

(1) Consolidated Financial Statements

(2) Financial Statement Schedules

All other schedules have been omitted since they are not required, not applicable or the information is included in the financial statements or notes thereto.

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* Refers to the respective page of Donegal Group Inc.'s 1997 Annual Report to Stockholders. The Consolidated Financial Statements and Notes to Consolidated Financial Statements

and Auditor's Report thereon on pages 13 through 27 are incorporated herein by reference. With the exception of the portions of such Annual Report specifically incorporated by reference in this Item and Items 5, 6, 7 and 8, such Annual Report shall not be deemed filed as part of this Form 10-K Report or otherwise subject to the liabilities of Section 18 of the Securities Exchange Act of 1934.

(3) Exhibits

Exhibit No.	Description of Exhibits	Reference
(3)(i)	Certificate of Incorporation of Registrant	(a)
(3)(ii)	Amended and Restated By-laws of Registrant	(b)
(4)	Form of Registrant's Common Stock Certificate	(a)
Management Contracts and Compensatory Plans or Arrangements		
(10)(A)	Donegal Mutual Insurance Company Money Purchase Pension Plan and Trust dated March 12, 1985	(a)
(10)(B)	Donegal Mutual Insurance Company Profit Sharing Plan and Trust dated March 12, 1985	(a)
(10)(C)	Donegal Group Inc. Key Executive Incentive Bonus Plan dated September 29, 1986	(c)
(10)(D)	Donegal Group Inc. Employee Stock Purchase Plan, as amended	(c)
(10)(E)	Donegal Group Inc. Equity Incentive Plan, as amended	(c)
(10)(F)	Donegal Group Inc. Agency Stock Purchase Plan	(j)
(10)(G)	Donegal Group Inc. Amended and Restated 1996 Equity Incentive Plan	(b)
(10)(H)	Donegal Group Inc. Amended and Restated 1996 Equity Incentive Plan for Directors	filed herewith

(10)(I)	Donegal Group Inc. Executive Restoration Plan	(b)

Other Material Contracts

(10)(J)	Tax Sharing Agreement dated September 29, 1986 between Donegal Group Inc. and Atlantic States Insurance Company	(a)
(10)(K)	Services Allocation Agreement dated September 29, 1986 between Donegal Mutual Insurance Company, Donegal Group Inc. and Atlantic States Insurance Company	(a)
(10)(L)	Proportional Reinsurance Agreement dated September 29, 1986 between Donegal Mutual Insurance Company and Atlantic States Insurance Company	(a)
(10)(M)	Amendment dated October 1, 1988 to Proportional Reinsurance Agreement between Donegal Mutual Insurance Company and Atlantic States Insurance Company	(d)
(10)(N)	Multi-Line Excess of Loss Reinsurance Agreement effective January 1, 1993 between Donegal Mutual Insurance Company, Southern Insurance Company of Virginia, Atlantic States Insurance Company and Pioneer Mutual Insurance Company, and Christiana General Insurance Corporation of New York, Cologne Reinsurance Company of America, Continental Casualty Company, Employers Reinsurance Corporation and Munich American Reinsurance Company	(f)
(10)(O)	Amendment dated July 16, 1992 to Proportional Reinsurance Agreement between Donegal Mutual Insurance Company and Atlantic States Insurance Company	(e)
(10)(P)	Amendment dated as of December 21, 1995 to Proportional Reinsurance Agreement between Donegal Mutual Insurance Company and Atlantic States Insurance Company	(g)

(10)(Q)	Credit Agreement dated as of December 29, 1995 between Donegal Group Inc. and Fleet National Bank of Connecticut	(g)
(10)(R)	Stock Purchase Agreement dated as of December 21, 1995 between Donegal Mutual Insurance Company and Donegal Group Inc.	(g)
(10)(S)	Donegal Group Inc. 1996 Employee Stock Purchase Plan.	(h)
(10)(T)	Reinsurance and Retrocession Agreement dated May 21, 1996 between Donegal Mutual Insurance Company and Pioneer Insurance Company.	(b)
(10)(U)	Reinsurance and Retrocession Agreement dated May 21, 1996 between Donegal Mutual Insurance Company and Delaware American Insurance Company.	(b)
(10)(V)	Reinsurance and Retrocession Agreement dated May 21, 1996 between Donegal Mutual Insurance Company and Southern Insurance Company of Virginia.	(b)
(13)	1997 Annual Report to Stockholders (electronic filing contains only those portions incorporated by reference into this Form 10-K report).	filed herewith

(20)	Proxy Statement relating to the Annual Meeting of Stockholders to be held on April 16, 1998, provided, however, that the Compensation Committee Report and the Performance Graph shall not be deemed filed as part of this Form 10-K Report	filed herewith
(21)	Subsidiaries of Registrant	filed herewith
(23)	Consent of Independent Auditors	filed herewith
(27)	Financial Data Schedule	filed herewith

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(a) Such exhibit is hereby incorporated by reference to the like-described exhibits in Registrant's Form S-1 Registration Statement No. 33-8533 declared effective October 29, 1986.

(b) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 10-K Report for the year ended December 31, 1996.

(c) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 10-K Report for the year ended December 31, 1986.

(d) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 10-K Report for the year ended December 31, 1988.

(e) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 10-K Report for the year ended December 31, 1992.

(f) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form S-2 Registration Statement No. 33-67346 declared effective September 29, 1993.

(g) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 8-K Report dated December 21, 1995.

(h) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form S-8 Registration Statement No. 333-1287 filed February 29, 1996.

(i) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 10-K Report for the year ended December 31, 1995.

(j) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form S-2 Registration Statement No. 333-06787 declared effective August 1, 1996.

DONEGAL GROUP INC. AND SUBSIDIARIES

SCHEDULE I - SUMMARY OF INVESTMENTS
OTHER THAN INVESTMENTS IN RELATED PARTIES

December 31, 1997

	Cost	Fair Value	Amount at Which Shown in the Balance Sheet
Fixed Maturities:			
Held to maturity:			
United States government and governmental agencies and authorities including obligations of states and political subdivisions	$ 99,071,055	$102,267,924	$ 99,071,055
All other corporate bonds ..	7,249,829	7,570,500	7,249,829
Mortgage-backed securities .	10,925,321	11,044,462	10,925,321
Total fixed maturities held to maturity	117,246,205	120,882,886	117,246,205
Available for sale:			
United States government and governmental agencies and authorities including obligations of states and political subdivisions	52,175,532	52,958,751	52,958,751
All other corporate bonds ..	3,247,602	3,252,500	3,252,500
Mortgage-backed securities .	1,499,208	1,520,000	1,520,000
Total fixed maturities available for sale	56,922,342	57,731,251	57,731,251
Total fixed maturities	174,168,547	178,614,137	174,977,456
Equity Securities:			
Preferred stocks			
Public utilities	250,000	255,000	255,000
Banks	1,112,500	1,148,191	1,148,191
Industrial and miscellaneous	987,500	1,064,128	1,064,128
Total preferred stocks	2,350,000	2,467,319	2,467,319
Common stocks			
Banks and insurance companies	858,276	1,334,430	1,334,430
Industrial and miscellaneous	3,342,744	3,472,813	3,472,813
Total common stocks	4,201,020	4,807,243	4,807,243
Total equity securities	6,551,020	7,274,562	7,274,562
Short-term investments	22,712,787	22,712,787	22,712,787
Total investments	203,432,354	208,601,486	204,964,805

DONEGAL GROUP INC. AND SUBSIDIARIES

SCHEDULE II - CONDENSED FINANCIAL INFORMATION OF PARENT COMPANY

Condensed Balance Sheets
($ in thousands)
December 31, 1997 and 1996

ASSETS

	1997	1996
Investment in subsidiaries (equity method)	$ 99,857	$ 88,916
Short-term investments, at cost, which approximates market	3	7
Cash	730	427
Property and equipment	2,139	1,248
Current income taxes	243	158
Loan costs	205	246
Other receivables	--	30
Total assets	$ 103,177	$ 91,032

LIABILITIES AND STOCKHOLDERS' EQUITY

	1997	1996*
Cash dividends declared to stockholders	$ 604	$ 493
Accounts payable and accrued expenses	208	174
Deferred income taxes	268	266
Line of credit	10,500	8,500
Total liabilities	11,580	9,433
Stockholders' equity		
Preferred stock, $1.00 par value, authorized 1,000,000 shares, none issued		
Common stock, $1.00 par value, authorized 10,000,000 shares, issued 6,122,431 and 4,540,569 shares and outstanding 6,030,715 and 4,471,782 shares	6,123	4,540
Additional paid-in capital	38,932	37,863
Net unrealized gains on investments	1,012	423
Retained earnings, including equity in undistributed net income of subsidiaries ($56,082 and $45,730)	46,422	39,665
Treasury stock at cost	(892)	(892)
Total stockholders' equity	91,597	81,599
Total liabilities and stockholders' equity	$ 103,177	$ 91,032

*RESTATED

DONEGAL GROUP INC. AND SUBSIDIARIES

SCHEDULE II - CONDENSED FINANCIAL INFORMATION OF PARENT COMPANY

Condensed Statements of Income
($ in thousands)

Years ended December 31, 1997, 1996 and 1995

	1997	1996*	1995*
Revenues			
Dividends-subsidiary	$ 950	$ 0	$ 900
Lease income	643	541	491
Investment income	15	31	13
Total revenues	1,608	572	1,404
Expenses			
Operating expenses	643	548	411
Interest	1,022	416	4
Total expenses	1,665	964	415
Income (loss) before income tax benefit and equity in undistributed net income of subsidiaries	(57)	(392)	989
Income tax (benefit)	(346)	(533)	(298)
Income before equity in undistributed net income of subsidiaries	289	141	1,287
Equity in undistributed net income of subsidiaries	10,352	8,417	8,273
Net income	$10,641	$8,558	$9,560

*RESTATED

DONEGAL GROUP INC. AND SUBSIDIARIES

SCHEDULE II - CONDENSED INFORMATION OF PARENT COMPANY

Condensed Statements of Cash Flows
($ in thousands)
Years ended December 31, 1997, 1996 and 1995

	1997	1996*	1995*
Cash flows from operating activities:			
Net income	$ 10,641	$ 8,558	$ 9,560
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed net income of subsidiaries	(10,352)	(8,417)	(8,273)
Change in accounts payable and accrued expenses	34	(143)	225
Depreciation and amortization	401	309	264
Change in deferred income tax	2	16	15
Change in current income tax receivable	(85)	183	(332)
Change in other receivables	30	8	(284)
Net adjustments	(9,970)	(8,044)	(8,385)
Net cash provided by operating activities	671	514	1,175
Cash flows from investing activities:			
Net sales (purchases) of short-term investments	4	1,110	(744)
Net purchase of property and equipment	(1,251)	(203)	(279)
Capital contribution to subsidiaries		(5,000)	
Acquisition of Delaware Atlantic	--	(202)	(5,300)
Net cash provided by (used in) investing activities	(1,247)	(4,295)	(6,323)
Cash flows from financing activities:			
Cash dividends paid	(2,252)	(1,879)	(1,622)
Issuance of common stock	1,131	2,512	1,723
Purchase of treasury stock	--	(72)	--
Line of credit, net	2,000	3,500	5,000
Net cash provided by (used in) financing activities	879	4,061	(5,101)
Net change in cash	303	280	(47)
Cash beginning	427	147	194
Cash ending	$ 730	$ 427	$ 147

*RESTATED

DONEGAL GROUP INC. AND SUBSIDIARIES

SCHEDULE III - SUPPLEMENTARY INSURANCE INFORMATION

Segment	Net Earned Premiums	Net Investment Income	Net Losses and Loss Expenses	Amortization of Deferred Policy Acquisition Costs	Other Underwriting Expenses	Net Premiums Written
Year Ended December 31, 1997						
Property and casualty	$107,302,168	$11,492,012	$67,656,518	$18,696,000	$ 17,058,668	$107,604,989
Parent	--	15,265	--	--	--	--
	$107,302,168	$11,507,277	$67,656,518	$18,696,000	$ 17,058,668	$107,604,989
Year Ended December 31, 1996						
Property and casualty	$104,527,038	$10,768,518	$70,420,924	$17,032,000	$ 15,876,797	$109,169,176
Parent	--	30,851	--	--	--	--
	$104,527,038	$10,799,369	$70,420,924	$17,032,000	$ 15,876,797	$109,169,176
Year Ended December 31, 1995						
Property and casualty	$ 89,522,203	$ 9,700,820	$58,069,695	$14,412,000	$ 14,702,852	$ 95,784,490
Parent	--	12,924	--	--	--	--
	$ 89,522,203	$ 9,713,744	$58,069,695	$14,412,000	$ 14,702,852	$ 95,784,490

DONEGAL GROUP INC. AND SUBSIDIARIES

SCHEDULE III - SUPPLEMENTARY INSURANCE INFORMATION

	At December 31,			
Segment	Deferred Policy Acquisition Costs	Liability for Losses and Loss Expenses	Unearned Premiums	Other Policy Claims and Benefits Payable
1997				
Property and casualty	$8,448,060	$118,112,390	$71,367,691	$ --
1996				
Property and casualty	$7,837,899	$114,621,961	$70,555,906	$ --

DONEGAL GROUP INC. AND SUBSIDIARIES

SCHEDULE IV - REINSURANCE

	Gross Amount	Ceded To Other Companies	Assumed From Other Companies	Net Amount	Percentage Assumed to Net
Year Ended December 31, 1997					
Property and casualty premiums	$51,753,477	$51,753,477	$107,302,168	$107,302,168	100%
Year Ended December 31, 1996					
Property and casualty premiums	$49,802,516	$41,185,853	$ 95,910,375	$104,527,038	92%
Year Ended December 31, 1995					
Property and casualty premiums	$44,243,538	$29,546,138	$ 74,824,803	$89,522,203	84%

DONEGAL GROUP INC. AND SUBSIDIARIES

SCHEDULE VI - SUPPLEMENTARY INSURANCE INFORMATION
CONCERNING PROPERTY AND CASUALTY SUBSIDIARIES

	Deferred Policy Acquisition Costs	Liability for Losses and Loss Expenses	Discount, if any, Deducted From Reserves	Unearned Premiums
At December 31,				
1997	$8,448,060	$118,112,390	$ --	$71,367,691
1996	$7,837,899	$114,621,961	$ --	$70,555,906

DONEGAL GROUP INC. AND SUBSIDIARIES

SCHEDULE VI - SUPPLEMENTARY INSURANCE INFORMATION
CONCERNING PROPERTY AND CASUALTY SUBSIDIARIES

	Net Earned Premiums	Investment Income	Losses and Loss Expenses Related to (1) Current Year	Losses and Loss Expenses Related to (2) Prior Years	Amortization of Deferred Policy Acquisition Costs	Net Paid Losses and Loss Expenses	Net Premiums Written
Year Ended December 31, 1997	$107,302,168	$11,492,012	$69,040,518	$(1,384,000)	$18,696,000	$65,610,249	$107,604,989
Year Ended December 31, 1996	$104,527,038	$10,768,518	$73,211,924	$(2,791,000)	$17,032,000	$66,148,749	$109,169,176
Year Ended December 31, 1995	$ 89,522,203	$ 9,700,820	$61,162,695	$(3,093,000)	$14,412,000	$50,231,653	$95,784,490

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Date: March 30, 1998

By: /s/ Donald H. Nikolaus
Donald H. Nikolaus, President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the Registrant in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Donald H. Nikolaus Donald H. Nikolaus	President and a Director (principal executive officer)	March 30, 1998
/s/ Ralph G. Spontak Ralph G. Spontak	Senior Vice President and Secretary (principal financial and accounting officer)	March 30, 1998
/s/ Robert S. Bolinger Robert S. Bolinger	Director	March 30, 1998
Thomas J. Finley	Director	March , 1998
/s/ Patricia A. Gilmartin Patricia A. Gilmartin	Director	March 30, 1998
/s/ Philip H. Glatfelter, II Philip H. Glatfelter, II	Director	March 30, 1998
/s/ C. Edwin Ireland C. Edwin Ireland	Director	March 30, 1998
R. Richard Sherbahn	Director	March , 1998

EXHIBIT INDEX
(Pursuant to Item 601 of Regulation S-K)

Exhibit No.	Description of Exhibits	Reference
(3)(i)	Certificate of Incorporation of Registrant	(a)
(3)(ii)	Amended and Restated By-laws of Registrant	(b)
(4)	Form of Registrant's Common Stock Certificate	(a)
Management Contracts and Compensatory Plans or Arrangements		
(10)(A)	Donegal Mutual Insurance Company Money Purchase Pension Plan and Trust dated March 12, 1985	(a)
(10)(B)	Donegal Mutual Insurance Company Profit Sharing Plan and Trust dated March 12, 1985	(a)
(10)(C)	Donegal Group Inc. Key Executive Incentive Bonus Plan dated September 29, 1986	(c)
(10)(D)	Donegal Group Inc. Employee Stock Purchase Plan, as amended	(c)
(10)(E)	Donegal Group Inc. Equity Incentive Plan, as amended	(c)
(10)(F)	Donegal Group Inc. Agency Stock Purchase Plan	(j)
(10)(G)	Donegal Group Inc. Amended and Restated 1996 Equity Incentive Plan	(b)
(10)(H)	Donegal Group Inc. Amended and Restated 1996 Equity Incentive Plan for Directors	filed herewith
(10)(I)	Donegal Group Inc. Executive Restoration Plan	(b)

Other Material Contracts
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(10)(J)	Tax Sharing Agreement dated September 29, 1986 between Donegal Group Inc. and Atlantic States Insurance Company	(a)
(10)(K)	Services Allocation Agreement dated September 29, 1986 between Donegal Mutual Insurance Company, Donegal Group Inc. and Atlantic States Insurance Company	(a)
(10)(L)	Proportional Reinsurance Agreement dated September 29, 1986 between Donegal Mutual Insurance Company and Atlantic States Insurance Company	(a)
(10)(M)	Amendment dated October 1, 1988 to Proportional Reinsurance Agreement between Donegal Mutual Insurance Company and Atlantic States Insurance Company	(d)
(10)(N)	Multi-Line Excess of Loss Reinsurance Agreement effective January 1, 1993 between Donegal Mutual Insurance Company, Southern Insurance Company of Virginia, Atlantic States Insurance Company and Pioneer Mutual Insurance Company, and Christiana General Insurance Corporation of New York, Cologne Reinsurance Company of America, Continental Casualty Company, Employers Reinsurance Corporation and Munich American Reinsurance Company	(f)
(10)(O)	Amendment dated July 16, 1992 to Proportional Reinsurance Agreement between Donegal Mutual Insurance Company and Atlantic States Insurance Company	(e)

(10)(P)	Amendment dated as of December 21, 1995 to Proportional Reinsurance Agreement between Donegal Mutual Insurance Company and Atlantic States Insurance Company	(g)
(10)(Q)	Credit Agreement dated as of December 29, 1995 between Donegal Group Inc. and Fleet National Bank of Connecticut	(g)
(10)(R)	Stock Purchase Agreement dated as of December 21, 1995 between Donegal Mutual Insurance Company and Donegal Group Inc.	(g)
(10)(S)	Donegal Group Inc. 1996 Employee Stock Purchase Plan.	(h)
(10)(T)	Reinsurance and Retrocession Agreement dated May 21, 1996 between Donegal Mutual Insurance Company and Pioneer Insurance Company.	(b)
(10)(U)	Reinsurance and Retrocession Agreement dated May 21, 1996 between Donegal Mutual Insurance Company and Delaware American Insurance Company.	(b)
(10)(V)	Reinsurance and Retrocession Agreement dated May 21, 1996 between Donegal Mutual Insurance Company and Southern Insurance Company of Virginia.	(b)
(13)	1997 Annual Report to Stockholders (electronic filing contains only those portions incorporated by reference into this Form 10-K report).	filed herewith
(20)	Proxy Statement relating to the Annual Meeting of Stockholders to be held on April 16, 1998, provided, however, that the Compensation Committee Report and the Performance Graph shall not be deemed filed as part of this Form 10-K Report	filed herewith
(21)	Subsidiaries of Registrant	filed herewith
(23)	Consent of Independent Auditors	filed herewith

(27)	Financial Data Schedule	filed herewith

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(a) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form S-1 Registration Statement No. 33-8533 declared effective October 29, 1986.

