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, 2002

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: (888) 877-0600

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

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

CLASS A COMMON STOCK, $.01 PAR VALUE

CLASS B COMMON STOCK, $.01 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]

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

On June 28, 2002, the aggregate market value (based on the closing sales prices on that date) of the voting stock held by non-affiliates of the Registrant was $31,102,112.

Indicate the number of shares outstanding of each of the Registrant's classes of common stock, as of the latest practicable date: 6,187,569 shares of Class A Common Stock and 2,988,757 shares of Class B Common Stock were outstanding on March 11, 2003.

DOCUMENTS INCORPORATED BY REFERENCE:

1. Portions of the Registrant's annual report to stockholders for the fiscal year ended December 31, 2002 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 17, 2003 are incorporated by reference into Part III of this report.

DONEGAL GROUP INC.

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PART I

ITEM 1. BUSINESS.

(a) GENERAL DEVELOPMENT OF BUSINESS.

Donegal Group Inc. is an insurance holding company formed in August 1986, which is headquartered in Pennsylvania and engages, through its subsidiaries, in the property and casualty insurance business in 14 Mid-Atlantic and Southeastern states. As used in this Report, "DGI" or the "Company" refers to Donegal Group Inc. and its insurance subsidiaries, Atlantic States Insurance Company ("Atlantic States") and Southern Insurance Company of Virginia ("Southern"). To reduce expenses and enhance operating efficiencies, during 2001, two of DGI's former insurance company subsidiaries, Delaware Atlantic Insurance Company ("Delaware Atlantic") and Pioneer Insurance Company, a New York company ("Pioneer New York"), merged into Atlantic States. During 2002, one of DGI's former insurance company subsidiaries, Pioneer Insurance Company, an Ohio company ("Pioneer Ohio"), was merged into Atlantic States, and another of DGI's former insurance subsidiaries, Southern Heritage Insurance Company ("Southern Heritage"), was merged into Southern. Except as otherwise noted, all financial information included in this Report for Atlantic States and Southern includes the financial information of those former subsidiaries through the dates of the mergers.

Donegal Mutual Insurance Company (the "Mutual Company") currently owns approximately 66% of the outstanding Class A Common Stock and approximately 62% of the outstanding Class B Common Stock of the 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.

The Company's strategy is to seek growth both internally and through acquisitions. Since the formation of the Company and Atlantic States in 1986, the Company has completed the following acquisitions:

COMPANY ACQUIRED	YEAR ACQUIRED	NET PREMIUMS WRITTEN YEAR PRIOR TO ACQUISITION
Southern Insurance Company of Virginia	1988	$1,128,843
Delaware Atlantic Insurance Company(1)	1995	2,824,398
Pioneer Insurance Company (Ohio)(2)	1997	4,499,273
Southern Heritage Insurance Company(3)	1998	32,002,540
Pioneer Insurance Company (New York)(1)	2001	1,917,723

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(1) Merged into Atlantic States in 2001.
(2) Merged into Atlantic States in 2002.
(3) Merged into Southern in 2002.

The Company evaluates other acquisition candidates on a continuing basis. However, there can be no assurance as to whether or when the Company will effect any additional acquisitions.

In June 2002, the Mutual Company established an affiliation with Le Mars Mutual Insurance Company of Iowa, an Iowa property and casualty insurance company ("Le Mars"), under which the Mutual Company purchased a $4 million surplus note from Le Mars and provides management services to Le Mars. Designees of the Mutual Company constitute a majority of the members of the Board of Directors of Le Mars. Neither the Company nor the Mutual Company owns any equity interest in Le Mars. The financial results of Le Mars are not consolidated with the financial results of the Company or the Mutual Company, and neither the Company nor the Mutual Company bears any responsibility for the insurance obligations of Le Mars.

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 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, with the Mutual Company remaining solely responsible for any losses in the pooled business with dates of loss on or before the close of business on September 30, 1986. Pursuant to amendments to the pooling agreement subsequent to October 1, 1986, the Mutual Company has increased the percentage of retrocessions of the pooled business to Atlantic States, and, since July 1, 2000, 70% of the pooled business has been retroceded to Atlantic States.

From January 1, 1991 to December 31, 2001, Southern ceded 50% of its direct written premiums to the Mutual Company. This reinsurance arrangement was terminated effective December 31, 2001. 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.

DGI and the Mutual Company jointly own Donegal Financial Services Corporation ("Donegal Financial"), the holding company for Province Bank FSB ("Province Bank"), a federal savings bank headquartered in Marietta, Pennsylvania. Province Bank opened for business in September 2000, and its deposits are insured by the Savings Association Insurance Fund of the Federal Deposit Insurance Corporation. Donegal Financial's capital stock is owned 55% by the Mutual Company and 45% by the Company.