(b) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 10-K Report for the year ended December 31, 1996.

(c) Such exhibit is hereby incorporated by reference to the like-described exhibits in Registrant's Form 10-K Report for the year ended December 31, 1986.

(d) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 10-K Report for the year ended December 31, 1988.

(e) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 10-K Report for the year ended December 31, 1992.

(f) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form S-2 Registration Statement No. 33-67346 declared effective September 29, 1993.

(g) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 8-K Report dated December 21, 1995.

(h) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form S-8 Registration Statement No. 333-1287 filed February 29, 1996.

(i) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 10-K Report for the year ended December 31, 1995.

(j) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form S-2 Registration Statement No. 333-06787 declared effective August 1, 1996.

DONEGAL GROUP INC.
AMENDED & RESTATED
1996 EQUITY INCENTIVE PLAN
FOR DIRECTORS

DONEGAL GROUP INC., a corporation organized under the laws of the State of Delaware, hereby sets forth the 1996 Equity Incentive Plan for Directors. The Plan provides for the grant of (i) Options to Outside Directors of the Company and the Mutual Company and (ii) Restricted Stock Awards to Directors of the Company and the Mutual Company, as each of such capitalized terms is hereinafter defined.

1. DEFINITIONS. Whenever the following terms are used in the Plan they shall have the meanings specified below unless the context clearly indicates to the contrary:

"Board" shall mean the Board of Directors of the Company.

"Code" shall mean the Internal Revenue Code of 1986, as amended. Reference to a specific section of the Code shall include such section, any valid regulation promulgated thereunder and any comparable provision of any future legislation amending, supplementing or superseding such section.

"Common Stock" shall mean the Common Stock, $1.00 par value, of the Company.

"Company" shall mean Donegal Group Inc., a Delaware corporation.

"Director" shall mean a member of the Board of Directors of the Company and/or the Mutual Company.

"Exchange Act" shall mean the Securities Exchange Act of 1934, as amended.

"Fair Market Value" of the Common Stock on any date shall mean the closing price of the Common Stock for such date, as reported in The Wall Street Journal, or if not so reported, as otherwise reported by the National Association of Securities Dealers Automated Quotation ("Nasdaq") System, or if the Common Stock is not reported by Nasdaq, the fair market value shall be as determined by the Board. If no closing price is reported quoted for such date, the next preceding date for which such sale prices are quoted shall be used.

"Grantee" shall mean a Director to whom a Restricted Stock Award is granted.

"Mutual Company" shall mean Donegal Mutual Insurance Company.

"Option" shall mean a nonqualified stock option granted under the provisions of Section 4 of the Plan to purchase Common Stock of the Company.

"Optionee" shall mean an Outside Director to whom an Option is granted.

"Outside Director" shall mean a Director who is not also an employee of the Company, the Mutual Company or any affiliate of the Company or the Mutual Company.

"Plan" shall mean this 1996 Equity Incentive Plan for Directors.

"Restricted Stock Award" shall mean a restricted stock award granted under the provisions of Section 5 of the Plan.

"Secretary" shall mean the Secretary of the Company.

"Termination of Service" shall mean such time as a Director shall cease to serve as a member of the Board of Directors of the Company or the Mutual Company, whether as a result of resignation, failure to be reelected, removal for cause, death or any other reason.

2. ADMINISTRATION.

(a) ADMINISTRATION BY THE BOARD. The Plan shall be administered by the Board.

(b) DUTY AND POWERS OF THE BOARD. It shall be the duty of the Board to conduct the general administration of the Plan in accordance with its provisions. The Board shall have the power to interpret the Plan, the Options and the Restricted Stock Awards and to adopt rules for the administration, interpretation and application of the Plan as are consistent therewith and to interpret, amend or revoke any such rules. The Board shall have the discretion to determine who will be granted Options and to determine the number of Options to be granted to any Outside Director, the timing of such grant and the terms of exercise. The Board shall not have any discretion to determine who will be granted Restricted Stock Awards under the Plan.

(c) BOARD ACTIONS. The Board may act either by vote of a majority of its members present at a meeting of the Board at which a quorum is present or by a memorandum or other written instrument signed by all members of the Board.

(d) COMPENSATION; PROFESSIONAL ASSISTANCE; GOOD FAITH ACTIONS. Members of the Board shall not receive any compensation for their services in administering the Plan, but all expenses and liabilities they incur in connection with the administration of the Plan shall be borne by the Company. The Board may employ attorneys, consultants, accountants or other persons. The Board, the Company and the officers and directors of the Company shall be entitled to rely upon the advice, opinions or valuations of any such persons. All actions taken and all interpretations and determinations made by the Board in good faith shall be final and binding upon all Optionees and Grantees, the Company and all other interested persons. No member of the Board shall be personally liable for any action, determination or interpretation made in good faith with respect to the Plan, and all members of the Board shall be fully protected and indemnified by the Company in respect to any such action, determination or interpretation.

3. SHARES SUBJECT TO THE PLAN.

(a) LIMITATIONS. The shares of stock issuable pursuant to Options or Restricted Stock Awards shall be shares of the Common Stock. The total number of such shares that may be issued pursuant to Options or Restricted Stock Awards granted under the Plan shall not exceed 200,000 in the aggregate.

(b) EFFECT OF UNEXERCISED OR CANCELLED OPTIONS. If an Option expires or is cancelled for any reason without having been fully exercised or vested, the number of shares subject to such Option that were not purchased or did not vest prior to such expiration or cancellation may again be made subject to an Option or Restricted Stock Award granted hereunder.

(c) CHANGES IN CAPITALIZATION. Subject to any required action by the stockholders of the Company, the number of shares of Common Stock covered by each outstanding Option and Restricted Stock Award and the number of shares of Common Stock that have been authorized for issuance under the Plan but as to which no Options or Restricted Stock Awards have yet been granted or which have been returned to the Plan upon cancellation or expiration of an Option, as well as the price per share of Common Stock covered by each such outstanding Option, shall be proportionately adjusted for any increase or decrease in the number of issued shares of Common Stock resulting from a stock split, reverse stock split, stock dividend, combination or reclassification of the Common Stock, or any other increase or decrease in the number of issued shares of Common Stock effected without receipt of consideration by the Company; provided, however, that conversion of any convertible securities of the Company shall not be deemed to have been "effected without receipt of consideration." Such adjustment shall be made by the Board, whose determination in that respect shall be final, binding and conclusive. Except as expressly provided herein, no issuance by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of shares of Common Stock subject to an Option or Restricted Stock Award.

(d) DISSOLUTION OR LIQUIDATION. In the event of the proposed dissolution or liquidation of the Company, all outstanding Options will terminate immediately prior to the consummation of such proposed action, unless otherwise provided by the

Board. The Board may, in the exercise of its discretion in such instances, declare that any Option shall terminate as of a date fixed by the Board and give each Option holder the right to exercise his Option as to all or any part of the shares of Common Stock covered by the Option, including shares as to which the Option would not otherwise be exercisable.

(e) SALE OR MERGER. In the event of a proposed sale of all or substantially all of the assets of the Company, or the merger of the Company with or into another corporation, the Board, in the exercise of its sole discretion, may take such action as it deems desirable, including, but not limited to: (i) causing an Option to be assumed or an equivalent option to be substituted by the successor corporation or a parent or subsidiary of such successor corporation, (ii) providing that each Option holder shall have the right to exercise his Option as to all of the shares of Common Stock covered by the Option, including shares as to which the Option would not otherwise be exercisable, or (iii) declaring that an Option shall terminate at a date fixed by the Board, provided that the Option holder is given notice and opportunity to exercise the then exercisable portion of his Option prior to such date.

4. STOCK OPTIONS.

(a) GRANTING OF OPTIONS.

(i) ELIGIBILITY. Each Outside Director shall be eligible to be granted Options.

(ii) GRANTING OF OPTIONS. Options may be granted by the Board at any time and from time to time while the Plan shall be in effect. The Board shall have the authority to determine the Outside Directors to whom Options are granted, the number of Options to be granted to each and the timing and vesting of each grant. The Board's determinations with respect to Options granted under the Plan need not be uniform and may be made selectively among Outside Directors as the Board, in its discretion, shall determine.

(iii) TYPE OF OPTIONS. All Options granted under the Plan shall be options not intended to qualify as incentive stock options under Section 422 of the Code.

(b) TERMS OF OPTIONS.

(i) OPTION AGREEMENT. Each Option shall be evidenced by a written stock option agreement that shall be executed by the Optionee and on behalf of the Company and that shall contain such terms and conditions as the Board determines are required or appropriate under the Plan.

(ii) OPTION PRICE. The exercise price of the shares subject to each Option shall be not less than 100% of the Fair Market Value for such shares on the date the Option is granted.

(iii) DATE OF GRANT. The date on which an Option shall be deemed to have been granted under the Plan shall be the date of the Board's authorization of the Option or such later date as may be determined by the Board at the time the Option is authorized.

(iv) EXERCISE TERM. Each stock option agreement shall state the period or periods of time within which the Option may be exercised, in whole or in part, as determined by the Board, provided that no Option shall be exercisable after ten years from the date of grant thereof. The Board shall have the power to permit an acceleration of previously established exercise terms, subject to the requirements set forth herein, upon such circumstances and subject to such terms and conditions as the Board deems appropriate.

(v) RIGHTS UPON TERMINATION OF SERVICE. Upon an Optionee's Termination of Service, for any reason other than death, the Optionee shall have the right to exercise the Option during its term within a period of three months after such termination to the extent that the Option was exercisable at the time of termination, or within such other period, and subject to such terms and conditions, as may be specified by the Board. In the event that an Optionee dies prior to the expiration of his Option and without having fully exercised his Option, the Optionee's representative or successor shall have the right to exercise the Option during its term within a period of one year after Termination of Service due to death to the extent that the Option was exercisable at the time of Termination of Service, or within such other period, and subject to such terms and conditions, as may be specified by the Board.

(c) EXERCISE OF OPTIONS.

(i) PERSON ELIGIBLE TO EXERCISE. During the lifetime of the Optionee, only the Optionee may exercise an Option or any portion thereof. After the death of the Optionee, any exercisable portion of an Option may be exercised by the Optionee's personal representative or by any person empowered to do so under the deceased Optionee's will or under the then applicable laws of descent and distribution. The Company may require appropriate proof from any such person of such person's right to exercise the Option or any portion thereof.

(ii) FRACTIONAL SHARES. The Company shall not be required to issue fractional shares on exercise of an Option.

(iii) MANNER OF EXERCISE. Options may be exercised in whole or in part, from time to time, by giving written notice of exercise to the Secretary, specifying the number of shares to be purchased. The purchase price of the shares with respect to which an Option is exercised shall be payable in full with the notice of exercise in cash, Common Stock at Fair Market Value, or a combination thereof, as the Board may determine from time to time and subject to such terms and conditions as may be prescribed by the Board for such purpose. The Board may also, in its discretion and subject to prior notification to the Company by an Optionee, permit an Optionee to enter into an agreement with the Company's transfer agent or a brokerage firm of national standing whereby the Optionee will simultaneously exercise the Option and sell the shares acquired thereby through the Company's transfer agent or such a brokerage firm and either the Company's transfer agent or the brokerage firm executing the sale will remit to the Company from the proceeds of sale the exercise price of the shares as to which the Option has been exercised.

(iv) RIGHTS OF STOCKHOLDERS. An Optionee shall not be, nor have any of the rights of, a stockholder of the Company in respect to any shares that may be purchased upon the exercise of any Option or portion thereof unless and until certificates representing such shares have been issued by the Company to such Optionee.

(v) GENERAL RESTRICTIONS. Each Option granted under the Plan shall be subject to the requirement that, if at any time the Board shall determine that (i) the listing, registration or qualification of the shares of Common Stock subject or related thereto upon any securities exchange or under any state or federal law, or (ii) the consent or approval of any government regulatory body, or (iii) the satisfaction of any tax payment or withholding obligation, or (iv) an agreement by the Optionee with respect to the disposition of shares of Common Stock, is necessary or desirable as a condition of or in connection with the granting of such Option or the issuance or purchase of shares of Common Stock thereunder, such Option shall not be consummated in whole or in part unless such listing, registration, qualification, consent, approval, payment, withholding or agreement shall have been effected or obtained free of any conditions not acceptable to the Board.

5. RESTRICTED STOCK AWARDS.

(a) GRANTING OF AWARDS.

(i) ELIGIBILITY. Each Director shall be eligible to be granted Restricted Stock Awards.

(ii) GRANTING OF AWARDS. Each Director shall be granted annual Restricted Stock Awards consisting of 100 shares of Common Stock, such Restricted Stock Awards to be made on the first business day of January in each year, commencing January 2, 1997, provided that the Director served as a member of the Board or of the Board of Directors of the Mutual Company during any portion of the preceding calendar year.

(b) TERMS OF RESTRICTED STOCK AWARDS.

(i) RESTRICTED STOCK AGREEMENT. Each Restricted Stock Award shall be evidenced by a written restricted stock agreement that shall be executed by the Grantee and the Company and that shall contain such restrictions, terms and conditions as are required by the Plan.

(ii) RESTRICTIONS ON TRANSFER. The shares of Common Stock comprising the Restricted Stock Awards may not be sold or otherwise transferred by the Grantee until one year after the date of grant. Although the shares of Common Stock comprising each Restricted Stock Award shall be registered in the name of the Grantee, the Company reserves the right to place a restrictive legend on the stock certificate. None of such shares of Common Stock shall be subject to forfeiture.

(iii) RIGHTS AS STOCKHOLDER.

(a) Subject to the restrictions on transfer set forth in Section 5(b)(ii) hereof, a Grantee shall have all the rights of a stockholder with respect to the shares of Common Stock issued pursuant to Restricted Stock Awards made hereunder, including the right to vote the shares and receive all dividends and other distributions paid or made with respect to the shares.

(b) In the event of changes in the capital stock of the Company by reason of stock dividends, split-ups or combinations of shares, reclassifications, mergers, consolidations, reorganizations or liquidations while the shares comprising a Restricted Stock Award shall be subject to restrictions on transfer, any and all new, substituted or additional securities to which the Grantee shall be entitled by reason of the ownership of a Restricted Stock Award shall be subject immediately to the terms, conditions and restrictions of the Plan.

(c) If a Grantee receives rights or warrants with respect to any shares comprising a Restricted Stock Award, such rights or warrants or any shares or other securities acquired by the exercise of such rights or warrants may be held, exercised, sold or otherwise disposed of by the Grantee free and clear of the restrictions and obligations set forth in the Plan.

(iv) GENERAL RESTRICTIONS. Each Restricted Stock Award granted under the Plan shall be subject to the requirement that if, at any time the Board shall determine that (i) the listing, registration or qualification of the shares of Common Stock subject or related thereto upon any securities exchange or under any state or federal law, or (ii) the consent or approval of any government regulatory body, or (iii) the satisfaction of any tax payment or withholding obligation, or (iv) an agreement by the Grantee with respect to the disposition of shares of Common Stock, is necessary or desirable as a condition of or in connection with the granting of such Restricted Stock Award, such Restricted Stock Award shall not be consummated in whole or in part unless such listing, registration, qualification, consent, approval or agreement shall have been effected or obtained free of any conditions not acceptable to the Board.

6. MISCELLANEOUS PROVISIONS.

(a) NO ASSIGNMENT OR TRANSFER. No Option or interest or right therein or part thereof, and, for a period of one year after the date of grant, no Restricted Stock Award or any interest therein or part thereof, shall be liable for the debts, contracts, or engagements of the Optionee or Grantee or his successors in interest nor shall they be subject to disposition by transfer, alienation, anticipation, pledge, encumbrance, assignment or any other means, whether such disposition is voluntary or involuntary or by operation of law by judgment, levy, attachment, garnishment or any other legal or equitable proceedings (including bankruptcy), and any attempted disposition thereof shall be null and void and of no effect; provided, however, that nothing in this Section 6(a) shall prevent transfers by will or by the applicable laws of descent and distribution.

(b) AMENDMENT, SUSPENSION OR TERMINATION OF THE PLAN. The Plan may be wholly or partially amended or otherwise modified, suspended or terminated at any time or from time to time by the Board, subject to any required stockholder approval or any stockholder approval that the Board may deem advisable for any reason, such as for the purpose of obtaining or retaining any statutory or regulatory benefits under tax, securities or other laws or satisfying any applicable stock exchange listing requirements. Neither the amendment, suspension nor termination of the Plan shall, without the consent of the Optionee or Grantee, alter or impair any rights or obligations under any outstanding Option or Restricted Stock Award. No Option or Restricted Stock Award may be granted during any period of suspension nor after termination of the Plan.

(c) WITHHOLDING. Whenever the Company proposes or is required to issue or transfer shares of Common Stock under the Plan, the Company shall have the right to require the recipient to remit to the Company an amount sufficient to satisfy any federal, state or local withholding tax requirements prior to the delivery of any certificate for such shares. If and to the extent authorized by the Board, in its sole discretion, an Optionee may make an election, by means of a form of election to be prescribed by the Board, to have shares of Common Stock that are acquired upon exercise of an Option withheld by the Company or to tender other shares of Common Stock or other securities of the Company owned by the Optionee to the Company at the time of exercise of an Option to pay the amount of tax that would otherwise be required by law to be withheld by the Company as a result of any exercise of an Option. Any such election shall be irrevocable and shall be subject to termination by the Board, in its sole discretion, at any time. Any securities so withheld or tendered will be valued by the Board as of the date of exercise.

(d) RESERVATION OF SHARES. The Company, during the term of the Plan, will at all times reserve and keep available such number of shares as shall be sufficient to satisfy the requirements of the Plan. Inability of the Company to obtain authority from any regulatory body having jurisdiction, which authority is deemed by the Company's counsel to be necessary to the lawful issuance and sale of any shares hereunder, shall relieve the Company of any liability for the failure to issue or sell such shares as to which such requisite authority shall not have been obtained.

(e) DURATION OF THE PLAN. The Plan shall remain in effect until all Options granted under the Plan have been satisfied by the issuance of shares, but no Option or Restricted Stock Award shall be granted more than ten years after the earlier of the date the Plan is adopted by the Company or is approved by the Company's stockholders.

(f) NO PROHIBITION ON CORPORATE ACTION. No provision of the Plan shall be construed to prevent the Company or any officer or director thereof from taking any action deemed by the Company or such officer or director to be appropriate or in the Company's best interest, whether or not such action could have an adverse effect on the Plan or any Options or Restricted Stock Awards granted hereunder, and no Director or Director's estate, personal representative or beneficiary shall have any claim against the Company or any officer or director thereof as a result of the taking of such action.

(g) INDEMNIFICATION. With respect to the administration of the Plan, the Company shall indemnify each present and future member of the Board against, and each member of the Board shall be entitled without further action on his part to indemnity from the Company for, all expenses (including the amount of judgments and the amount of approved settlements made with a view to the curtailment of costs of litigation, other than amounts paid to the Company itself) reasonably incurred by him in connection with or arising out of, any action, suit or proceeding in which he may be involved by reason of his being or having been a member of the Board, whether or not he continues to be such member at the time of incurring such expenses; provided, however, that such indemnity shall not include any expenses incurred by any such member of the Board (i) in respect of matters as to which he shall be finally adjudged in any such action, suit or proceeding to have been guilty of gross negligence or willful misconduct in the performance of his duty as such member of the Board; or (ii) in respect of any matter in which any settlement is effected for an amount in excess of the amount approved by the Company on the advice of its legal counsel; and provided further that no right of indemnification under the provisions set forth herein shall be available to or enforceable by any such member of the Board unless, within 60 days after institution of any such action, suit or proceeding, he shall have offered the Company in writing the opportunity to handle and defend same at its own expense. The foregoing right of indemnification shall inure to the benefit of the heirs, executors or administrators of each such member of the Board and shall be in addition to all other rights to which such member may be entitled as a matter of law, contract or otherwise.

(h) COMPLIANCE WITH PLAN PROVISIONS. No Optionee or Grantee shall have any right with respect to the Plan, the Common Stock reserved for issuance under the Plan or in any Option or Restricted Stock Award until a written stock option agreement or a written restricted stock agreement, as the case may be, shall have been executed on behalf of the Company and by the Optionee or Grantee, and all the terms, conditions and provisions of the Plan and the Option or Restricted Stock Award applicable to such Optionee or Grantee (and each person claiming under or through him) have been met.

(i) APPROVAL OF COUNSEL. In the discretion of the Board, no shares of Common Stock, other securities or property of the Company or other forms of payment shall be issued hereunder with respect to any Option or Restricted Stock Award unless counsel for the Company shall be satisfied that such issuance will be in compliance with applicable federal, state, local and foreign legal, securities exchange and other applicable requirements.

(j) EFFECTS OF ACCEPTANCE. By accepting any Option or Restricted Stock Award or other benefit under the Plan, each Optionee and Grantee and each person claiming under or through him shall be conclusively deemed to have indicated his acceptance and ratification of, and consent to, any action taken under the Plan by the Company, the Board or its delegates.

(k) CONSTRUCTION. The masculine pronoun shall include the feminine and neuter, and the singular shall include the plural, where the context so indicates.

(l) COMPLIANCE WITH RULE 16b-3. To the extent that Rule 16b-3 under the Exchange Act applies to Options or Restricted Stock Awards granted under the Plan, it is the intention of the Company that the Plan comply in all respects with the requirements of Rule 16b-3, that any ambiguities or inconsistencies in construction of the Plan be interpreted to give effect to such intention and that if the Plan shall not so comply, whether on the date of adoption or by reason of any later amendment to or interpretation of Rule 16b-3, the provisions of the Plan shall be deemed to be automatically amended so as to bring them into full compliance with such rule.

(m) STOCKHOLDER APPROVAL. Except with respect to the Restricted Stock Awards to be granted on January 2, 1997, no Option may be exercised and no Restricted Stock Award may be granted until the Plan shall have been approved by the affirmative vote of the holders of a majority of the shares of the Company's outstanding Common Stock present or represented and entitled to vote at a duly convened meeting of stockholders held on or before December 31, 1997. The failure of the stockholders of the Company to approve the Plan shall in no way terminate or otherwise impair the Restricted Stock Awards granted to Directors hereunder on January 2, 1997.

(n) TITLES. Titles are provided herein for convenience only and are not to serve as a basis for interpretation or construction of the Plan.

Adopted by the Board of Directors on December 19, 1996.

Approved by the Stockholders on April 17, 1997.

Amended by the Board of Directors on March 16, 1998.

Amended by the Stockholders on April ___, 1998.

FINANCIAL HIGHLIGHTS

Year Ended December 31,	1997	1996*	1995*	1994*	1993*
Income Statement Data					
Net premiums earned	$107,302,168	$104,527,038	$89,522,203	$79,026,809	$71,466,765
Investment income	11,507,277	10,799,369	9,713,744	8,188,852	6,842,392
Total revenues	121,327,606	117,581,664	101,615,698	88,607,550	80,165,058
Net income	10,641,186	8,557,774	9,559,610	4,589,397	6,777,461
Net income per common share					
Basic	1.77	1.46	1.72	.84	1.56
Diluted	1.77	1.45	1.68	.82	1.53
Balance Sheet Data					
Total assets	$304,104,505	$287,990,994	$244,943,598	$215,013,165	$176,979,530
Stockholders' equity	91,596,663	81,599,274	73,020,689	61,338,761	58,872,709
Book value per share	15.19	13.69	12.85	11.23	10.79

Management's Discussion and Analysis of Results of Operation and Financial Condition

Donegal Group Inc. ("DGI" or the "Company") is a regional insurance holding company doing business in Pennsylvania, Maryland, Delaware, Virginia and Ohio through its four wholly owned property-casualty insurance subsidiaries, Atlantic States Insurance Company ("Atlantic States"), Southern Insurance Company of Virginia ("Southern"), Delaware Atlantic Insurance Company ("Delaware") and Pioneer Insurance Company ("Pioneer") (collectively "Insurance Subsidiaries"). The Company's major lines of business in 1997 and their percentage of total net earned premiums were Automobile Liability (27.8%), Workers' Compensation (15.9%), Automobile Physical Damage (17.1%), Homeowners (17.6%), and Commercial Multiple Peril (15.6%). The Insurance Subsidiaries are subject to regulation by Insurance Departments in those states in which they operate and undergo periodic examination by those departments. The Insurance Subsidiaries are also subject to competition from other insurance carriers in their operating areas. DGI was formed in September 1986 by Donegal Mutual Insurance Company (the "Mutual Company"), which owns 58.2% of the outstanding common shares of the Company as of December 31, 1997.

On July 15, 1997, the Company issued a 4 for 3 stock split in the form of a 33 1/3% stock dividend to stockholders of record as of June 25, 1997. Per share information prior to July 15, 1997, has been restated for this change.

Atlantic States participates in an intercompany pooling arrangement with the Mutual Company and assumes 65% (60% in 1995) of the pooled business. Southern cedes 50% of its business to the Mutual Company and Delaware cedes 70% of its Workers' Compensation business to the Mutual Company. Because the Mutual Company places substantially all of the business assumed from Southern and Delaware into the pool, from which the Company has a 65% allocation, the Company's results of operations include approximately 83% of the business written by Southern and approximately 76% of the Workers' Compensation business written by Delaware.

In March 1997, the Company acquired all of the outstanding stock of Pioneer. This transaction was accounted for as if it were a "pooling of interest," and as such the Company's financial statements have been restated to include Pioneer as a consolidated subsidiary from January 1, 1993, to the present.

In addition to the Company's insurance subsidiaries, it also owns all of the outstanding stock of Atlantic Insurance Services, Inc. ("AIS"), an insurance services organization currently providing inspection and policy auditing information on a fee for service basis to its affiliates and the insurance industry.

Results of Operation 1997 Compared to 1996

Total revenues for 1997 were $121,327,606 which were $3,745,942, or 3.2%, greater than 1996. Net premiums earned increased to $107,302,168, an increase of $2,775,130, or 2.7%, over 1996. Direct premiums written by the combined pool of Atlantic States and the Mutual Company decreased $107,786, with Workers' Compensation decreasing $4,052,981, or 19.5%, due to a mandatory rate rollback for that line in Pennsylvania. A 12.4% increase in the direct premiums written of Southern, a 6.6% increase in the direct premiums written of Delaware and an 18.5% decrease in the direct premiums written of Pioneer accounted for the majority of the remaining increase. The Company reported realized investment gains of $314,136, compared to realized investment gains of $172,734 in 1996. Gains in both years resulted from normal turnover of the Company's investment portfolio. As of December 31, 1997, 99.9% of the Company's bond portfolio was classified as Class 1 (highest quality) by the National Association of Insurance Commissioners' Security Valuation Office. Investment income increased $707,908. An increase in the average invested assets from $180,352,394 to $198,727,027, offset by a decrease in the average yield to 5.8% from 6.0% in 1996, accounted for the change.

The GAAP combined ratio of insurance operations was 97.6% in 1997, compared to 100.4% in 1996. The GAAP combined ratio is the sum of the ratios of incurred losses and loss adjustment expense to premiums earned (loss ratio), underwriting expenses to premiums earned (expense ratio) and policyholder dividends to premiums earned (dividend ratio). The loss ratio in 1997 was 63.1%, compared to 67.4% in 1996, accounting for the majority of the change in the combined ratio. This decrease in the loss ratio resulted from a return to more normal weather patterns in 1997, compared to severe winter weather experienced in the primary operating areas of the Company in the first quarter of 1996. The expense ratio for 1997 was 33.3%, compared to 31.5% in 1996, with the dividend ratio decreasing from 1.5% in 1996 to 1.2% in 1997 due primarily to the rate rollback in Workers' Compensation in 1997.

Results of Operation 1996 Compared to 1995

Total revenues for 1996 were $117,581,664 which were $15,965,966, or 15.7%, greater than 1995. Net premiums earned increased to $104,527,038, an increase of $15,004,835, or 16.8%, over 1995. An increase in Atlantic States' share of the pool with the Mutual Company, from 60% to 65% effective January 1, 1996 accounted for $6,701,309, or 7.5%, of this increase. A 1.9% increase in the direct premiums written by the combined pool of Atlantic States and the Mutual Company, a 15.8% increase in the direct premiums written of Southern, a 6.3% increase in the direct premiums written of Delaware and an 11.3% increase in the direct premiums written of Pioneer accounted for the majority of the remaining increase. The Company reported realized investment gains of $172,734, compared to realized investment gains of $399,706 in 1995. Gains in both years resulted from normal turnover of the Company's investment portfolio. As of December 31, 1996, 99.9% of the Company's bond portfolio was classified as Class 1 (highest quality) by the National Association of Insurance Commissioners' Security Valuation Office. Investment income increased $1,085,625. An increase in the average invested assets from $159,823,000 to $180,352,394, offset by a decrease in the average yield to 6.0% from 6.1% in 1995, accounted for the change.

The GAAP combined ratio of insurance operations was 100.4% in 1996, compared to 98.6% in 1995. The GAAP combined ratio is the sum of the ratios of incurred losses and loss adjustment expense to premiums earned (loss ratio), underwriting expenses to premiums earned (expense ratio) and policyholder dividends to premiums earned (dividend ratio). The loss ratio in 1996 was 67.4%, compared to 64.9% in 1995, accounting for the change. This increase in the loss ratio resulted from increased claim activity due to severe winter weather in the primary operating areas of the Company in the first quarter of 1996. The loss ratio in the first quarter was 72.4%, compared to 65.7% for the rest of the year. The expense ratio for 1996 was 31.5%, compared to 32.5% in 1995, with the dividend ratio increasing from 1.2% in 1995 to 1.5% in 1996 due to improved loss ratios in Workers' Compensation in 1996.

Liquidity and Capital Resources

The Company generates sufficient funds from its operations and maintains a high degree of liquidity in its investment portfolio. The primary source of funds to meet the demands of claim settlements and operating expenses are premium collections, investment earnings and maturing investments. As of December 31, 1997, the Company had no material commitment for capital expenditures.

In investing funds made available from operations, the Company maintains securities' maturities consistent with its projected cash needs for the payment of claims and expenses. The Company maintains a portion of its investment portfolio in relatively short-term and highly liquid assets to ensure the availability of funds.

As of December 31, 1997, pursuant to a credit agreement dated December 29, 1995, with Fleet National Bank of Connecticut, the Company had unsecured borrowings of $10.5 million. Such borrowings were made in connection with the acquisition of Delaware and a $5 million capital contribution to Atlantic States in 1996. Per the terms of the credit agreement, the Company may borrow up to $20 million at interest rates equal to the bank's then current prime rate or the then current London interbank Eurodollar bank rate plus 1.70%. At December 31, 1997, the interest rate on the outstanding balance was 7.60625%. In addition, the Company will pay a non-use fee at a rate of 3/10 of 1% per annum on the average daily unused portion of the bank's commitment. On each December 29, commencing December 29, 1999, the credit line will be reduced by $4 million. Any outstanding loan in excess of the remaining credit line after such reduction will then be payable.

The Company issued a note for $5,191,774 to the Mutual Company in connection with the purchase of Pioneer. This note, which was due December 31, 1997, was replaced by a similar note effective December 31, 1997, and payable December 31, 1998. Interest is payable on the new note on a quarterly basis at a rate of 7% per annum.

The Company's principal sources of cash with which to meet obligations and pay stockholder dividends are dividends from the Insurance Subsidiaries which 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 their domiciliary insurance regulatory authorities. The Insurance Subsidiaries are also subject to Risk Based Capital (RBC) requirements which may further impact their ability to pay dividends. At December 31, 1997, all four companies' statutory capital and surplus were substantially above the RBC requirements. At December 31, 1997, amounts available for distribution as dividends to DGI without prior approval of the insurance regulatory authorities were $7,349,284 from Atlantic States, $703,727 from Southern, $1,070,463 from Delaware and $542,799 from Pioneer.

Net unrealized gains resulting from fluctuations in the fair value of investments reported in the balance sheet at fair value were $1,011,417 (net of applicable federal income tax) at December 31, 1997, and $422,916 (net of applicable federal income tax) at December 31, 1996.

Credit Risk

The Company provides property and liability coverages through its subsidiaries' independent agency systems located throughout its operating area. The majority of this business is billed directly to the insured, although a portion of the Company's commercial business is billed through its agents, who are extended credit in the normal course of business.

The Company's Insurance Subsidiaries have reinsurance agreements in place with the Mutual Company, as described in Note 2 of the financial statements, and with a number of other major authorized reinsurers, as described in Note 8 of the financial statements.

Impact of Inflation

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

Year 2000 Issues

The year 2000 issue (i.e. the ability of computer systems to properly process information which contains dates beginning with January 1, 2000 and thereafter) affects virtually all companies. All computer systems used for processing of business for the Company are owned and operated by the Mutual Company. Certain of these computer systems utilized by the Mutual Company to process information use only two digits to identify a year. Because of this, the year 2000 would be represented in the system as "00" and would in most cases be interpreted by the computer as "1900" rather than "2000", resulting in processing errors.

The ability to process information in a timely and accurate manner is vital to the Company's property and casualty insurance business. The Company recognizes that the systems used to process its business must be able to accurately identify and process information containing year 2000 dates by the end of 1998. The Mutual Company has a vigorous and comprehensive project underway to ensure compliance in time to meet this deadline. This project was initiated as part of a review of the main application systems in 1995. The Mutual Company is taking the steps it deems appropriate to meet this challenge, including migrating to the most current version of vendors' software, which improves functionality in addition to being year 2000 compliant, replacing existing software with new software systems and rewriting existing computer programs. The goal of this project is to be substantially year 2000 compliant by the end of 1998.

Impact of New Accounting Standards

Disclosure of Information about Capital Structure

In February 1997, the Financial Accounting Standards Board issued SFAS No. 129, "Disclosure of Information about Capital Structure." SFAS No. 129 establishes standards for disclosing information about an entity's capital structure. SFAS No. 129 contains no change in disclosure requirements for entities that were previously subject to the requirements of APB Nos. 10 and 15 and SFAS No. 47, and as such the adoption of SFAS No. 129 did not have any effect on the Company's reporting.

Reporting Comprehensive Income

SFAS No. 130, "Reporting Comprehensive Income", requires enterprises to include a Statement of Comprehensive Income as part of their full set of financial statements for fiscal years beginning after December 15, 1997, with earlier adoption permitted. The Company intends to adopt SFAS No. 130 in 1998.

Disclosures about Segments of an Enterprise and Related Information

SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information", requires enterprises to provide disclosures about operating segments using the "management approach" for fiscal years beginning after December 15, 1997, with earlier adoption permitted. The Company intends to adopt SFAS No. 131 in 1998. The Company has not yet determined what its operating segments will be under SFAS No. 131.

Employers' Disclosures about Pensions and Other Postretirement Benefits

SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits," revises employer's disclosures about pensions and other postretirement benefit plans. It does not change the measurement or recognition of these plans. SFAS No. 132 is effective for fiscal years beginning after December 15, 1997, with earlier adoption permitted. The Company intends to adopt SFAS No. 132 in 1998.

Donegal Group Inc.
Consolidated Balance Sheets

December 31,	1997	1996*
Assets		
Investments		
Fixed maturities		
Held to maturity, at amortized cost (fair value $120,882,886 and $116,264,317)	$ 117,246,205	$ 114,339,006
Available for sale, at fair value (amortized cost $56,922,342 and $53,264,748)	57,731,251	53,536,543
Equity securities, available for sale, at fair value (cost $6,551,020 and $2,774,946)	7,274,562	3,142,944
Short-term investments, at cost, which approximates fair value	22,712,787	21,470,757
Total investments	204,964,805	192,489,250
Cash	3,413,315	3,700,163
Accrued investment income	2,741,207	2,628,563
Premiums receivable	11,244,628	11,075,415
Reinsurance receivable	40,953,032	40,875,009
Deferred policy acquisition costs	8,448,060	7,837,899
Federal income taxes receivable	56,454	--
Deferred tax asset, net	3,302,043	3,613,307
Prepaid reinsurance premiums	22,882,283	22,373,319
Property and equipment, net	4,938,524	2,622,399
Accounts receivable--securities	456,493	98,622
Due from affiliate	141,313	--
Other	562,348	677,048
Total assets	$ 304,104,505	$ 287,990,994
Liabilities and Stockholders' Equity		
Liabilities		
Losses and loss expenses	$ 118,112,390	$ 114,621,961
Unearned premiums	71,367,691	70,555,906
Accrued expenses	3,214,767	2,387,040
Current income taxes	--	644,529
Reinsurance balances payable	735,009	746,935
Cash dividend declared to stockholders	604,054	492,619
Line of credit	10,500,000	8,500,000
Accounts payable--securities	2,499,059	2,748,838
Other	283,098	204,989
Due to affiliate - Pioneer acquisition	5,191,774	5,191,774
Due to affiliate - other	--	297,129
Total liabilities	212,507,842	206,391,720
Stockholders' Equity		
Preferred stock, $1.00 par value, authorized 1,000,000 shares; none issued		
Common stock, $1.00 par value, authorized 10,000,000 shares, issued 6,122,431 and 4,540,569 shares and outstanding 6,030,715 and 4,471,782 shares	6,122,431	4,540,569
Additional paid-in capital	38,932,117	37,862,715
Net unrealized gains on investments available for sale, net of taxes	1,011,417	422,916
Retained earnings	46,422,454	39,664,830
Treasury stock, at cost	(891,756)	(891,756)
Total stockholders' equity	91,596,663	81,599,274
Total liabilities and stockholders' equity	$ 304,104,505	$ 287,990,994

* Restated

See accompanying notes to consolidated financial statements.

Donegal Group Inc.
Consolidated Statements of Income

Year Ended December 31,	1997	1996*	1995*
Revenues			
Premiums earned	$159,055,645	$145,712,891	$119,068,341
Premiums ceded	51,753,477	41,185,853	29,546,138
Net premiums earned	107,302,168	104,527,038	89,522,203
Investment income, net of investment expenses	11,507,277	10,799,369	9,713,744
Installment payment fees	818,981	786,779	712,279
Lease income	643,183	541,010	491,115
Service fees	741,861	754,734	776,651
Net realized investment gains	314,136	172,734	399,706
Total revenues	121,327,606	117,581,664	101,615,698
Expenses			
Losses and loss expenses	99,408,492	98,615,417	75,318,765
Reinsurance recoveries	31,751,974	28,194,493	17,249,070
Net losses and loss expenses	67,656,518	70,420,924	58,069,695
Amortization of deferred policy acquisition costs	18,696,000	17,032,000	14,412,000
Other underwriting expenses	17,058,668	15,876,797	14,702,852
Policy dividends	1,319,384	1,609,369	1,106,357
Other	1,513,256	1,530,635	1,256,839
Interest	910,237	375,311	7,604
Total expenses	107,154,063	106,845,036	89,555,347
Income before income taxes	14,173,543	10,736,628	12,060,351
Income taxes	3,532,357	2,178,854	2,500,741
Net income	$ 10,641,186	$ 8,557,774	$ 9,559,610
Net income per common share			
Basic	$ 1.77	$ 1.46	$ 1.72
Diluted	$ 1.77	$ 1.45	$ 1.68

* Restated

See accompanying notes to consolidated financial statements.