Effective as of the close of business on April 19, 2001, the Company: (a) effected a one-for-three reverse stock split of its previously authorized Common Stock and redesignated that Common Stock as Class B Common Stock; and (b) declared a dividend of two shares of Class A Common Stock payable on each share of Class B Common Stock then outstanding. As a result of the reverse stock split and the stock dividend, each person who held shares of the Company's previously authorized Common Stock as of the close of business on April 19, 2001 thereafter continued to hold, exclusive of any fractional interest in a share of Class B Common Stock, the

same number of shares of the Company's capital stock, two-thirds of which were shares of Class A Common Stock and one-third of which were shares of Class B Common Stock. Except as otherwise required by law, each share of Class A Common Stock is entitled one-tenth of a vote with respect to each matter submitted to the stockholders of the Company for approval and each share of Class B Common Stock is entitled to one vote with respect to each matter submitted to the stockholders of the Company for approval. The Class A Common Stock and the Class B Common Stock vote together as a single class unless otherwise required by law. A slightly higher dividend is paid on the Class A Common Stock than on the Class B Common Stock. All share information set forth in this Report for periods after April 19, 2001 reflects these transactions.

(b) FINANCIAL INFORMATION ABOUT INDUSTRY SEGMENTS.

The Company has three segments, which consist of its investment function, its personal lines of insurance and its commercial lines of insurance. Financial information about these segments is set forth in Note 17 to the Consolidated Financial Statements incorporated by reference herein.

(c) NARRATIVE DESCRIPTION OF BUSINESS.

RELATIONSHIP WITH THE MUTUAL COMPANY

DGI's insurance operations are interrelated with the insurance operations of the Mutual Company and, because of the percentage of the pooled business assumed by DGI's subsidiary, Atlantic States, DGI's results of operations are dependent to a material extent upon the success of the Mutual Company. In addition, various reinsurance agreements exist between the Company's insurance subsidiaries 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. As of March 11, 2003, the Mutual Company owned approximately 66.0% of DGI's Class A Common Stock and approximately 62.0% of DGI's Class B Common Stock.

Through the pool and through its insurance subsidiaries, DGI writes personal and commercial property and casualty insurance lines, including automobile, homeowners, commercial multi-peril, workers' compensation and other lines of business.

The Mutual Company provides all personnel for the Company and its insurance subsidiaries. Expenses are allocated to the Company and Southern 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 under such agreement were $28,586,888 in 2002.

The Mutual Company leases office equipment and automobiles from the Company under a lease dated January 1, 2000. The Mutual Company made lease payments to the Company of $789,697 in 2002.

Under the terms of the intercompany pooling agreement, 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 is included in the pooled business. Pursuant to amendments to the pooling agreement since its commencement on October 1, 1986, the Mutual Company has increased the percentage of retrocessions of the pooled business to Atlantic States, and, as most recently amended, effective as of July 1, 2000, 70% of the pooled business is retroceded to Atlantic States. All premiums, losses, loss 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, subject to approval by the Coordinating Committee discussed below. 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.

The underwriting pool is intended to produce a more uniform and stable underwriting result from year to year for the participants 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, each of which has its own capital and surplus.

The Mutual Company and Province Bank are parties to a lease dated September 1, 2000, whereby Province Bank leases from the Mutual Company 3,600 square feet of one of the Mutual Company's buildings located in Marietta, Pennsylvania for an annual rent based on an independent appraisal. The Mutual Company and Province Bank are also parties to an Administrative Services Agreement dated September 1, 2000, whereby the Mutual Company is obligated to provide various human resource services, principally payroll and employee benefits administration, administrative support, facility and equipment maintenance services and purchasing, to Province Bank, subject to the overall limitation that the costs charged by the Mutual Company may not exceed the costs of independent vendors for similar services and further subject to annual maximum cost limitations specified in the Administrative Services Agreement. The Mutual Company and the Company conduct business with Province Bank, primarily through checking accounts, on the same terms and conditions as are offered to the other large commercial customers of Province Bank.