Donegal Group Inc.
Consolidated Statements of Stockholders' Equity

	Preferred Stock Shares	Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital
Balance, January 1, 1995*	0	$ 0	4,162,770	$ 4,162,770	$ 34,005,370
Issuance of common stock			163,592	163,592	1,559,422
Net income*					
Change in unrealized gains (losses) on investments (Net of applicable federal income taxes)*					
Cash dividends $.30 per share					
Balance, December 31, 1995*	0	$ 0	4,326,362	$ 4,326,362	$ 35,564,792
Issuance of common stock			214,207	214,207	2,297,923
Net income*					
Change in unrealized gains (losses) on investments (Net of applicable federal income taxes)*					
Purchase of 43,739 shares of treasury stock					
Cash dividends $.33 per share					
Balance, December 31, 1996*	0	$ 0	4,540,569	$ 4,540,569	$ 37,862,715
Issuance of common stock			61,523	61,523	1,069,402
Net income					
Change in unrealized gains on investments (Net of applicable federal income taxes)					
Cash dividends $.39 per share					
Stock dividend			1,520,339	1,520,339	
Balance, December 31, 1997	0	$ 0	6,122,431	$ 6,122,431	$ 38,932,117

	Net Unrealized Gains (Losses) on Investments Available for Sale	Retained Earnings	Treasury Stock	Total Stockholders' Equity
Balance, January 1, 1995*	$ (1,180,608)	$ 25,171,009	$ (819,780)	$ 61,338,761
Issuance of common stock				1,723,014
Net income*		9,559,610		9,559,610
Change in unrealized gains (losses) on investments (Net of applicable federal income taxes)*	2,079,294			2,079,294
Cash dividends $.30 per share		(1,679,990)		(1,679,990)
Balance, December 31, 1995*	$ 898,686	$ 33,050,629	$ (819,780)	$73,020,689
Issuance of common stock				2,512,130
Net income*		8,557,774		8,557,774
Change in unrealized gains (losses) on investments (Net of				

applicable federal income taxes)*	(475,770)			(475,770)
Purchase of 43,739 shares of treasury stock			(71,976)	(71,976)
Cash dividends				
$.33 per share		(1,943,573)		(1,943,573)
Balance,				
December 31, 1996*	$ 422,916	$ 39,664,830	$ (891,756)	$ 81,599,274
Issuance of common stock				1,130,925
Net income		10,641,186		10,641,186
Change in unrealized gains				
on investments (Net of				
applicable federal income taxes)	588,501			588,501
Cash dividends				
$.39 per share		(2,363,223)		(2,363,223)
Stock dividend		(1,520,339)		
Balance,				
December 31, 1997	$ 1,011,417	$ 46,422,454	$ (891,756)	$ 91,596,663

* Restated

Donegal Group Inc.
Consolidated Statements of Cash Flows

Year Ended December 31,	1997	1996*	1995*
Cash Flows from Operating Activities:			
Net income	$10,641,186	$ 8,557,774	$ 9,559,610
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	390,857	256,694	402,367
Realized investment gains	(314,136)	(172,734)	(399,706)
Changes in Assets and Liabilities:			
Losses and loss expenses	3,490,429	15,727,682	10,409,854
Unearned premiums	811,785	13,923,360	8,499,300
Accrued expenses	827,727	(300,425)	980,274
Premiums receivable	(169,213)	1,509,474	(2,925,535)
Deferred policy acquisition costs	(610,161)	(935,681)	(1,350,349)
Deferred income taxes	7,108	3,380	(521,952)
Reinsurance receivable	(78,023)	(12,649,518)	(2,533,170)
Accrued investment income	(112,644)	(124,330)	(388,711)
Amounts due from affiliate	(438,442)	1,514,009	374,827
Reinsurance balances payable	(11,926)	64,586	(70,170)
Prepaid reinsurance premiums	(508,964)	(9,281,222)	(2,237,013)
Current income taxes	(700,983)	1,353,718	(821,857)
Other, net	192,808	44,969	(121,725)
Net adjustments	2,776,222	10,933,962	9,296,434
Net cash provided by operating activities	13,417,408	19,491,736	18,856,044
Cash Flows from Investing Activities:			
Purchase of fixed maturities			
Held to maturity	(15,834,418)	(30,795,475)	(26,505,938)
Available for sale	(21,614,427)	(21,900,833)	(28,445,845)
Purchase of equity securities	(10,598,546)	(9,077,146)	(6,072,439)
Sale of fixed maturities			
Available for sale	--	7,247,675	5,327,499
Maturity of fixed maturities			
Held to maturity	11,909,421	11,996,190	11,496,250
Available for sale	18,860,222	17,634,933	6,631,844
Sale of equity securities	6,695,236	9,493,480	8,121,345
Acquisition and assumption of Delaware	--	(202,243)	(5,300,000)
Purchase of property and equipment	(2,758,851)	(255,754)	(336,537)
Net sales (purchases) of short-term investments	(1,242,030)	(6,391,292)	11,763,556
Net cash used in investing activities	(14,583,393)	(22,250,465)	(23,320,265)
Cash Flows from Financing Activities:			
Issuance of common stock	1,130,925	2,512,130	1,723,014
Line of credit, net	2,000,000	3,500,000	5,000,000
Cash dividends paid	(2,251,788)	(1,878,648)	(1,621,631)
Purchase of treasury stock	--	(71,976)	--
Net cash provided by financing activities	879,137	4,061,506	5,101,383
Net increase (decrease) in cash	(286,848)	1,302,777	637,162
Cash at beginning of year	3,700,163	2,397,386	1,760,224
Cash at end of year	$ 3,413,315	$ 3,700,163	$ 2,397,386

* Restated

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

1--Summary of Significant Accounting Policies

Organization and Business

The Company was organized as a regional insurance holding company by Donegal Mutual Insurance Company (the "Mutual Company") and operates in Pennsylvania, Maryland, Delaware, Virginia and Ohio through its wholly owned stock insurance companies, Atlantic States Insurance Company ("Atlantic States"), Southern Insurance Company of Virginia ("Southern"), Delaware Atlantic Insurance Company ("Delaware"), and Pioneer Insurance Company ("Pioneer") (collectively "Insurance Subsidiaries"). The Company's major lines of business in 1997 and their percentages of total net earned premiums were Automobile Liability (27.8%), Workers' Compensation (15.9%), Automobile Physical Damage (17.1%), Homeowners (17.6%) and Commercial Multiple Peril (15.6%). The Insurance Subsidiaries are subject to regulation by Insurance Departments in those states in which they operate and undergo periodic examination by those departments. The Insurance Subsidiaries are also subject to competition from other insurance carriers in their operating areas. Atlantic States participates in an intercompany pooling arrangement with the Mutual Company and assumes 65% (60% in 1995) of the pooled business. Southern cedes 50% of its business to the Mutual Company and Delaware cedes 70% of its Workers' Compensation business to the Mutual Company. At December 31, 1997, the Mutual Company held 58.2% of the outstanding common stock of the Company.

On July 15, 1997, the Company issued a 4 for 3 stock split in the form of a 33 1/3% stock dividend to stockholders of record as of June 25, 1997. Per share information prior to July 15, 1997, has been restated for this change.

In March 1997, the Company acquired all of the outstanding stock of Pioneer. This transaction was accounted for as if it were a "pooling of interest," and as such the Company's financial statements have been restated to include Pioneer as a consolidated subsidiary from January 1, 1993, to the present.

In addition to the Company's insurance subsidiaries, it also owns all of the outstanding stock of Atlantic Insurance Services, Inc. ("AIS"), an insurance services organization currently providing inspection and policy auditing information on a fee for service basis to its affiliates and the insurance industry.

Basis of Consolidation

The consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles, include the accounts of Donegal Group Inc. and its wholly owned subsidiaries. All significant inter-company accounts and transactions have been eliminated in consolidation. The term "Company" as used herein refers to the consolidated entity. Certain amounts in the 1996 and 1995 financial statements have been reclassified to conform to the current year presentation.

Use of Estimates

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ significantly from those estimates.

Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the liabilities for losses and loss expenses. While management uses available information to provide for such liabilities, future additions to these liabilities may be necessary based on changes in trends in claim frequency and severity.

Investments

The Company classifies its debt and equity securities into the following categories:

Held to Maturity--Debt securities that the Company has the positive intent and ability to hold to maturity; reported at amortized cost.

Available for Sale--Debt and equity securities not classified as either held-to-maturity or trading; reported at fair value, with unrealized gains and losses excluded from income and reported as a separate component of stockholders' equity (net of tax effects).

Short-term investments are carried at amortized cost, which approximates fair value.

If there is a decline in fair value which is other than temporary, the carrying value for investments in the held to maturity and available for sale categories is reduced to fair value. Such decline in carrying value is recognized as a realized loss and charged to income.

Premiums and discounts on debt securities are amortized over the life of the security as an adjustment to yield using the effective interest method. Realized investment gains and losses are computed using the specific identification method.

Premiums and discounts for mortgage-backed debt securities are amortized using anticipated prepayments with significant changes in estimated prepayments accounted for under the prospective method.

Fair Values of Financial Instruments

The Company has used the following methods and assumptions in estimating its fair value disclosures:

Investments--Fair values for fixed maturity securities are based on quoted market prices, when available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments or values obtained from independent pricing services through a bank trustee. The fair values for equity securities are based on quoted market prices.

Cash and Short-Term Investments--The carrying amounts reported in the balance sheet for these instruments approximate their fair values.

Premium and Reinsurance Receivables and Payables-- The carrying amounts reported in the balance sheet for these instruments approximate their fair values.

Line of Credit--The carrying amounts reported in the balance sheet for the line of credit approximates fair value due to the variable rate nature of the line of credit.

Revenue Recognition

Insurance premiums are recognized as income over the terms of the policies. Unearned premiums are calculated on a daily pro-rata basis.

Policy Acquisition Costs

Policy acquisition costs, consisting primarily of commissions, premium taxes and certain other variable underwriting costs, are deferred and amortized over the period in which the premiums are earned. Anticipated losses and loss expenses, expenses for maintenance of policies in force and anticipated investment income are considered in the determination of the recoverability of deferred acquisition costs.

Property and Equipment

Property and equipment are reported at depreciated cost that is computed using the straight-line method based upon estimated useful lives of the assets.

Losses and Loss Expenses

The liability for losses and loss expenses includes amounts determined on the basis of estimates for losses reported prior to the close of the accounting period and other estimates, including those for incurred but not reported losses and salvage and subrogation recoveries.

These liabilities are continuously reviewed and updated by management, and management believes that such liabilities are adequate to cover the ultimate net cost of claims and expenses. When management determines that changes in estimates are required, such changes are included in current earnings.

In addition, various Insurance Departments, as an integral part of their examination process, periodically review the Company's liabilities for losses and loss expenses. Such departments may require the Company to recognize additions to the liabilities based on their judgements about information available to them at the time of their examination.

The Company has no material exposures to environmental liabilities.

Income Taxes

The Company and its subsidiaries currently file a consolidated federal income tax return.

The Company accounts for income taxes using the asset and liability method. The objective of the asset and liability method is to establish deferred tax assets and liabilities for the temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities at enacted tax rates expected to be in effect when such amounts are realized or settled.

Credit Risk

The Company provides property and liability coverages through its Insurance Subsidiaries' independent agency systems located throughout its operating area. The majority of this business is billed directly to the insured, although a portion of the Company's commercial business is billed through its agents, who are extended credit in the normal course of business.

The Company's Insurance Subsidiaries have reinsurance agreements in place with the Mutual Company and with a number of other authorized reinsurers with at least an A.M. Best rating of A- or an equivalent financial condition.

Reinsurance Accounting and Reporting

The Company relies upon reinsurance agreements to limit its maximum net loss from large single risks or risks in concentrated areas, and to increase its capacity to write insurance. Reinsurance does not relieve the primary insurer from liability to its policyholders. To the extent that a reinsurer may be unable to pay losses for which it is liable under the terms of a reinsurance agreement, the Company is exposed to the risk of continued liability for such losses. However, in an effort to reduce the risk of non-payment, the Company requires all of its reinsurers to have an A.M. Best rating of A- or better or, with respect to foreign reinsurers, to have a financial condition which, in the opinion of management, is equivalent to a company with at least an A- rating. If the Company's reinsurers incur losses from their reinsurance arrangements with the Company, it is probable that the reinsurance premiums payable by the Company in the future could increase. Estimated amounts of reinsurance recoverable are reported as assets in the accompanying consolidated balance sheets as are prepaid reinsurance premiums which represent the unearned portion of premiums ceded.

Stock-Based Compensation

Stock-based compensation plans are accounted for under the provisions of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. As such, compensation expense would be recorded on the date of a stock option grant only if the current market price of the underlying stock exceeded the exercise price. SFAS No. 123, "Accounting for Stock-Based Compensation," permits entities to recognize as expense, over the vesting period, the fair value of all stock-based awards on the date of the grant. Alternatively, SFAS No. 123 allows entities to continue to apply the provisions of APB Opinion No. 25 and provide pro forma net income and earnings per share disclosures for employee stock option grants made in 1995 and future years as if the fair-value-based method defined in SFAS No. 123 had been applied. The Company has elected to continue to apply the provisions of APB Opinion No. 25 and provide the pro forma disclosures under SFAS No. 123.

Net Income per Common Share

The Company adopted SFAS No. 128, "Earnings Per Share," which is effective for financial statement periods ending after December 15, 1997, as of the end of 1997. The statement supersedes APB Opinion No. 15 and specifies that the calculation of earnings per share be reported on both a basic and diluted basis. Basic earnings per share are calculated by dividing income available to stockholders by the weighted average number of common shares outstanding for the period, while diluted earnings per share reflects the dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. Diluted earnings per share is computed similarly to fully diluted earnings per share under APB No. 15. All per share information prior to the fourth quarter of 1997 has been restated to reflect the adoption of SFAS No. 128.

2--Transactions with Affiliates

The Company conducts business and has various agreements with the Mutual Company which are described below.

A. Reinsurance Pooling and Other Reinsurance Arrangements

Atlantic States cedes to the Mutual Company all of its insurance business and assumes from the Mutual Company 65% (60% in 1995) of the Mutual Company's total pooled insurance business, including that assumed from Atlantic States and substantially all of the business assumed and retained by the Mutual Company from Southern and Delaware. Atlantic States, Southern, Delaware and Pioneer each have a catastrophe reinsurance agreement with the Mutual Company which limits the maximum liability under any one catastrophic occurrence to $400,000, $300,000, $300,000 and $200,000, respectively, and $700,000 for a catastrophe involving more than one of the companies. The Mutual Company and Delaware have an excess of loss reinsurance agreement in which the Mutual Company assumes up to $200,000 of losses in excess of $50,000 and workers' compensation quota share agreement whereby Delaware cedes 70% of that business. The Mutual Company and Pioneer have an excess of loss reinsurance agreement in which the Mutual Company assumes up to $200,000 of losses in excess of $50,000. The Mutual Company and Pioneer also have an aggregate excess of loss reinsurance agreement, entered into as part of the sale of Pioneer from the Mutual Company to DGI, in which the Mutual Company agrees to assume the adverse loss development of claims with dates of loss prior to December 31, 1996, as developed through December 31, 1998, and to assume an amount equal to the loss and loss adjusting ratio in excess of 60% through December 31, 1998. The Mutual Company and Southern have an excess of loss reinsurance agreement in which the Mutual Company assumes up to $25,000 of losses in excess of $100,000 and a quota share agreement whereby Southern cedes 50% of its direct business less certain reinsurance to the Mutual Company. Southern, Delaware and Pioneer each have retrocessional reinsurance agreements effective July 1, 1996 with the Mutual Company under which they cede, and then assume back, 100% of their business net of other reinsurance.

The following amounts represent reinsurance transactions with the Mutual Company during 1997, 1996 and 1995. Amounts for losses and loss expenses exclude salvage and subrogation recoverable because such amounts are determined on a net basis only consistent with the Mutual Company's statutory records:

CEDED REINSURANCE:	1997	1996	1995
Premiums written	$ 47,946,847	$ 46,443,220	$ 27,963,315
Premiums earned	$ 47,488,716	$ 37,175,897	$ 25,787,237
Losses and loss expenses	$ 28,582,315	$ 25,838,753	$ 14,439,306
Unearned premiums	$ 22,131,526	$ 21,673,395	$ 12,406,072
Liability for losses and loss expenses	$ 35,295,994	$ 33,850,684	$ 20,891,048
ASSUMED REINSURANCE:			
Premiums written	$107,604,989	$108,982,894	$ 79,550,369
Premiums earned	$107,302,168	$ 95,910,375	$ 74,824,803
Losses and loss expenses	$ 68,104,859	$ 65,579,955	$ 49,332,144
Unearned premiums	$ 48,485,408	$ 48,182,587	$ 35,110,068
Liability for losses and loss expenses	$ 83,271,292	$ 80,203,642	$ 66,020,750

Losses and loss expenses assumed from the Mutual Company for 1997, 1996 and 1995 are reported net of inter-company catastrophe recoveries which amounted to approximately $0, $9.5 million, and $0, respectively.

B. EXPENSE SHARING

The Mutual Company provides facilities, management and other services to the Company, and the Company reimburses the Mutual Company for such services on a periodic basis under usage agreements and pooling arrangements. The charges are based upon the relative participation of the Company and the Mutual Company in the pooling arrangement, and management of both the Company and the Mutual Company consider this allocation to be reasonable. Charges for these services totalled $21,739,911, $19,365,166 and $17,951,966 for 1997, 1996 and 1995, respectively.

C. LEASE AGREEMENT

The Company leases office equipment and automobiles to the Mutual Company under a 10-year lease dated January 1, 1990. Future annual commitments under these leases are $723,000 for 1998, 1999 and 2000.

D. INSPECTION AND POLICY AUDITING SERVICES

AIS provides inspection and policy auditing services to the Mutual Company on a fee for service basis. Charges for these services totalled $544,651, $600,453, and $660,606 for 1997, 1996 and 1995, respectively.

3--Investments

The amortized cost and estimated fair values of fixed maturities and equity securities at December 31, 1997 and 1996, are as follows:

1997

HELD TO MATURITY	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 41,450,057	$ 341,162	$ 99,819	$ 41,691,400
Obligations of states and political subdivisions	57,620,998	2,955,526	--	60,576,524
Corporate securities	7,249,829	327,364	6,693	7,570,500
Mortgage-backed securities	10,925,321	154,057	34,916	11,044,462
Totals	$117,246,205	$ 3,778,109	$ 141,428	$120,882,886

1997				
AVAILABLE FOR SALE	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$40,066,278	$ 159,106	$ 28,883	$40,196,501
Obligations of states and political subdivisions	12,109,254	652,996	--	12,762,250
Corporate securities	3,247,602	8,412	3,514	3,252,500
Mortgage-backed securities	1,499,208	20,792	--	1,520,000
Equity securities	6,551,020	821,409	97,867	7,274,562
Totals	$63,473,362	$ 1,662,715	$ 130,264	$65,005,813

1996				
HELD TO MATURITY	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 38,646,994	$ 258,233	$ 297,377	$ 38,607,850
Obligations of states and political subdivisions	57,094,620	1,792,187	75,388	58,811,419
Corporate securities	5,916,899	279,056	8,455	6,187,500
Mortgage-backed securities	12,680,493	128,691	151,636	12,657,548
Totals	$114,339,006	$ 2,458,167	$ 532,856	$116,264,317

1996				
AVAILABLE FOR SALE	Gross Amortized Cost	Gross Unrealized Gains	Estimated Unrealized Losses	Fair Value
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$35,624,984	$ 44,880	$ 162,770	$35,507,094
Obligations of states and political subdivisions	12,586,391	414,299	13,190	12,987,500
Corporate securities	3,456,881	4,150	25,031	3,436,000
Mortgage-backed securities	1,596,492	16,044	6,587	1,605,949
Equity securities	2,774,946	479,311	111,313	3,142,944
Totals	$56,039,694	$ 958,684	$ 318,891	$56,679,487

The amortized cost and estimated fair value of fixed maturities at December 31, 1997, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
Held to maturity:		
Due in one year or less	$ 5,848,961	$ 5,837,500
Due after one year through five years	25,200,668	25,766,300
Due after five years through ten years	49,608,748	51,266,351
Due after ten years	25,662,507	26,968,273
Mortgage-backed securities	10,925,321	11,044,462
Total held to maturity	$117,246,205	$120,882,886
Available for sale:		
Due in one year or less	$ 7,451,076	$ 7,451,500
Due after one year through five years	25,934,215	26,013,001
Due after five years through ten years	15,150,229	15,572,750
Due after ten years	6,887,614	7,234,000
Mortgage-backed securities	1,499,208	1,520,000
Total available for sale	$ 56,922,342	$ 57,731,251

The amortized cost of fixed maturities on deposit with various regulatory authorities at December 31, 1997 and 1996, amounted to $2,785,752 and $2,665,627, respectively.