All of the Company's officers are officers of the Mutual Company, four of the Company's six directors are directors of the Mutual Company and two 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. Under the Company's and the Mutual Company's By-laws, any new agreement between the Company and the Mutual Company and any proposed change in any existing agreement between the Company and the Mutual Company must first be submitted for approval by the respective Boards of Directors of the Company and the Mutual Company and, if approved, submitted to the Coordinating Committee for approval. The proposed new agreement or change in an existing

agreement will receive Coordinating Committee approval only if both of the Company's Coordinating Committee members conclude the new agreement or change in an existing agreement is fair and equitable to the Company and its stockholders and if both of the Mutual Company's members conclude the agreement is fair and equitable to the Mutual Company and its policyholders. The decisions of the Coordinating Committee are binding on the Company and the Mutual Company. The purpose of this provision is to protect the interests of the stockholders of the Company and the interests of the policyholders of the Mutual Company. The Coordinating Committee meets on an as-needed basis.

DGI'S BUSINESS STRATEGY

DGI, in conjunction with the Mutual Company, has multiple strategies that 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 incentive commissions based upon premium volume and profitability and the right to participate in the Company's Agency Stock Purchase Plan.

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

- A goal of expanding operations in its current marketing areas in the Mid-Atlantic and Southeastern regions of the United States and into the Mid-Western region of the United States.

- A goal of obtaining sufficient rate increases in both commercial and personal lines to improve underwriting results while maintaining the existing book of business and preserving the Company's ability to write new business.

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, 2002, 2001 and 2000:

	YEAR ENDED DECEMBER 31,		
	2002	2001	2000
Net Premiums Written:			
Commercial	35.3%	36.9%	37.2%
Personal	64.7	63.1	62.8

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

- 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.

- 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 accounting principles generally accepted in the United States of America ("GAAP") and statutory accounting principles prescribed or permitted by state insurance authorities. The GAAP combined ratio is the sum of the ratios of incurred losses and loss expenses to net premiums earned (loss ratio), underwriting expenses to net premiums earned (expense ratio) and policyholder dividends to net premiums earned (dividend ratio). The statutory combined ratio is the sum of the ratios of incurred losses and loss expenses to net premiums earned (loss ratio),

underwriting expense to net premiums written (expense ratio) and policyholder dividends to net premiums written (dividend ratio). These ratios can differ for various reasons, including the following: the Company does not anticipate salvage and subrogation in recording losses for statutory purposes but does so for GAAP; and guaranty fund assessments are estimated and accrued when an insolvency occurs based on the ultimate loss from the insolvency for statutory purposes while for GAAP the assessments are accrued on an annual basis as premiums upon which the assessment will be based are written.

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,		
	2002	2001	2000
GAAP combined ratio	99.6%	103.8%	101.8%
Statutory operating ratios:			
Loss ratio	69.1	70.5	68.8
Expense ratio	28.3	31.4	30.9
Dividend ratio	0.6	1.0	0.9
Statutory combined ratio	98.0%	102.9%	100.6%
Industry statutory combined ratio(1)	105.7%	118.0%	110.5%

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(1) Source: A.M. Best Company, Inc.

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.

During 2002, 2001 and 2000, the Company incurred assessments totaling $486,190, $1,286,578 and $813,000, respectively, from the Pennsylvania Insurance Guaranty Association relating to the insolvencies of three medical malpractice insurers and Reliance Insurance Company.

Also during 2002, the Company experienced an increase in costs with assigned risk buyout programs in the State of New York. Under a buyout program, one insurer pays another

issuer to assume the first insurer's obligations to participate in a state-mandated involuntary coverage program, such as an assigned risk plan, for those who are unable to obtain automobile insurance in the voluntary market because of underwriting considerations. Under these programs, the servicing carrier performs all administrative functions relating to the assigned risk policies, including collecting premiums and making payments for losses and loss adjustment expenses. The Company makes payments to the servicing carrier, which includes an administrative fee, as well as a fee for rate inadequacy costs above the collected premiums. The Company's costs for the buyout program in New York State were $445,295 for the first five months of 2002, compared to $146,218 for all of 2001; as a result, in June 2002 the Company suspended writing private passenger and commercial automobile lines in New York State. The rise in costs in the State of New York was the result of significant increases in the population of assigned risk policies and the deteriorating rate adequacy in the residual market.

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,		
	2002	2001	2000
	(dollars in thousands)		
Net Premiums Written:			
Commercial:			
Automobile	$17,451	$16,527	$15,112
Workers' compensation	23,845	22,979	21,174
Commercial multi-peril	25,536	24,174	21,722
Other	1,895	1,725	1,597
Total commercial	68,727	65,405	59,605
Personal:			
Automobile	84,643	74,396	65,528
Homeowners	34,637	31,431	29,413
Other	6,497	5,796	5,576
Total personal	125,777	111,623	100,517
Total business	$194,504	$177,028	$160,122
Statutory Combined Ratios:			
Commercial:			
Automobile	88.9%	108.9%	99.9%
Workers' compensation	94.9	109.9	91.9
Commercial multi-peril	85.8	96.2	102.2
Other	72.4	77.0	39.0
Total commercial	89.3	103.7	96.2
Personal:			
Automobile	106.4	104.5	100.3
Homeowners	97.4	101.6	110.9
Other	84.1	86.8	103.5
Total personal	102.8	102.7	103.6
Total business	98.0%	102.9%	100.6%

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 insurance 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 analyses 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 department 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.

Reference is made to "Risk Factors" for information on risks that affect the business of the Company and the Mutual Company.

MARKETING

DGI's insurance products, together with the products of its subsidiaries and the Mutual Company, are marketed through approximately 1,500 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 Plans 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 more stable and profitable segment of the property and casualty insurance business than the large commercial insurance markets. 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, provides a foundation for growth and 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 claims 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 areas 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 $35,000 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 period in which the changes in estimates 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 and 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 expense reserves 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 estimated future liabilities for losses and loss expenses, and further adjustments could be required in the future. 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 losses and loss expenses.

Differences between liabilities reported in DGI's financial statements prepared on the basis of GAAP and its insurance subsidiaries' financial statements prepared on a statutory accounting basis result from reducing statutory liabilities for anticipated salvage and subrogation recoveries. These differences amounted to $7,334,635, $8,197,948 and $8,042,860 at December 31, 2002, 2001 and 2000, 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,		
	2002	2001	2000
		(in thousands)	
Gross liability for unpaid losses and loss expenses at beginning of year	$179,840	$156,476	$144,180
Less reinsurance recoverable	65,296	53,767	44,946
Net liability for unpaid losses and loss expenses at beginning of year	114,544	102,709	99,234
Provision for net losses and loss expenses for claims incurred in the current year	122,434	110,143	103,671
Change in provision for estimated net losses and loss expenses for claims incurred in prior years	6,834	8,035	712
Total incurred	129,268	118,178	104,383
Net losses and loss payments for claims incurred during:			
The current year	67,656	63,290	61,848
Prior years	46,869	43,053	39,060
Total paid	114,525	106,343	100,908

	YEAR ENDED DECEMBER 31,		
	2002	2001	2000
		(in thousands)	
Net liability for unpaid losses and loss expenses at end of year	129,485	114,544	102,709
Plus reinsurance recoverable	81,405	65,296	53,767
Gross liability for unpaid losses and loss expenses at end of year	$210,692	$179,840	$156,476

The Company recognized an increase in the liability of losses and loss expenses of prior years of $6,834,000, $8,035,000 and $712,000 in 2002, 2001 and 2000, respectively. These developments are primarily attributable to variations from expected claim severity in the private passenger and commercial automobile liability, workers' compensation and commercial multiple peril lines of business.

The following table sets forth the development of the liability for net unpaid losses and loss expenses for DGI on a GAAP basis from 1992 to 2002, with supplemental loss data for 2001 and 2002. Loss data in the table includes business assumed from the Mutual Company as part of the pooling arrangement.

"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 1993 liability has developed an excess after nine years, in that reestimated net losses and loss expenses are expected to be $12.7 million less than the estimated liability initially established in 1993 of $52.8 million.

The "Cumulative excess" shows the cumulative excess at December 31, 2002 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 would mean 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 1993 column indicates that as of December 31, 2002 payments equal to $41.4 million of the currently reestimated ultimate liability for net losses and loss expenses of $40.1 million had been made.

During the past several years, the Company has experienced a period during which redundancies in its loss and loss expense reserves have declined. In the most recent two years, the Company has experienced deficiencies in these reserves. These deficiencies were primarily related to the workers' compensation and commercial automobile lines of business. During 2002, the Company addressed the deficiencies in these two lines of business by strengthening both case basis and IBNR reserves.