Net investment income of the Company, consisting primarily of interest and dividends, is attributable to the following sources:

	1997	1996	1995
Fixed maturities	$10,703,397	$ 9,924,660	$8,652,976
Equity securities	238,777	233,072	233,822

	1997	1996	1995
Short-term investments	1,141,834	1,091,855	1,237,888
Real estate	127,250	81,650	81,350
Investment income	12,211,258	11,331,237	10,206,036
Investment expenses	703,981	531,868	492,292
Net investment income	$11,507,277	$10,799,369	$9,713,744

Gross realized gains and losses from sales of investments during 1997, 1996 and 1995 are as follows:

	1997	1996	1995
Gross realized gains:			
Fixed maturities	$ 84,196	$ 29,206	$ 348,139
Equity securities	408,429	404,381	658,595
	492,625	433,587	1,006,734
Gross realized losses:			
Fixed maturities	694	689	1,152
Equity securities	177,795	260,164	605,876
	178,489	260,853	607,028
Net realized gains	$314,136	$172,734	$ 399,706

4--Deferred Policy Acquisition Costs

Changes in deferred policy acquisition costs are as follows:

	1997	1996	1995
Balance, January 1	$ 7,837,899	$ 6,902,218	$ 5,551,869
Acquisition costs deferred	19,306,161	17,967,681	15,762,349
Amortization charged to earnings	18,696,000	17,032,000	14,412,000
Balance, December 31	$ 8,448,060	$ 7,837,899	$ 6,902,218

5--Property and Equipment

Property and equipment at December 31, 1997 and 1996, consisted of the following:

	1997	1996	Estimated Useful Life
Cost--office equipment	$ 3,653,494	$ 2,434,436	5-15 years
automobiles	768,643	785,473	3 years
leasehold improvements	59,233	81,719	15-40 years
real estate	2,621,896	1,139,397	15-50 years
software	31,526	18,409	5 years
	7,134,792	4,459,434	
Accumulated depreciation	(2,196,268)	(1,837,035)	
	$ 4,938,524	$ 2,622,399	

Depreciation expense for 1997, 1996, and 1995 amounted to $442,726, $384,154 and $364,904, respectively.

6--Liability for Losses and Loss Expenses

Activity in the liability for losses and loss expenses is summarized as follows:

	1997	1996	1995
Balance at January 1	$ 114,621,961	$ 98,894,279	$ 88,484,425
Less reinsurance recoverable	39,194,405	27,738,898	25,167,086
Net balance at January 1	75,427,556	71,155,381	63,317,339
Incurred related to:			
Current year	69,040,518	73,211,924	61,162,695
Prior years	(1,384,000)	(2,791,000)	(3,093,000)
Total incurred	67,656,518	70,420,924	58,069,695
Paid related to:			
Current year	39,133,249	42,669,749	30,831,653
Prior years	26,477,000	23,479,000	19,400,000
Total paid	65,610,249	66,148,749	50,231,653
Net balance at December 31	77,473,825	75,427,556	71,155,381
Plus reinsurance recoverable	40,638,565	39,194,405	27,738,898
Balance at December 31	$ 118,112,390	$ 114,621,961	$ 98,894,279

The Company recognized a decrease in the liability for losses and loss adjustment expenses of prior years (favorable development) of $1.4 million, $2.8 million and $3.1 million in 1997, 1996 and 1995, respectively. These favorable developments are primarily attributable to the Company's strengthening of case reserves in prior years, the effects of which are being recognized currently.

7--Line of Credit

At December 31, 1997, pursuant to a credit agreement dated December 29, 1995, with Fleet National Bank of Connecticut, the Company had unsecured borrowings of $10.5 million. Such borrowings were made in connection with the acquisition of Delaware and a $5 million capital contribution to Atlantic States in 1996. Per the terms of the credit agreement, the Company may borrow up to $20 million at interest rates equal to the bank's then current prime rate or the then current London interbank Eurodollar bank rate plus 1.70%. At December 31, 1997, the interest rate on the outstanding balance was 7.60625%. In addition, the Company will pay a non-use fee at a rate of 3/10 of 1% per annum on the average daily unused portion of the bank's commitment. On each December 29, commencing December 29, 1999, the credit line will be reduced by $4 million. Any outstanding loan in excess of the remaining credit line, after such reduction, will then be payable.

8--Unaffiliated Reinsurers

In addition to the primary reinsurance in place with the Mutual Company, the Insurance Subsidiaries have other reinsurance in place, principally with four unaffiliated reinsurers. The following amounts represent statutory reinsurance transactions with unaffiliated reinsurers during 1997, 1996 and 1995:

Ceded reinsurance:	1997	1996	1995
Premiums written	$4,315,594	$4,023,855	$3,819,834
Premiums earned	$4,264,761	$4,009,956	$3,758,901
Losses and loss expenses	$3,169,659	$2,355,740	$2,809,765
Unearned premiums	$ 750,757	$ 699,924	$ 686,025
Liability for losses and loss expenses	$5,342,571	$5,343,721	$6,846,750

9--Federal Income Taxes

The provision for federal income tax consists of the following:

	1997	1996	1995
Current	$3,525,249	$2,175,474	$3,022,693
Deferred	7,108	3,380	(521,952)
Federal tax provision	$3,532,357	$2,178,854	$2,500,741

The effective tax rate is different than the amount computed at the statutory federal rate of 34% for 1997, 1996 and 1995. The reason for such difference and the related tax effect are as follows:

	1997	1996	1995

Income before income taxes	$ 14,173,543	$ 10,736,628	$ 12,060,351
Computed "expected" taxes at 34%	$ 4,819,005	$ 3,650,454	$ 4,100,519
Tax-exempt interest	(1,130,311)	(1,076,764)	(770,084)
Dividends received deduction	(48,477)	(48,108)	(46,789)
Deduction for exercise of options	(1,700)	(399,904)	(324,254)
Other, net	(106,160)	53,176	(74,982)
Change in valuation allowance	--	--	(383,669)
Federal income tax provision	$ 3,532,357	$ 2,178,854	$ 2,500,741

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 1997 and 1996, are as follows:

	1997	1996
Deferred tax assets:		
Unearned premium	$3,297,008	$3,128,626
Loss reserves	4,064,877	3,910,691
Total	$7,361,885	$7,039,317
Deferred tax liabilities:		
Depreciation expense	$ 341,945	$ 286,816
Deferred policy acquisition costs	2,872,343	2,664,886
Salvage receivable	324,521	257,431
Unrealized gain	521,033	216,877
Total	$4,059,842	$3,426,010
Net deferred tax assets	$3,302,043	$3,613,307

A valuation allowance is provided when it is more likely than not that some portion of the tax asset will not be realized. Management has determined that it is not required to establish a valuation allowance for the deferred tax asset of $7,361,885 and $7,039,317 at December 31, 1997 and 1996, since it is more likely than not that the deferred tax asset will be realized through reversals of existing temporary differences, future taxable income, carryback to taxable income in prior years, previously realized investment gains and the implementation of tax planning strategies.

10--Stock Compensation Plans

The Company applies APB Opinion No. 25 in accounting for its stock-based compensation plans. Accordingly, no compensation cost has been recognized for its fixed stock option plans and certain of its stock purchase plans. Compensation cost for these stock-based compensation plans determined under SFAS No. 123 would not have had a material impact on net income and earnings per share for 1997, 1996 or 1995.

The calculation of pro-forma net income reflects only options granted in 1997, 1996 and 1995. Therefore, the full impact of calculating compensation cost for stock options under SFAS No. 123 is not reflected because compensation cost is reflected over the options' vesting period and compensation cost for options granted prior to January 1, 1995 is not considered.

Equity Incentive Plans

The Company has had an Equity Incentive Plan for key employees since 1986 and adopted a nearly identical new plan in 1996. Both plans provide for the granting of awards by the Board of Directors in the form of stock options, stock appreciation rights, restricted stock or any combination of the above. During 1996 the new plan was adopted which made 345,850 shares available. The plan was amended in 1997 making a total of 695,850 shares available. These shares were adjusted for the Company's 4-for-3 stock split in July 1997, increasing the number of shares available to 927,800. The plans provide that stock options may become exercisable up to 10 years from date of grant, with an option price not less than fair market value on date of grant. The stock appreciation rights permit surrender of the option and receipt of the excess of current market price over option price in cash.

Information regarding activity in the Company's stock option plans is presented below:

	Number of Shares	Weighted Average Exercise Price Per Share
Outstanding at December 31, 1994	360,650	$ 11.01
Granted - 1995	--	--
Exercised - 1995	150,650	10.47
Forfeited - 1995	7,500	10.80
Outstanding at December 31, 1995	202,500	$ 11.42
Granted - 1996	--	--
Exercised - 1996	202,500	11.42
Forfeited - 1996	--	--
Outstanding at December 31, 1996	--	$ --
Granted - 1997	399,337	18.00
Exercised - 1997	2,222	18.00
Forfeited - 1997	10,224	18.00
Outstanding at December 31, 1997	386,891	$ 18.00
Exercisable at:		
December 31, 1995	202,500	$ 11.42
December 31, 1996	--	$ --
December 31, 1997	130,000	$ 18.00

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Shares available for future grants at December 31, 1997 are 540,909.

1996 Equity Incentive Plan For Directors

During 1996 the Company adopted an Equity Incentive Plan For Directors which made 90,000 shares available for award. These shares were adjusted for the Company's 4 for 3 stock split in July 1997, increasing the number of shares available to 118,400. Awards may be made in the form of stock options, and the plan additionally provides for the issuance of 100 shares of restricted stock to each director on the first business day of January in each year, commencing January 2, 1997. As of December 31, 1997, the Company has 60,003 unexercised options under this plan. Additionally, 1,200 shares of restricted stock were issued on January 2, 1997.

Employee Stock Purchase Plans

During 1996 the Company adopted the 1996 Employee Stock Purchase Plan which replaced a similar plan that had been adopted effective January 1, 1988. The 1996 plan made 100,000 shares available for issuance. These shares were adjusted for the Company's 4 for 3 stock split in July 1997, increasing the number of shares available to 129,116.

The 1996 Plan extends over a 10-year period and provides for shares to be offered to all eligible employees at a purchase price equal to the lesser of 85% of the fair market value of the Company's common stock on the last day before the first day of the enrollment period (June 1 and December 31). A summary of plan activity follows:

	Shares Issued	
	Price	Shares
January 1,1995	11.90000	6,004
July 1, 1995	10.62500	6,938
January 1, 1996	14.23750	5,630
July 1, 1996	14.66250	6,077
January 1, 1997	14.66250	6,575
July 1, 1997	12.35756	8,518

On January 1, 1998, the Company issued an additional 6,676 shares at a price of $15.53906 per share under this plan.

Agency Stock Purchase Plan

On December 31, 1996, the Company adopted the Agency Stock Purchase Plan which made 300,000 shares available for issuance. These shares were adjusted for the Company's 4 for 3 stock split in July 1997, increasing the number of shares available to 395,589. The plan provides for agents of affiliated companies of DGI to invest up to $12,000 per subscription period (April 1 to September 30 and October 1 to March 31) under various methods. Stock is issued at the end of the subscription period at a price equal to 90% of the average market price during the last ten trading days of the subscription period. During 1997, 30,150 shares were issued under this plan.

Pro-Forma Disclosures

The weighted average grant date fair value of options granted during 1997, 1996 and 1995 for the various plans was as follows:

	1997	1996	1995
Equity Incentive Plan	$4.75	$ --	$ --
1996 Equity Incentive Plan for Directors	4.75	--	--
Employee Stock Purchase Plans	3.12	3.27	2.78
Agency Stock Purchase Plan	3.41	--	--

The fair values above were calculated based upon risk-free interest rates of 5% for the Stock Purchase Plans and 6% for the Equity Incentive Plans, expected lives of 6 months for the Stock Purchase Plans and 5 years for the Equity Incentive Plans, expected volatility of 34% and an expected dividend yield of 2.40%.

Had the Company recognized stock compensation expense in accordance with SFAS No. 123, net income and earnings per share would have been reduced to the pro-forma amounts shown below:

	1997	1996	1995
Net income:			
As reported	$10,641,186	$8,557,774	$9,559,610
Pro-forma	10,263,965	8,530,468	9,536,550
Basic earnings per share:			
As reported	1.77	1.46	1.72
Pro-forma	1.71	1.46	1.71
Diluted earnings per share:			
As reported	1.77	1.45	1.68
Pro-forma	1.70	1.45	1.67

11--Statutory Net Income, Capital and Surplus and Dividend Restrictions

The following is selected information for the Insurance Subsidiaries as determined in accordance with accounting practices prescribed or permitted by insurance regulatory authorities:

	1997	1996	1995
ATLANTIC STATES			
Statutory capital and surplus	$ 56,606,354	$ 47,914,415	$ 40,726,246
Statutory unassigned surplus	$ 25,645,490	$ 16,953,551	$ 14,765,382
Statutory net income	$ 7,349,284	$ 5,410,536	$ 5,224,905

SOUTHERN

Statutory capital and surplus	$ 7,069,112	$ 6,608,944	$ 6,380,420
Statutory unassigned surplus	$ 2,316,842	$ 1,856,674	$ 2,378,150
Statutory net income	$ 703,727	$ 255,480	$ 679,335

DELAWARE

Statutory capital and surplus	$ 7,657,691	$ 6,798,477	$ 5,695,634
Statutory unassigned surplus	$ 2,457,691	$ 1,598,477	$ 495,634
Statutory net income	$ 1,070,463	$ 1,120,952	$ 494,576

PIONEER

Statutory capital and surplus	$ 5,377,492	$ 5,048,582	$ 5,108,442
Statutory unassigned surplus	$ (1,622,508)	$ (1,951,418)	$ (1,391,558)
Statutory net income (loss)	$ 542,799	$ (367,614)	$ (439,335)

The Company's principal source of cash for payment of dividends are dividends from its Insurance Subsidiaries which are required by law to maintain certain minimum capital and 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 their domiciliary insurance regulatory authorities. Atlantic States, Southern, Delaware and Pioneer are also subject to Risk Based Capital (RBC) requirements which may further impact their ability to pay dividends. At December 31, 1997, all four companies' statutory capital and surplus were substantially above the RBC requirements. At December 31, 1997, amounts available for distribution as dividends to DGI without prior approval of insurance regulatory authorities are $7,349,284 from Atlantic States, $703,688 from Southern, $1,070,463 from Delaware and $542,799 from Pioneer.

12--Reconciliation of Statutory Filings to Amounts Reported Herein

The Company's Insurance Subsidiaries are required to file statutory financial statements with state insurance regulatory authorities. Accounting principles used to prepare these statutory financial statements differ from financial statements prepared on the basis of generally accepted accounting principles.

Reconciliations of statutory net income and capital and surplus, as determined using statutory accounting principles, to the amounts included in the accompanying financial statements are as follows:

	Year Ended December 31,		
	1997	1996	1995
Statutory net income of insurance subsidiaries	$ 9,666,273	$ 6,419,354	$ 5,959,481
Increases (decreases):			
Deferred policy acquisition costs	610,161	935,681	1,350,349
Deferred federal income taxes	(7,108)	(3,380)	521,952
Salvage and subrogation recoverable	984,981	1,067,201	1,291,504
Consolidating eliminations and adjustments	(950,000)	--	(900,000)
Parent-only net income	291,831	155,894	1,301,558
Non-insurance subsidiary net income (loss)	45,048	(16,976)	34,766
Net income as reported herein	$ 10,641,186	$ 8,557,774	$ 9,559,610

	December 31,		
	1997	1996	1995
Statutory capital and surplus of insurance subsidiaries	$ 76,710,649	$ 66,370,418	$ 57,910,742
Increases (decreases):			
Deferred policy acquisition costs	8,448,060	7,837,899	6,902,218
Deferred federal income taxes	3,302,043	3,613,307	3,411,544
Salvage and subrogation recoverable	6,155,467	5,170,486	4,103,285
Statutory reserves	8,712,694	10,035,325	6,413,472
Non-admitted assets and other adjustments, net	394,432	355,540	462,199
Fixed maturities available for sale	808,908	271,795	1,008,225
Consolidating eliminations and adjustments	(16,121,711)	(16,121,711)	(10,621,711)
Parent-only equity	2,953,248	3,878,390	3,225,914
Non-insurance subsidiary equity	232,873	187,825	204,801
Stockholders' equity as reported herein	$ 91,596,663	$ 81,599,274	$ 73,020,689

13--Supplementary Information on Statement of Cash Flows

The following schedule reflects income taxes and interest paid during 1997, 1996 and 1995:

	1997	1996	1995
Income taxes	$4,094,338	$ 825,136	$3,844,550
Interest	$ 904,385	$ 369,869	$ 7,229

14--Earnings Per Share

The following information illustrates the computation of net income, outstanding shares and earnings per share on both a basic and diluted basis for the years ending December 31, 1997, 1996 and 1995:

	Net Income	Weighted Average Shares Outstanding	Earnings Per Share
1997:			
Basic	$10,641,186	5,996,203	$1.77
Effect of stock options	--	30,955	--
Diluted	$10,641,186	6,027,158	$1.77
1996:			
Basic	$8,557,774	5,860,505	$1.46
Effect of stock options	--	40,364	(0.01)
Diluted	$8,557,774	5,900,869	$1.45
1995:			
Basic	$9,559,610	5,565,071	$1.72
Effect of stock options	--	131,525	(0.04)
Diluted	$9,559,610	5,696,596	$1.68

15--Condensed Financial Information of Parent Company

CONDENSED BALANCE SHEETS
($ in thousands)

December 31,	1997	1996*
ASSETS		
Investment in subsidiaries (equity method)	$ 99,857	$ 88,916
Cash	730	427
Property and equipment	2,139	1,248
Other	451	441
Total assets	$103,177	$ 91,032
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Cash dividends declared to stockholders	$ 604	$ 493
Line of credit	10,500	8,500
Other	476	440
Total liabilities	11,580	9,433
Stockholders' equity		
Preferred stock, $1.00 par value, authorized 1,000,000 shares, none issued		
Commonstock, $1.00 par value, authorized 10,000,000 shares, issued 6,122,431 and 4,540,569 shares and outstanding 6,030,715 and 4,471,782 shares	6,123	4,540
Additional paid-in capital	38,932	37,863
Net unrealized gains on investments	1,012	423
Retained earnings, including equity in undistributed net income of subsidiaries($56,082 and $45,730)	46,422	39,665
Treasury stock, at cost	(892)	(892)
Total stockholders' equity	91,597	81,599
Total liabilities and stockholders' equity	$103,177	$ 91,032

* Restated

CONDENSED STATEMENTS OF INCOME
($ in thousands)

Year Ended December 31,	1997	1996*	1995*
Revenues			
Dividends-subsidiaries	$ 950	$ 0	$ 900
Other	658	572	504
Total revenues	1,608	572	1,404
Expenses			
Operating expenses	643	548	411
Interest	1,022	416	4
Total expenses	1,665	964	415
Income before income tax benefit and equity in undistributed net income of subsidiaries	(57)	(392)	989
Income tax benefit	(346)	(533)	(298)
Income before equity in undistributed net income of subsidiaries	289	141	1,287
Equity in undistributed net income of subsidiaries	10,352	8,417	8,273
Net income	$ 10,641	$ 18,558	$ 9,560

* Restated

CONDENSED STATEMENTS OF CASH FLOWS
($ in thousands)

Year Ended December 31,	1997	1996*	1995*
Cash flows from operating activities:			
Net income	$ 10,641	$ 8,558	$ 9,560
Adjustments:			
Equity in undistributed net income of subsidiaries	(10,352)	(8,417)	(8,273)
Other	382	373	(112)

Net adjustments	(9,970)	(8,044)	(8,385)
Net cash provided	671	514	1,175
Cash flows from investing activities:			
Net purchase of property and equipment	(1,251)	(203)	(279)
Capital contributions to subsidiaries	--	(5,000)	--
Acquisition of Delaware Atlantic	--	(202)	(5,300)
Other	4	1,110	(744)
Net cash used	(1,247)	(4,295)	(6,323)
Cash flows from financing activities:			
Cash dividends paid	(2,252)	(1,879)	(1,622)
Issuance of common stock	1,131	2,512	1,723
Purchase of treasury stock	--	(72)	--
Line of credit, net	2,000	3,500	5,000
Net cash provided (used)	879	4061	(5,101)
Net change in cash	303	280	(47)
Cash at beginning of year	427	147	194
Cash at ending of year	$ 730	$ 427	$ 147

* Restated

16--Interim Financial Data (unaudited)

1997	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net premiums earned	$26,404,333	$26,823,505	$27,260,693	$26,813,637
Total revenues	29,823,371	30,253,860	30,909,916	30,340,459
Loss and loss adjusting expenses	16,912,543	17,329,403	17,111,129	16,303,443
Net income	2,562,433	2,400,597	2,911,728	2,766,428
Net income per common share				
Basic	$ .43	$ .40	$ .49	$ .46
Diluted	.43	.40	.48	.45

1996	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net premiums earned	$25,835,495	$25,979,371	$26,260,774	$26,451,398
Total revenues	29,177,941	29,119,386	29,429,202	29,855,135
Loss and loss adjusting expenses	18,711,207	17,282,421	17,297,396	17,129,900
Net income	1,336,394	2,508,036	2,284,045	2,429,299
Net income per common share				
Basic	$ .23	$ .43	$ .39	$ .41
Diluted	.23	.43	.38	.41

Results for the first quarter of 1996 were adversely affected by the record snowfall levels in the Company's operating area in January 1996. This resulted in a loss ratio of 72.4% in the first quarter, compared to 65.7% for the rest of the year.

Donegal Group Inc.
Independent Auditors' Report

THE STOCKHOLDERS AND BOARD OF DIRECTORS

DONEGAL GROUP INC.

We have audited the accompanying consolidated balance sheets of Donegal Group Inc. as of December 31, 1997 and 1996, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 1997. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Donegal Group Inc. as of December 31, 1997 and 1996, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1997 in conformity with generally accepted accounting principles.

KPMG PEAT MARWICK LLP

Harrisburg, Pennsylvania
February 27, 1998

Board of Directors and Officers

Donegal Group Inc.

Board of Directors

Donald H. Nikolaus	President, Chief Executive Officer and a Director
C. Edwin Ireland	Chairman of the Board and a Director
Philip H. Glatfelter, II	Vice Chairman of the Board and a Director
Robert S. Bolinger	Director
Thomas J. Finley, Jr.	Director
Patricia A. Gilmartin	Director
R. Richard Sherbahn	Director

Officers

C. Edwin Ireland	Chairman of the Board
Philip H. Glatfelter, II	Vice Chairman of the Board
Donald H. Nikolaus	President and Chief Executive Officer
Ralph G. Spontak	Senior Vice President, Chief Financial Officer, and Secretary
Daniel J. Wagner	Treasurer

Donegal Mutual Insurance Company

Board of Directors

Donald H. Nikolaus	President, Chief Executive Officer and a Director
C. Edwin Ireland	Chairman of the Board and a Director
Philip H. Glatfelter, II	Vice Chairman of the Board and a Director
Frederick W. Dreher,III	Director
Patricia A. Gilmartin	Director
Charles A. Heisterkamp, III	Director
John E. Hiestand	Director
R. Richard Sherbahn	Director
William H. Shupert	Senior Vice President of Underwriting and a Director
Ralph G. Spontak	Senior Vice President Chief Financial Officer, Secretary and a Director

Other Officers

David L. Douglass	Vice President of Commercial Underwriting
Kenneth L. Dull	Vice President of Research and Development
Cyril J. Greenya	Senior Vice President of Underwriting
David W. Plouse	Vice President of Investments
James B. Price	Senior Vice President of Claims
Robert G. Shenk	Senior Vice President of Claims
Daniel J. Wagner	Treasurer
Frank J. Wood	Senior Vice President of Marketing

Corporate Information

Annual Meeting

April 16, 1998 at the Company's headquarters at 10:00 a.m.

Form 10-K

A copy of Donegal Group's Annual Report on Form 10-K will be furnished free upon written request to Ralph G. Spontak, Senior Vice President and Chief Financial Officer, at the address listed below.

Market Information

Donegal Group's common stock is traded on NASDAQ under the symbol "DGIC." During 1996 and 1997, the stock price ranged as follows (information prior to July 15, 1997 restated for 4-for-3 stock split on that date):

Quarter	High	Low	Cash Dividend Declared Per Share
1996			
1st*	14 5/8	13 7/8	--
2nd*	14 1/4	12 9/16	.0825
3rd*	14 1/16	12 3/16	.0825
4th*	15 9/16	13 1/8	.1650
1997			
1st*	18 15/16	15	--
2nd*	19	17	.09
3rd*	21	18 1/4	.10
4th	22 1/4	20 1/4	.20

* Restated

Corporate Offices

1195 River Road
P.O. Box 302
Marietta, Pennsylvania 17547
(717) 426-1931

E-mail Address: info@donegalgroup.com

Donegal Website: http://www.donegalgroup.com

Transfer Agent

First Chicago Trust Company of New York
P.O. Box 2500
Jersey City, NJ 07303-2500
(800) 317-4445
E-mail Address: fctc@em.fcnbd.com
FCTC Website: http://www.fctc.com
Hearing Impaired: TDD: 201-222-4955

Dividend Reinvestment Plan

The Company offers a dividend reinvestment plan through its transfer agent.
For information contact:
Donegal Group Inc. Dividend Reinvestment Plan
c/o First Chicago Trust Company of New York
P.O. Box 2598
Jersey City, NJ 07303-2598
(800) 317-4445

Stockholders

The number of common stockholders of record as of December 31, 1997 was 476.

DONEGAL GROUP INC.

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
TO BE HELD APRIL 16, 1998

To the Stockholders of
DONEGAL GROUP INC.:

The Annual Meeting of Stockholders of Donegal Group Inc. (the "Company") will be held at 10:00 a.m., prevailing time, on April 16, 1998, at the Company's offices, 1195 River Road, Marietta, Pennsylvania 17547, for the following purposes:

1. To elect two Class C directors to serve until the expiration of their three-year terms and until their successors are elected;

2. To consider and vote upon a proposal to approve an amendment to the Company's Certificate of Incorporation to increase the authorized number of shares of the Company's Common Stock from 10,000,000 shares to 15,000,000 shares;

3. To consider and vote upon a proposal to approve an amendment to the Company's 1996 Equity Incentive Plan for Directors;

4. To act upon the election of KPMG Peat Marwick LLP as independent public accountants for the Company for 1998; and

5. To transact such other business as may properly come before the Annual Meeting and any adjournment, postponement or continuation thereof.

The Board of Directors has fixed the close of business on February 20, 1998 as the record date for the determination of the stockholders entitled to notice of and to vote at the Annual Meeting.

A copy of the Company's Annual Report for the year ended December 31, 1997 is being mailed to stockholders together with this Notice.

Holders of Common Stock are requested to complete, sign and return the enclosed form of proxy in the envelope provided whether or not they expect to attend the Annual Meeting in person.

By Order of the Board of Directors,

/s/ Donald H. Nikolaus

Donald H. Nikolaus,
President and Chief Executive Officer

March 23, 1998
Marietta, Pennsylvania

DONEGAL GROUP INC.

This Proxy Statement and the form of proxy enclosed herewith, which are first being mailed to stockholders on or about March 23, 1998, are furnished in connection with the solicitation by the Board of Directors of Donegal Group Inc. (the "Company") of proxies to be voted at the Annual Meeting of Stockholders (the "Annual Meeting") to be held at 10:00 a.m., prevailing time, on April 16, 1998, and at any adjournment, postponement or continuation thereof, at the Company's principal executive offices, which are located at 1195 River Road, Marietta, Pennsylvania 17547.

Shares represented by proxies in the accompanying form, if properly signed and returned, will be voted in accordance with the specifications made thereon by the stockholders. Any proxy not specifying to the contrary will be voted in favor of the adoption of the proposals referred to in the Notice of Annual Meeting and for the election of the nominees for director named below. A stockholder who signs and returns a proxy in the accompanying form may revoke it at any time before it is voted by giving written notice of revocation or a duly executed proxy bearing a later date to the Secretary of the Company or by attending the Annual Meeting and voting in person.

The cost of solicitation of proxies in the accompanying form will be borne by the Company, including expenses in connection with preparing and mailing this Proxy Statement. Such solicitation will be made by mail and may also be made on behalf of the Company in person or by telephone or telegram by the Company's regular officers and employees, none of whom will receive special compensation for such services. The Company, upon request therefor, will also reimburse brokers, nominees, fiduciaries and custodians and persons holding shares in their names or in the names of nominees for their reasonable expenses in sending proxies and proxy material to beneficial owners.

Only holders of Common Stock of record at the close of business on February 20, 1998 will be entitled to notice of and to vote at the Annual Meeting. Each share of Common Stock is entitled to one vote on all matters to come before the Annual Meeting. Cumulative voting rights do not exist with respect to the election of directors.

As of the close of business on February 20, 1998, the Company had outstanding 6,057,732 shares of Common Stock, $1.00 par value. A majority of the outstanding shares will constitute a quorum at the Annual Meeting. As of February 20, 1998, Donegal Mutual Insurance Company (the "Mutual Company") owned 3,529,091 shares of the Company's outstanding Common Stock, or approximately

58.3% of the Company's outstanding Common Stock. The Mutual Company has advised the Company that the Mutual Company will vote its shares for the election of Thomas J. Finley, Jr. and R. Richard Sherbahn as Class C directors, for the proposal to approve an amendment to the Company's Certificate of Incorporation to increase the Company's authorized Common Stock, for the proposal to approve an amendment to the 1996 Equity Incentive Plan for Directors (the "Director Plan") and for the election of KPMG Peat Marwick LLP as the Company's independent public accountants for 1998. Accordingly, Messrs. Finley and Sherbahn will be elected as Class C directors, the amendment to the Certificate of Incorporation will be approved, the amendment to the Director Plan will be approved and KPMG Peat Marwick LLP will be elected as the Company's independent public accountants for 1998, irrespective of the votes cast by the stockholders of the Company other than the Mutual Company.

Unless otherwise stated, all information in this Proxy Statement gives retroactive effect to the four-for-three split of the Company's Common Stock effected through a stock dividend of one share of Common Stock for each three shares outstanding, which was paid on July 15, 1997 to stockholders of record on June 25, 1997.

BENEFICIAL OWNERSHIP OF COMMON STOCK

The following table sets forth as of February 20, 1998 the amount and percentage of the Company's outstanding Common Stock beneficially owned by (i) each person who is known by the Company to own beneficially more than 5% of its outstanding Common Stock, (ii) each director and nominee for director, (iii) each executive officer named in the Summary Compensation Table and (iv) all executive officers and directors of the Company as a group.

NAME OF INDIVIDUAL OR IDENTITY OF GROUP	SHARES BENEFICIALLY OWNED(1)	PERCENT OF OUTSTANDING COMMON STOCK(2)
5% HOLDERS:		
Donegal Mutual Insurance Company 1195 River Road Marietta, Pennsylvania 17547	3,529,091	58.3%
Wellington Management Company, LLP 75 State Street Boston, MA 02109	365,462(3)	6.03%
DIRECTORS:		
C. Edwin Ireland	12,711(4)	--
Donald H. Nikolaus	107,026(5)	1.7%
Patricia A. Gilmartin	6,310(4)	--
Philip H. Glatfelter, II	6,576(4)	--
R. Richard Sherbahn	4,844(4)	--
Robert S. Bolinger	5,511(4)	--
Thomas J. Finley, Jr	5,311(4)	--
EXECUTIVE OFFICERS (6):		
Ralph G. Spontak	43,954(7)	--
William H. Shupert	23,177(8)	--
Robert G. Shenk	16,588(9)	--
Frank J. Wood	14,935(10)	--
All directors and executive officers as a group (14 persons)	288,166(11)	4.6%

- ------------------

(1) Information furnished by each individual named. This table includes shares that are owned jointly, in whole or in part, with the person's spouse, or individually by his or her spouse.

(2) Less than 1% unless otherwise indicated.

(3) As reported by Wellington Management Company, LLP as of December 31, 1997 in a filing made with the Securities and Exchange Commission (the "SEC").

(4) Includes 4,445 shares of Common Stock the director has the option to purchase under the Director Plan that are currently exercisable or that become exercisable within 60 days after the date of this Proxy Statement.

(5) Includes 66,667 shares of Common Stock Mr. Nikolaus has the option to purchase under the Company's 1996 Equity Incentive Plan that are currently exercisable or that become exercisable within 60 days after the date of this Proxy Statement.

(6) Excludes Executive Officers listed under "Directors."

(7) Includes 33,333 shares of Common Stock Mr. Spontak has the option to purchase under the Company's 1996 Equity Incentive Plan that are currently exercisable or that become exercisable within 60 days after the date of this Proxy Statement.

(8) Includes 18,667 shares of Common Stock Mr. Shupert has the option to purchase under the Company's 1996 Equity Incentive Plan that are currently exercisable or that become exercisable within 60 days after the date of this Proxy Statement.

(9) Includes 13,333 shares of Common Stock Mr. Shenk has the option to purchase under the Company's 1996 Equity Incentive Plan that are currently exercisable or that become exercisable within 60 days after the date of this Proxy Statement.

(10) Includes 13,333 shares of Common Stock Mr. Wood has the option to purchase under the Company's 1996 Equity Incentive Plan that are currently exercisable or that become exercisable within 60 days after the date of this Proxy Statement.

(11) Includes 180,886 shares of Common Stock purchasable upon the exercise of options granted under the 1996 Equity Incentive Plan that are currently exercisable or that become exercisable within 60 days after the date of this Proxy Statement, and 26,670 shares of Common Stock purchasable upon the exercise of options granted under the Director Plan that are currently exercisable or that become exercisable within 60 days after the date of this Proxy Statement.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16 of the Securities Exchange Act of 1934 (the "Exchange Act") requires that the officers and directors of a corporation, such as the Company, which has a class of equity securities registered under Section 12 of the Exchange Act, as well as persons who own more than 10% of a class of equity securities of such a corporation, file reports of their ownership of such securities, as well as monthly statements of changes in such ownership, with the corporation, the SEC and the Nasdaq Stock Market. Based upon written representations received by the Company from its officers and directors, and the Company's review of the monthly statements of ownership changes filed with the Company by its officers and directors during 1997, the Company believes that all such filings required during 1997 were made on a timely basis.

RELATIONSHIP WITH THE MUTUAL COMPANY

The Company was formed by the Mutual Company in August 1986 and was a wholly owned subsidiary of the Mutual Company until November 1986, when the Company sold 600,000 shares of Common Stock in a public offering, thereby reducing the Mutual Company's ownership of the Company's outstanding Common Stock from 100% to approximately 79.5%, which subsequently increased to approximately 84%. In September 1993, the Company sold 1,150,000 shares of Common Stock in a public offering. At the same time, the Mutual Company sold 200,000 shares of the Company's Common Stock, reducing the Mutual Company's ownership of the Company's outstanding Common Stock to approximately 57%. Between December 22, 1994 and December 31, 1995, the Mutual Company purchased an aggregate of 172,000 shares of the Company's Common Stock in the open market in exempt transactions under SEC Rule 10b-18 and in private transactions. Between December 31, 1995 and December 31, 1996, the Mutual Company purchased an aggregate of 114,000 shares of the Company's Common Stock in private transactions. On November 14, 1997 and February 17, 1998, the Mutual Company purchased 16,846 shares and 16,735 shares, respectively, of the Company's Common Stock pursuant to the Company's Dividend Reinvestment Plan, which was adopted in July 1997. These purchases increased the Mutual Company's ownership of the Company's

Common Stock to 3,529,091 shares, or approximately 58.3% of the Company's outstanding Common Stock as of February 20, 1998.

The Company's operations are interrelated with the operations of the Mutual Company, and various reinsurance arrangements exist between the Company and the Mutual Company. The Company believes that its various transactions with the Mutual Company have been on terms no less favorable to the Company than the terms that could have been negotiated with an independent third party.

The Mutual Company provides all personnel for the Company and its principal insurance subsidiaries, Atlantic States Insurance Company ("Atlantic States"), Delaware Atlantic Insurance Company ("Delaware Atlantic"), Southern Insurance Company of Virginia ("Southern") and Pioneer Insurance Company ("Pioneer"). Expenses are allocated to the Company, Delaware Atlantic, Southern and Pioneer according to a time allocation and estimated usage agreement, and to Atlantic States in relation to the relative participation of the Mutual Company and Atlantic States in the pooling agreement described herein. Expenses allocated to the Company were $21,739,911 in 1997.

Atlantic States participates in an underwriting pool with the Mutual Company whereby Atlantic States cedes premiums, losses and loss adjustment expenses on all of its business to the Mutual Company and assumes from the Mutual Company a specified portion of the premiums, losses and loss adjustment expenses of the Mutual Company and Atlantic States. Under the pooling agreement, which became effective on October 1, 1986, Atlantic States cedes to the Mutual Company all of its insurance business written on or after October 1, 1986. Substantially all of the Mutual Company's property and casualty insurance business written or in force on or after October 1, 1986 is also included in the pooled business, including the business reinsured from Southern. Pursuant to amendments to the pooling agreement subsequent to October 1, 1986, the Mutual Company, which is solely responsible for any losses in the pooled business with dates of loss on or before the close of business on September 30, 1986, has increased the percentage of retrocessions of the pooled business to Atlantic States. Since January 1, 1996, 65% of the pooled business has been retroceded to Atlantic States. All premiums, losses, loss adjustment expenses and other underwriting expenses are prorated among the parties on the basis of their participation in the pool. The pooling agreement may be amended or terminated at the end of any calendar year by agreement of the parties. The allocations of pool participation percentages between the Mutual Company and Atlantic States are based on the pool participants' relative amounts of capital and surplus, expectations of future relative amounts of capital and surplus and the ability of the Company to raise capital for Atlantic States. The Company does not currently anticipate a further increase in Atlantic States' percentage of participation in the pool, nor does the Company intend to terminate the participation of Atlantic States in the pooling agreement. Additional information describing the pooling agreement is contained in the Company's 1997 Annual Report to Stockholders, a copy of which is enclosed with this Proxy Statement and to which reference is hereby made.

On December 29, 1988, the Company acquired all of the outstanding common stock of Southern, which converted from a mutual insurance company known as Southern Mutual Insurance Company to a stock insurance company on the same date. Since January 1, 1991, the Mutual Company has reinsured 50% of Southern's business. Because the Mutual Company places substantially all of the business assumed from Southern in the pool, from which the Company has an allocation of 65% from and after January 1, 1996, the Company's operations include approximately 80% of the business written by Southern. Southern and the Mutual Company settle the balances resulting from this reinsurance arrangement on a monthly basis.

As of December 31, 1995, the Company acquired all of the outstanding capital stock of Delaware Atlantic pursuant to a Stock Purchase Agreement dated as of December 21, 1995 between the Company and the Mutual Company. As part of this transaction, the Mutual Company entered into an aggregate excess of loss reinsurance agreement with Delaware Atlantic whereby the Mutual Company assumed the risk of any loss from an adverse development in Delaware Atlantic's loss and loss adjustment expense reserve at the end of 1995 compared to the end of 1996 and losses and loss adjustment expenses incurred by Delaware Atlantic during the month of December 1995 and for the 1996 year by reason of the fact that Delaware Atlantic's loss and loss adjustment expense ratio for those periods exceeded the lesser of the loss and loss expense ratios of immediately preceding periods or 60%. This reinsurance agreement did not result in any additional payment from the Mutual Company to Delaware Atlantic.

Effective July 1, 1996, the Mutual Company entered into retrocessional reinsurance contracts with each of Southern, Delaware Atlantic and Pioneer, which was then a wholly owned subsidiary of the Mutual Company, (individually, an "Affiliate"), whereby the Mutual Company agreed to reinsure each Affiliate in respect of 100% of the net liability that may accrue to such Affiliate from its insurance operations and retrocede 100% of the net liability back to each Affiliate, which the Affiliate assumes.

As of March 31, 1997, the Company acquired all of the outstanding capital stock of Pioneer pursuant to a Stock Purchase Agreement dated as of April 7, 1997 between the Company and the Mutual Company. As part of this transaction, the Mutual Company entered into an aggregate excess of loss reinsurance agreement with Pioneer whereby the Mutual Company assumed the risk of any loss from an adverse development in Pioneer's loss and loss adjustment expense reserve at the end of 1996 compared to the end of 1998 and losses and loss adjustment expenses incurred by Pioneer during the years ending December 31, 1997 and December 31, 1998 by reason of the fact that Pioneer's loss and loss adjustment expense ratio for those periods exceeded the lesser of the loss and loss expense ratios of immediately preceding periods or 60%. This reinsurance agreement resulted in additional payments of $186,800 from the Mutual Company to Pioneer in 1997.

All of the Company's officers are officers of the Mutual Company, five of the Company's seven directors are directors of the Mutual Company and three of the Company's executive officers are directors of the Mutual Company. The Company and the Mutual Company maintain a Coordinating Committee, which consists of two outside directors from each of the Company and the Mutual Company, none of whom holds seats on both Boards, to review and evaluate the pooling agreement between the Company and the Mutual Company and to be responsible for matters involving actual or potential conflicts of interest between the Company and the Mutual Company. The decisions of the Coordinating Committee are binding on the Company and the Mutual Company. The Company's Coordinating Committee members must conclude that intercompany transactions are fair and equitable to the Company. The purpose of this provision is to protect the interests of the stockholders of the Company other than the Mutual Company. The Coordinating Committee met one time in 1997. The Company's members on the Coordinating Committee are Messrs. Bolinger and Finley. See "Election of Directors." The Mutual Company's members on the Coordinating Committee are John E. Hiestand and Dr. Charles A. Heisterkamp, III.

Mr. Hiestand, age 60, has been a director of the Mutual Company since 1983 and has been President of Hiestand Memorials, Inc., a manufacturer of cemetery monuments, since 1977.

Dr. Heisterkamp, age 65, has been a director of the Mutual Company since 1979 and has practiced as a surgeon in Lancaster, Pennsylvania for more than the past five years.

ELECTION OF DIRECTORS

The Company's Board of Directors consists of seven members. Each director is elected for a three-year term and until his successor has been duly elected. The current three-year terms of the Company's directors expire in the years 1998, 1999 and 2000, respectively.

Two Class C directors are to be elected at the Annual Meeting. Unless otherwise instructed, the proxies solicited by the Board of Directors will be voted for the election of the nominees named below, both of whom are currently directors of the Company. If a nominee becomes unavailable for any reason, it is intended that the proxies will be voted for a substitute nominee designated by the Board of Directors. The Board of Directors has no reason to believe the nominees named will be unable to serve if elected. Any vacancy occurring on the Board of Directors for any reason may be filled by a majority of the directors then in office until the expiration of the term of the class of directors in which the vacancy exists. The two nominees for Class C director receiving the highest number of votes cast at the Annual Meeting will be elected as directors. Shares held by brokers or nominees as to which voting instructions have not been received from the beneficial owner or person otherwise entitled to vote and as to which the broker or nominee does not have discretionary voting power, i.e., broker non-votes, will be treated as not present and not entitled to vote for nominees for election as Class C directors. Votes withheld and broker non-votes will have no effect on the election of directors because they will not represent votes cast at the Annual Meeting for the purpose of electing directors.

The names of the nominees for Class C directors and the Class A and Class B directors who will continue in office after the Annual Meeting until the expiration of their respective terms, together with certain information regarding them, are as follows:

NOMINEES FOR CLASS C DIRECTORS

NAME	AGE	DIRECTOR SINCE	YEAR TERM WILL EXPIRE*
Thomas J. Finley, Jr.	77	1986	2001
R. Richard Sherbahn	69	1986	2001

DIRECTORS CONTINUING IN OFFICE

CLASS A DIRECTORS

NAME	AGE	DIRECTOR SINCE	YEAR TERM WILL EXPIRE
Robert S. Bolinger	61	1986	1999
Patricia A. Gilmartin	58	1986	1999
Philip H. Glatfelter, II	68	1986	1999

CLASS B DIRECTORS

NAME	AGE	DIRECTOR SINCE	YEAR TERM WILL EXPIRE
C. Edwin Ireland	88	1986	2000
Donald H. Nikolaus	55	1986	2000

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*If elected at the Annual Meeting

Mr. Bolinger has been President and Chief Executive Officer of Susquehanna Bancshares, Inc. since 1982 and of Farmers First Bank since 1976. Mr. Bolinger is also a director of Susquehanna Bancshares, Inc.

Mr. Finley retired in 1985 as President and Chief Executive Officer of the Insurance Federation of Pennsylvania, a position he held for 18 years prior to his retirement.

Mrs. Gilmartin has been an employee since 1969 of Donegal Insurance Agency, which has no affiliation with the Company, except that Donegal Insurance Agency receives insurance commissions in the ordinary course of business from the Company's subsidiaries and affiliates in accordance with such subsidiaries' and affiliates' standard commission schedules and agency contracts. Mrs. Gilmartin has been a director of the Mutual Company since 1979.

Mr. Glatfelter retired in 1989 as a Vice President of Meridian Bank, a position he held for more than five years prior to his retirement. Mr. Glatfelter has been a director of the Mutual Company since 1981 and has been Vice Chairman of the Mutual Company since 1991.

Mr. Ireland is former Chairman of the Lancaster Industrial Development Authority. He retired from Hamilton Watch Company in 1970. Prior thereto, he was Vice President, Secretary and Treasurer of Hamilton Watch Company. Mr. Ireland has been a director of the Mutual Company since 1972 and Chairman of its Board of Directors since 1985. He has been Chairman of the Company's Board of Directors since 1986.

Mr. Nikolaus has been President of the Mutual Company since 1981 and a director of the Mutual Company since 1972. He has been President of the Company since 1986. Mr. Nikolaus has been a partner in the law firm of Nikolaus & Hohenadel since 1972.

Mr. Sherbahn has owned and operated Sherbahn Associates, Inc., a life insurance and financial planning firm, since 1974. Mr. Sherbahn has been a director of the Mutual Company since 1967.

THE BOARD OF DIRECTORS AND ITS COMMITTEES

The Board of Directors met seven times in 1997. The Board of Directors has an Executive Committee, an Audit Committee, a Nominating Committee, a Compensation Committee and, together with the Mutual Company, a four-member Coordinating Committee.

The Company's Executive Committee met 22 times in 1997. Messrs. Nikolaus, Ireland and Glatfelter are the members of the Executive Committee. The Executive Committee has the authority to take all action that can be taken by the full Board of Directors, consistent with Delaware law, between meetings of the Board of Directors.

The Audit Committee of the Company consists of Messrs. Bolinger, Glatfelter and Ireland. The Audit Committee, which met one time in 1997, reviews audit reports and management recommendations made by the Company's independent auditing firm.

The Nominating Committee of the Company consists of Messrs. Finley, Ireland and Glatfelter. The Nominating Committee, which did not meet in 1997, is responsible for the nomination of candidates to stand for election to the Board of Directors at the Annual Meeting and the nomination of candidates to fill vacancies on the Board of Directors between meetings of stockholders. The Nominating Committee will consider written nominations for directors from stockholders to the extent such nominations are made in accordance with the Company's By-laws. The Company's By-laws require that any such nominations must be sent to the Company at its principal executive offices, attention: Secretary, not less than 30 days prior to the date of the stockholders meeting at which directors are to be elected. Such written nomination must set forth the name, age, address and principal occupation for the past five years of such nominee, the number of shares of the Company's Common Stock beneficially owned by such nominee and such other information about such nominee as would be required under the proxy solicitation rules of the SEC if proxies were solicited for the election of such nominee.

The Compensation Committee of the Company consists of Messrs. Ireland, Sherbahn and Glatfelter. The Compensation Committee met one time in 1997 to review and recommend compensation plans, approve certain compensation changes and grant options under and determine participants in the 1996 Equity Incentive Plan.

COMPENSATION OF DIRECTORS

Directors of the Company were paid an annual retainer of $15,000 in 1997 and were paid $500 for each meeting attended in excess of five per year. Directors who are members of committees of the Board of Directors receive $250 for each committee meeting attended. If a director serves on the Board of Directors of both the Mutual Company and the Company, the director receives only one annual retainer. If the Boards of Directors of both companies meet on the same day, directors receive only one meeting fee. In such event, the retainer and meeting fees are allocated 35% to the Mutual Company and 65% to the Company.

Pursuant to the Director Plan, each director of the Company and the Mutual Company receives an annual restricted stock award ("Restricted Stock Award") of 133 shares of the Company's Common Stock, provided that the director served as a member of the Board of Directors of the Company or the Mutual Company during any portion of the preceding calendar year. Pursuant to the Director Plan, each outside director of the Company and the Mutual Company is also eligible to receive non-qualified options to purchase shares of Common Stock in an amount determined by the Company's Board of Directors from time to time. See "Amendment of the 1996 Equity Incentive Plan for Directors."

EXECUTIVE COMPENSATION

SUMMARY COMPENSATION TABLE

The following table sets forth the compensation paid by the Company and the Mutual Company during each of the three fiscal years ended December 31, 1997 for services rendered in all capacities to the chief executive officer of the Company and the four other most highly compensated executive officers of the Company whose compensation exceeded $100,000 in the fiscal year ended December 31, 1997.

		ANNUAL COMPENSATION (1)			LONG-TERM COMPENSATION AWARDS		
NAME AND PRINCIPAL POSITION	YEAR	SALARY ($)	BONUS ($)	OTHER ANNUAL COMPENSATION ($)	RESTRICTED STOCK AWARDS ($)	SECURITIES UNDERLYING OPTIONS (#)	ALL OTHER COMPENSATION ($)
Donald H. Nikolaus,	1997	$356,000	$137,807	$7,725	2,050	--	$ 95,010(2)
President and Chief	1996	336,000	--	7,327	--	--	81,531
Executive Officer	1995	311,000	100,369	--	--	--	85,430
Ralph G. Spontak,	1997	235,000	78,444	2,943	2,050	--	50,636(2)
Senior Vice President,	1996	220,000	--	2,747	--	--	44,495
Chief Financial Officer and Secretary	1995	204,000	57,133	--	--	--	46,205
William H. Shupert,	1997	160,000	65,723	--	--	--	49,075(2)
Senior Vice President,	1996	149,000	--	--	--	--	28,669
Underwriting	1995	137,000	47,868	--	--	--	22,791
Robert G. Shenk	1997	130,000	19,417	--	--	--	15,153(2)
Senior Vice President,	1996	118,000	--	--	--	--	13,614
Claims	1995	107,000	15,966	--	--	--	13,001
Frank J. Wood	1997	110,500	25,441	--	--	--	21,064(2)
Senior Vice President,	1996	102,500	--	--	--	--	15,713
Marketing	1995	95,000	18,530	--	--	--	13,576

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(1) All compensation of officers of the Company is paid by the Mutual Company. Pursuant to the terms of an intercompany allocation agreement between the Company and the Mutual Company, the Company is charged for its proportionate share of all such compensation.

(2) Represents contributions made by the Company under its defined contribution pension plan of $15,140 for Mr. Nikolaus, $15,140 for Mr. Spontak, $15,089 for Mr. Shupert, $12,085 for Mr. Shenk and $10,147 for Mr. Wood and contributions made by the Company under its profit-sharing plan of $3,200 for Mr. Nikolaus, $3,200 for Mr. Spontak, $3,190 for Mr. Shupert, $2,589 for Mr. Shenk and $2,201 for Mr. Wood. In the case of Mr. Nikolaus, the total shown for 1997 also includes premiums paid under split-dollar life insurance policies of $25,535, premiums paid under a term life insurance policy of $3,825, directors and committee meeting fees of $23,900 and contributions made by the Company of $23,410 under the Company's Executive Restoration Plan, which is designed to restore certain retirement benefits to those individuals for whom contributions to the Company's pension and profit-sharing plans are restricted as a result of the application of Sections 401(a)(17) and 415 of the Internal Revenue Code of 1986, as amended (the "Code"). In the case of Mr. Spontak, the total shown for 1997 includes premiums paid under a split-dollar life insurance policy of $4,700, premiums paid under a term life insurance policy of $1,479, directors and committee meeting fees of $17,200 and contributions made by the Company of $8,917 under the Company's Executive Restoration Plan. In the case of Messrs. Shupert, Shenk and Wood, the totals shown for 1997 also include term life insurance premiums of $12,746, $479 and $2,752, respectively.

The following tables sets forth information with respect to options granted during the fiscal year ended December 31, 1997 to the persons named in the Summary Compensation Table.

OPTION GRANTS IN LAST FISCAL YEAR

	INDIVIDUAL GRANTS				POTENTIAL REALIZABLE VALUE AT ASSUMED ANNUAL RATE OF STOCK PRICE APPRECIATION FOR OPTION TERM	
NAME	NUMBER OF SECURITIES UNDERLYING OPTIONS GRANTED (#)	% OF TOTAL OPTIONS GRANTED TO EMPLOYEES IN FISCAL YEAR	EXERCISE PRICE ($/SH)	EXPIRATION DATE	5% ($)	10% ($)
Donald H. Nikolaus.......................	100,000(1)	25	18.00	1/2/2002	163,000	677,000
Ralph G. Spontak..........................	50,000(1)	13	18.00	1/2/2002	81,500	338,500
William H. Shupert.......................	28,000(1)	7	18.00	1/2/2002	45,640	189,560
Robert G. Shenk...........................	20,000(1)	5	18.00	1/2/2002	32,600	135,400
Frank J. Wood.............................	20,000(1)	5	18.00	1/2/2002	32,600	135,400

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(1) These options vest in three substantially equal cumulative annual installments on April 30, 1997, April 30, 1998 and April 30, 1999, respectively.

The following table sets forth information with respect to options exercised during the year ended December 31, 1997 and held on December 31, 1997 by the persons named in the Summary Compensation Table.

AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR
AND FISCAL YEAR END OPTION VALUES

			NUMBER OF SECURITIES UNDERLYING OPTIONS AT FISCAL YEAR END		VALUE OF UNEXERCISED IN-THE-MONEY OPTIONS AT FISCAL YEAR END	
NAME	SHARES ACQUIRED ON EXERCISE	VALUE REALIZED	EXERCISABLE	UNEXERCISABLE	EXERCISABLE	UNEXERCISABLE
Donald H. Nikolaus..................	--	--	33,333	66,667	$137,499	$275,001
Ralph G. Spontak....................	--	--	16,667	33,333	68,751	137,499
William H. Shupert..................	--	--	9,333	18,667	38,499	77,001
Robert G. Shenk.....................	--	--	6,667	13,333	27,501	54,999
Frank J. Wood.......................	--	--	6,667	13,333	27,501	54,999

REPORT OF THE COMPENSATION COMMITTEE OF DONEGAL GROUP INC.

THE FOLLOWING REPORT OF THE COMPANY'S COMPENSATION COMMITTEE AND THE PERFORMANCE GRAPH THAT IMMEDIATELY FOLLOWS SUCH REPORT SHALL NOT BE DEEMED PROXY SOLICITATION MATERIAL, SHALL NOT BE DEEMED FILED WITH THE SEC UNDER THE EXCHANGE ACT OR INCORPORATED BY REFERENCE IN ANY DOCUMENT SO FILED AND SHALL NOT OTHERWISE BE SUBJECT TO THE LIABILITIES OF SECTION 18 OF THE EXCHANGE ACT.

Under the rules established by the SEC, the Company is required to provide certain information about the compensation and benefits provided to the Company's President and Chief Executive Officer and the other executive officers listed in the Summary Compensation Table. The disclosure requirements as to these officers include the use of specified tables and a report of the Company's

Compensation Committee reviewing the factors that resulted in compensation decisions affecting these officers and the Company's other executive officers. The Compensation Committee of the Board of Directors has furnished the following report in fulfillment of the SEC's requirements.

The Compensation Committee reviews the general compensation policies of the Company, including the compensation plans and compensation levels for executive officers, and administers the Company's 1996 Equity Incentive Plan and the cash incentive compensation program in which the Company's executive officers participate. No members of the Compensation Committee are former or current officers of the Company, or have other interlocking relationships as defined by the SEC.

Compensation of the Company's executive officers has two principal elements: (i) an annual portion, consisting of a base salary that is reviewed annually and cash bonuses based on the Company's underwriting results, and (ii) a long-term portion, consisting of stock options. In general, the executive compensation program of the Company has been designed to:

(i) Attract and retain executive officers who contribute to the long-term success of the Company;

(ii) Motivate key senior executive officers to achieve strategic business objectives and reward them for the achievement of these objectives; and

(iii) Support a compensation policy that differentiates in compensation amounts based on corporate and individual performance and responsibilities.

A major component of the Company's compensation policy, which has been approved by the Compensation Committee, is that a significant portion of the aggregate annual compensation of the Company's executive officers should be based upon the Company's underwriting results as well as the contribution of the individual officer. For a number of years, the Company has maintained a cash incentive compensation program for the Company's executive officers. This program provides a formula pursuant to which a fixed percentage of the Company's underwriting results for the year is computed, as specified in the program, and then allocated among the executive officers selected to participate in the program for the particular year. The identity of the executive officers selected to participate in the program for the particular year as well as their participation in the amount determined by application of the fixed formula is based upon recommendations submitted by the Company's senior executive officers to the Compensation Committee. The Compensation Committee reviews those recommendations and fixes the percentage participation of the Company's executive officers in the program. The portion of the total compensation of the executive officers named in the Summary Compensation Table arising from the cash incentive compensation program formula was $326,832 in 1997 compared to zero in 1996 because the Company's underwriting income in 1997 was substantially greater than its underwriting income in 1996, as a result of losses caused by the severe winter storms during the first quarter of 1996. The Compensation Committee therefore believes that the amount of the incentive payments are tied directly to the Company's performance.

The principal factors considered by the Company when it established the cash incentive compensation program were:

(i) achievement of the Company's long-term underwriting objectives; and

(ii) the Company's long-term underwriting results compared to the long-term underwriting results of other property and casualty insurance companies.

Such factors as the Company's improved underwriting results, continued cost control and reductions in the Company's expense ratio, enhancement of the skills of the Company's workforce, the development of opportunities to expand the geographic reach of the Company's service area on a profitable basis, oversight of the reinspection of all properties covered by the Company's homeowners' business and the completion of a construction program to increase the efficiency of the Company's operations, as well as a subjective analysis of Mr. Nikolaus' performance, were considered by the Compensation Committee in approving Mr. Nikolaus' participation percentage under the Company's cash incentive program for 1997.

The Company's executive officers participate in the Company's 1996 Equity Incentive Plan, under which stock options are granted from time to time at the fair market value of the Company's Common Stock on the date of grant. The options typically vest over three years. The primary purpose of the 1996 Equity Incentive Plan is to provide an incentive for the Company's long-term performance. Such stock options provide an incentive for the creation of stockholder value over the long-term because the full benefit of the options can be realized only if the price of the Company's Common Stock appreciates over time. Stock options exercisable for the purchase of 100,000 shares and 251,333 shares of the Company's Common Stock, respectively, were granted to Mr. Nikolaus and to all of the Company's executive officers as a group under the 1996 Equity Incentive Plan during 1997.

The Compensation Committee believes the compensation of Mr. Nikolaus and the other executive officers of the Company is reasonable in view of the Company's performance and the contribution of those officers to that performance in 1997, as well as the performance of the Company in 1997 compared to the performance of other property and casualty insurance companies in 1997.

Section 162(m) of the Code generally disallows a tax deduction to publicly held companies for compensation of more than $1 million paid to a company's chief executive officer or any executive officer named in its Summary Compensation Table. Qualifying performance-based compensation is not subject to the deduction limit if certain requirements are met. The policy of the Compensation Committee is to structure the compensation of the Company's executive officers, including Mr. Nikolaus, to avoid the loss of the deductibility of any compensation, although Section 162(m) will not preclude the Compensation Committee from awarding compensation in excess of $1 million, if it should be warranted in the future. The Company believes that Section 162(m) will not have any effect on the deductibility of the compensation of Mr. Nikolaus and the other executive officers named in the Summary Compensation Table for 1997.

DONEGAL GROUP INC. COMPENSATION COMMITTEE

C. Edwin Ireland
R. Richard Sherbahn
Philip H. Glatfelter, II

COMPARISON OF TOTAL RETURN ON THE COMPANY'S COMMON STOCK WITH CERTAIN AVERAGES

The following graph provides an indicator of cumulative total stockholder returns on the Company's Common Stock compared to the Russell 2000 Index and a peer group of property and casualty insurance companies selected by Value Line, Inc. The members of the peer group are as follows: 20th Century Industries, ACE Limited, Allmerica Financial Corporation, Allstate Corporation, American Financial Group Inc., W.R. Berkley Corporation, The Chubb Corporation, Cincinnati Financial Corporation, USF&G Corporation, Fremont General Corporation, Frontier Insurance Group, Inc., Gainsco Inc., General Reinsurance Corporation, Hartford Financial Services Group, Markel Corporation, Mercury General Corporation, NAC Re Corporation, Old Republic International Corporation, Orion Capital Corporation, Ohio Casualty Corporation, The Progressive Corporation, SAFECO Corporation, Selective Insurance Group, Inc., The St. Paul Companies, Inc. and Transatlantic Holdings, Inc.

[GRAPHIC]

In the printed version of the document, a line graph appears which depicts the following plot points:

Comparison of Five-Year Cumulative Total Return*

	1992	1993	1994	1995	1996	1997
Donegal Group, Inc.	$100.00	$160.76	$140.40	$186.11	$208.36	$306.04
Russel 2000 Index	$100.00	$118.91	$116.55	$149.70	$174.30	$213.00
Insurance (Prop/Casualty)	$100.00	$102.18	$101.16	$142.15	$181.74	$280.29

Assumes $100 invested at the close of trading on 12/92 in Donegal Group, Inc. common stock, Russell 2000 index and insurance (Prop/Casualty).
*Cumulative total return assumes reinvestment of dividends.

CERTAIN TRANSACTIONS

Donald H. Nikolaus, President and a director of the Company and the Mutual Company, is also a partner in the law firm of Nikolaus & Hohenadel. Such firm has served as general counsel to the Mutual Company since 1970 and to the Company since 1986, principally in connection with the defense of claims litigation arising in Lancaster, Dauphin and York counties. Such firm is paid its customary fees for such services.

Patricia A. Gilmartin, a director of the Company and the Mutual Company, is an employee of Donegal Insurance Agency, which has no affiliation with the Company except that Donegal Insurance Agency receives insurance commissions in the ordinary course of business from the Company's subsidiaries and affiliates in accordance with such subsidiaries' and affiliates' standard commission schedules and agency contracts.

Frederick W. Dreher, a director of the Mutual Company, is a partner in the law firm of Duane, Morris & Heckscher LLP, which represents the Company and the Mutual Company in certain legal matters. Such firm is paid its customary fees for such services.

AMENDMENT TO CERTIFICATE OF INCORPORATION TO INCREASE THE AUTHORIZED SHARES OF COMMON STOCK

At the Annual Meeting, the stockholders will be asked to vote on a proposal to approve an amendment to Article 4(a) of the Company's Certificate of Incorporation to increase the number of authorized shares of Common Stock from 10,000,000 shares to 15,000,000 shares. As of February 20, 1998, 6,057,732 shares of Common Stock were outstanding, 91,716 shares of Common Stock were held in treasury and 2,245,538 shares of Common Stock were reserved for issuance upon the exercise of options granted and to be granted under the Company's 1996 Equity Incentive Plan, Director Plan, 1996 Employee Stock Purchase Plan and the Agency Stock Purchase Plan, leaving 1,605,014 shares of Common Stock available for issuance.

The increase in the authorized number of shares of the Company's Common Stock is being proposed because the Board of Directors believes that it is advisable to have a greater number of authorized but unissued shares of Common Stock available for various corporate programs and purposes. The Company may from time to time consider acquisitions, stock dividends or stock splits, and public or private financings to provide the Company and its subsidiaries with capital, all of which may involve the issuance of additional shares of Common Stock or securities convertible into Common Stock. Also, additional shares of Common Stock may be necessary to meet anticipated future obligations under the Company's employee and agent benefit plans. The Board of Directors believes that having authority to issue additional shares of Common Stock will avoid the possible delay of calling and holding a special meeting of stockholders to increase its authorized capital stock at the time a transaction may be proposed, so as to enhance the Company's ability to take prompt advantage of market conditions and to respond promptly to any future acquisition opportunities.

The Company has no present plan, understanding or arrangement to issue any of the additional shares of Common Stock that will be authorized if the amendment is approved.

If the proposal is approved, the Board of Directors will not solicit stockholder approval to issue the additional authorized shares except to the extent that such approval may be required by law or the rules of The Nasdaq Stock Market, and such shares may be issued for such consideration, cash or otherwise, at such times and in such amounts as the Board of Directors in its discretion may determine, without further action by the stockholders. The future issuance by the Company of shares of Common Stock may dilute the equity ownership position of current holders of Common Stock. Under the Nasdaq rules applicable to the Company, stockholder approval must be obtained prior to the issuance of shares for certain purposes, including the issuance of shares in an amount equal to or in excess of 20% of the Company's then outstanding shares in connection with a future acquisition by the Company.

Although the Board of Directors currently intends to utilize the additional shares of Common Stock solely for the purposes set forth above, such shares could also be used by the Board of Directors to dilute the stock ownership of persons seeking to obtain control of the Company, thereby possibly discouraging or deterring a non-negotiated attempt to obtain control of the Company and making removal of incumbent management more difficult. The proposal, however, is not a result of, nor does the Board of Directors have knowledge of, any effort to accumulate the Company's capital stock or to obtain control of the Company by means of a merger, tender offer, solicitation in opposition to the Board of Directors or otherwise.

The holders of Common Stock have no preemptive rights.

The Company's Certificate of Incorporation also authorizes the issuance of 1,000,000 shares of Series Preferred Stock, which the Board of Directors has the power to issue in one or more series and to fix the number of shares of each series and all designations, relative rights, preferences, qualifications, limitations and restrictions of the shares in each series. The proposed amendment does not increase or otherwise affect the Company's authorized Series Preferred Stock.

The text of Article 4(a) of the Company's Certificate of Incorporation, as proposed to be amended, is as follows:

> "4.(a) The aggregate number of shares which the Corporation shall have authority to issue is: Fifteen Million (15,000,000) shares of Common Stock of the par value of One Dollar ($1.00) per share (the "Common Stock") and One Million shares of Series Preferred Stock of the par value of One Dollar ($1.00) per share (the "Preferred Stock")."

Approval of the proposed amendment to the Certificate of Incorporation will require the affirmative vote of the holders of a majority of the shares of the Company's Common Stock outstanding and entitled to vote. Abstentions and broker non-votes are considered shares of stock outstanding and entitled to vote and are counted in determining the number of votes necessary for such majority. An abstention or broker non-vote will therefore have the practical effect of voting against approval of the amendment because it represents one fewer vote for approval of the amendment.

AMENDMENT OF THE 1996 EQUITY INCENTIVE PLAN FOR DIRECTORS

AMENDMENT OF THE DIRECTOR PLAN

The Director Plan provides for: (i) the grant of non-qualified options ("Director Options") to outside directors ("Outside Directors") of the Company and the Mutual Company at the discretion of the Board of Directors and (ii) an annual grant to each director of the Company and the Mutual Company ("Directors") of a Restricted Stock Award of 133 shares of Common Stock to be issued on the first business day of January in each year, commencing January 2, 1997, provided that the Director served as a member of the Board or the Board of Directors of the Mutual Company during any portion of the prior year. Director Options and Restricted Stock Awards collectively are hereinafter referred to as "Stock Rights."

The total number of shares of Common Stock that may be the subject of grants of Stock Rights under the Director Plan may not exceed 119,600 shares in the aggregate. As of March 1, 1998, Director Options to purchase 60,003 shares of Common Stock, in the aggregate, have been granted to Outside Directors under the Director Plan, and Restricted Stock Awards of 2,796 shares, in the aggregate, have been granted to the Directors under the Director Plan, leaving 56,801 shares of Common Stock available for future awards under the Director Plan.

The purpose of the Director Plan is to enhance the ability of the Company and the Mutual Company to attract and retain highly qualified directors, to compensate them for their services to the Company and the Mutual Company, as the case may be, and, in so doing, to strengthen the alignment of the interests of the Directors with the interests of the stockholders by ensuring ongoing ownership of the Company's Common Stock. In order to continue to provide these benefits, on March 16, 1998, the Board of Directors of the Company approved an amendment to the Director Plan to increase the number of shares of Common Stock available for awards thereunder from 119,600 shares to 200,000 shares.

The Director Plan is administered by the Board. The Board has the power to interpret the Director Plan, the Director Options and the Restricted Stock Awards, and, subject to the terms of the Director Plan, to determine who will be granted Director Options, the number of Director Options to be granted to any Outside Director, the timing of such grant and the terms of exercise. The Board also has the power to adopt rules for the administration, interpretation and application of the Director Plan. The Board does not have any discretion to determine who will be granted Restricted Stock Awards under the Director Plan, to determine the number of Restricted Stock Awards to be granted to each Director or to determine the timing of such grants.

RESTRICTED STOCK AWARDS

Restricted Stock Awards consist of shares of Common Stock that are issued in the name of the Director but that may not be sold or otherwise transferred by the grantee until one year after the date of grant. Upon the issuance of shares under a Restricted Stock Award, the Director has all rights of a stockholder with respect to the shares, except that such shares may not be sold, transferred or otherwise disposed of until one year after the date of grant.

Restricted Stock Awards are evidenced by written agreements in such form not inconsistent with the Director Plan as the Board shall approve from time to time. Each agreement contains such restrictions, terms and conditions as are required by the Director Plan. Although the Common Stock comprising each Restricted Stock Award is registered in the name of the grantee, a restrictive legend is placed on the stock certificate.

NON-QUALIFIED STOCK OPTIONS

The exercise price of Director Options granted under the Director Plan will be set by the Board and may not be less than 100% of the fair market value per share of the Common Stock on the date that the Director Option is granted.

Director Options are evidenced by written agreements in such form not inconsistent with the Director Plan as the Board shall approve from time to time. Each agreement will state the period or periods of time within which the Director Option may be exercised. The Board may accelerate the exercisability of any Director Options upon such circumstances and subject to such terms and conditions as the Board deems appropriate. Unless the Board accelerates exercisability, no Director Option that is unexercisable at the time of the optionee's termination of service as a Director may thereafter become exercisable. No Director Option may be exercised after ten years from the date of grant. If a Director Option expires or is canceled for any reason without having been fully exercised or vested, the number of shares subject to such Director Option that had not been purchased or become vested may again be made subject to a Director Option under the Director Plan.

The option price must be paid in full at the time of exercise unless otherwise determined by the Board. Payment must be made in cash, in shares of Common Stock valued at their then fair market value, or a combination thereof, as determined in the discretion of the Board. It is the policy of the Board that any taxes required to be withheld must also be paid at the time of exercise. The Board may, in its discretion, allow an optionee to enter into an agreement with the Company's transfer agent or a brokerage firm of national standing whereby the optionee will simultaneously exercise the Director Option and sell the shares acquired thereby and either the Company's transfer agent or the brokerage firm executing the sale will remit to the Company from the proceeds of sale the exercise price of the shares as to which the Director Option has been exercised as well as the required amount of withholding.

An outstanding Director Option that has become exercisable generally terminates one year after termination of a Director's service as a Director due to death and three months after termination of a Director's service as a Director for any reason other than death. A Director Option granted under the Director Plan may be exercised during the lifetime of the optionee only by the optionee.

Appropriate adjustments to outstanding Options and to the number or kind of shares subject to the Director Plan are provided for in the event of a stock split, reverse stock split, stock dividend, share combination or reclassification and certain other types of corporate transactions involving the Company, including a merger or a sale of substantially all of the assets of the Company.

AMENDMENT OR TERMINATION

The Director Plan will remain in effect until all Director Options granted under the Director Plan have been satisfied by the issuance of shares, except that no Stock Rights may be granted under the Director Plan after December 19, 2006. The Board may terminate, modify, suspend or amend the Director Plan at any time, subject to any required stockholder approval or any stockholder approval that the Board may deem to be advisable for any reason, such as for the purpose of obtaining or retaining any statutory or regulatory benefits under tax, securities or other laws or satisfying any applicable stock exchange listing requirements. No modification, amendment or termination of the Director Plan will alter or impair any rights or obligations under any outstanding Stock Right without the consent of the grantee. No Stock Right may be granted during any period of suspension nor after termination of the Director Plan.

FEDERAL INCOME TAX CONSEQUENCES

The Director Plan is not a qualified plan under Section 401(a) of the Code. The following description, which is based on existing laws, sets forth generally certain of the federal income tax consequences of Stock Rights granted under the Director Plan. This description may differ from the actual tax consequences of participation in the Director Plan.

An optionee will not recognize income for federal income tax purposes upon the receipt of a Director Option, nor will the Company be entitled to any deduction on account of such grant. Such optionee will recognize ordinary taxable income for federal income tax purposes at the time of exercise in the amount by which the fair market value of such shares then exceeds the option price. When the optionee disposes of the shares acquired upon exercise of the Director Option, the optionee will generally recognize capital gain or loss equal to the difference between (i) the amount received upon disposition of the shares, and (ii) the sum of the option price and the amount included in the optionee's income when the Director Option was exercised. Such gain will be long-term or short-term depending upon whether the shares were held for at least one year after the date of exercise.

A grantee of shares of restricted stock pursuant to a Restricted Stock Award will recognize ordinary income for federal income tax purposes in the year of receipt, measured by the value of the shares received determined without regard to the transfer restriction or other restrictions relating to such issue. Any gain or loss recognized upon the sale of the shares will generally be treated as capital gain or loss and will be long-term or short-term depending upon the holding period of the shares.

Under current law, any gain realized by an optionee or a grantee, as the case may be, other than long-term capital gain, is taxable at a maximum federal income tax rate of 39.6%. Long-term capital gain is taxable at a maximum federal income tax rate of 28% (20% if the holding period is at least 18 months).

The Company will be entitled to a tax deduction in connection with Stock Rights under the Director Plan in an amount equal to the ordinary income realized by the grantee at the time he or she recognizes such income.

VOTE REQUIRED

Approval of the amendment to the Director Plan will require the affirmative vote of the holders of a majority of the outstanding shares of the Company's Common Stock present in person or represented by proxy at the Annual Meeting and entitled to vote. Abstentions are considered shares of stock present in person or represented by proxy at the meeting and entitled to vote and are counted in determining the number of votes necessary for such majority. An abstention will therefore have the practical effect of voting against adoption of the Director Plan because it represents one fewer vote for adoption of the Director Plan. Broker non-votes are not considered shares present in person or represented by proxy and entitled to vote on the Director Plan and will have no effect on the vote. The Board of Directors recommends that the stockholders vote FOR the approval of the amendment to the Director Plan.

ELECTION OF INDEPENDENT PUBLIC ACCOUNTANTS

Unless instructed to the contrary, it is intended that votes will be cast pursuant to the proxies for the election of KPMG Peat Marwick LLP as the Company's independent public accountants for 1998. The Company has been advised by KPMG Peat Marwick LLP that none of its members has any financial interest in the Company. Election of KPMG Peat Marwick LLP will require the affirmative vote of the holders of a majority of the shares of the Company's Common Stock present in person or represented by proxy at the Annual Meeting.

A representative of KPMG Peat Marwick LLP will attend the Annual Meeting, will have the opportunity to make a statement, if he desires to do so, and will be available to respond to any appropriate questions presented by stockholders at the Annual Meeting.

ANNUAL REPORT

A copy of the Company's Annual Report for 1997 is being mailed to the Company's stockholders with this Proxy Statement.

STOCKHOLDER PROPOSALS

Any stockholder who, in accordance with and subject to the provisions of the proxy rules of the SEC, wishes to submit a proposal for inclusion in the Company's proxy statement for its 1999 Annual Meeting of Stockholders must deliver such proposal in writing to the Company's Secretary at the Company's principal executive offices at 1195 River Road, Marietta, Pennsylvania 17547, not later than November 23, 1998.

OTHER PROPOSALS

The Board of Directors does not know of any matters to be presented for consideration at the Annual Meeting other than the matters described in the Notice of Annual Meeting, but if any matters are properly presented, it is the intention of the persons named in the accompanying proxy to vote on such matters in accordance with their judgment.

By Order of the Board of Directors

/s/ Donald H. Nikolaus

Donald H. Nikolaus
President and Chief Executive Officer

March 23, 1998

SUBSIDIARIES OF REGISTRANT

Registrant owns 100% of the outstanding stock of the following insurance companies:

Name	State of Formation
Atlantic States Insurance Company	Pennsylvania
Southern Insurance Company of Virginia	Virginia
Pioneer Insurance Company	Ohio
Delaware Atlantic Insurance Company	Delaware

Registrant owns 100% of the outstanding stock of the following business corporation:

Name	State of Formation
Atlantic Inspection Services, Inc.	Maryland

Independent Auditors' Consent and Report on Schedules

The Board of Directors
Donegal Group Inc.:

The audits referred to in our report dated February 27, 1998, included the related financial statement schedules as of December 31, 1997, and for each of the years in the three-year period ended December 31, 1997, incorporated by reference in Form 10-K. These financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statement schedules based on our audits. In our opinion, such financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly in all material respects the information set forth therein.

We consent to the use of our reports incorporated by reference in the registration statements (Nos. 333-1287, 333-06681, 33-25541 and 33-26693) on Form S-8 and in the registration statement (No. 333-36585) on Form S-3 of Donegal Group Inc.

KPMG PEAT MARWICK LLP

Harrisburg, Pennsylvania
March 27, 1998

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YEAR
DEC-31-1997
DEC-31-1997
57,731,251
117,246,205
120,882,886
7,274,562
0
0
204,964,805
3,413,315
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8,448,060
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118,112,390
71,367,691
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0
10,500,000
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0
6,122,431
85,474,232
304,104,505
107,302,168
11,507,277
314,136
2,204,025
67,656,518
18,696,000
17,058,668
14,173,543
3,532,357
10,641,186
0
0
0
10,641,186
1.77
1.77
75,427,556
69,040,518
(1,384,000)
39,133,249
26,477,000
77,473,825
(1,384,000)