	YEAR ENDED DECEMBER 31					
	1992	1993	1994	1995	1996	1997
	(in thousands)					
Net liability at end of year for unpaid losses and loss expenses............	$44,339	$52,790	$63,317	$75,372	$78,889	$80,256
Net liability reestimated as of:						
One year later...............	45,408	50,583	60,227	72,380	77,400	77,459
Two years later..............	42,752	48,132	56,656	70,451	73,438	76,613
Three years later............	40,693	44,956	54,571	66,936	71,816	74,851
Four years later.............	38,375	42,157	51,825	64,356	69,378	73,456
Five years later.............	37,096	41,050	50,493	63,095	69,485	73,103
Six years later..............	36,682	40,572	49,593	62,323	69,949	
Seven years later............	36,730	39,991	49,504	62,534		
Eight years later............	36,437	40,113	49,758			
Nine years later.............	36,515	40,131				
Ten years later..............	36,586					
Cumulative (excess) deficiency.	$(7,753)	$(12,659)	$(13,559)	$(12,838)	$(8,940)	$(7,153)
Cumulative amount of liability paid through:						
One year later...............	$16,579	$16,126	$19,401	$24,485	$27,229	$27,803
Two years later..............	24,546	25,393	30,354	37,981	41,532	46,954
Three years later............	29,385	32,079	38,684	47,027	53,555	58,883
Four years later.............	32,925	36,726	43,655	53,276	59,995	65,898
Five years later.............	34,757	39,122	46,331	56,869	63,048	70,642
Six years later..............	35,739	40,440	47,802	58,286	65,595	
Seven years later............	36,518	40,903	48,520	59,160		
Eight years later............	36,809	41,152	48,925			
Nine years later.............	37,000	39,877				
Ten years later..............	37,174					

	YEAR ENDED DECEMBER 31				
	1998	1999	2000	2001	2002
	(in thousands)				
Net liability at end of year for unpaid losses and loss expenses............	$96,015	$99,234	$102,709	$114,544	$129,287
Net liability reestimated as of:					
One year later...............	95,556	100,076	110,744	121,378	
Two years later..............	95,315	103,943	112,140		
Three years later............	94,830	104,073			
Four years later.............	94,354				
Five years later.............					
Six years later..............					
Seven years later............					
Eight years later............					
Nine years later.............					
Ten years later..............					
Cumulative (excess) deficiency.	$(1,661)	$4,839	$9,431	$6,834	
Cumulative amount of liability paid through:					
One year later...............	$37,427	$39,060	$43,053	46,869	
Two years later..............	57,347	60,622	67,689		
Three years later............	69,973	76,811			
Four years later.............	78,757				
Five years later.............					
Six years later..............					
Seven years later............					
Eight years later............					
Nine years later.............					
Ten years later..............					

	YEAR ENDED DECEMBER 31			
	1994	1995	1996	1997
	(in thousands)			
Gross liability at end of year	$ 88,484	$ 108,118	$ 113,346	$ 115,801
Reinsurance recoverable	25,167	32,746	34,457	35,545
Net liability at end of year	63,317	75,372	78,889	80,256
Gross reestimated liability - latest	66,058	84,341	102,370	105,667
Reestimated recoverable - latest ...	16,300	21,807	32,421	32,564
Net reestimated liability - latest .	49,758	62,534	69,949	73,103

Gross cumulative deficiency (excess)	(22,426)	(23,777)	(10,976)	(10,134)

	YEAR ENDED DECEMBER 31				
	1998	1999	2000	2001	2002
	(in thousands)				
Gross liability at end of year	$ 136,727	$144,180	$156,476	$179,840	210,692
Reinsurance recoverable	40,712	44,946	53,767	65,296	81,405
Net liability at end of year	96,015	99,234	102,709	114,544	129,287
Gross reestimated liability - latest	129,795	158,315	173,051	194,303	
Reestimated recoverable - latest ...	35,441	54,242	60,911	72,925	
Net reestimated liability - latest .	94,354	104,073	112,140	121,378	
Gross cumulative deficiency (excess)	(6,932)	14,135	16,575	14,463	

REINSURANCE

DGI and the Mutual Company use several different reinsurers, all of which have an A.M. Best rating of A- (Excellent) 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 ($300,000 for 2002), and "catastrophic reinsurance," under which the reinsured recovers 95% of an accumulation of many losses resulting from a single event, including natural disasters (for 2002, $3,000,000 retention). DGI's principal reinsurance agreement in 2002, other than that with the Mutual Company, was an excess of loss treaty in which the reinsurers were Dorinco Reinsurance Company, GMAC Re Corporation and Erie Insurance Group. 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 $80,000,000 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. Atlantic States cedes to the Mutual Company all of its insurance business and assumes from the Mutual Company 70% (65% prior to July 1, 2000) 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 prior to 2002. Atlantic States and Southern each have a catastrophe reinsurance agreement with the Mutual Company that limits the maximum liability under any one catastrophic occurrence to $400,000 and $450,000, respectively, and $1,000,000 for a catastrophe involving more than one of the companies. The Mutual Company and Southern are parties to an excess of loss reinsurance agreement under which the Mutual Company assumes up to $175,000 of losses in excess of $125,000. Southern also has an agreement with the Mutual Company, under which it cedes, and then reassumes back, 100% of its business net of reinsurance. The purpose of this agreement is to provide Southern with the same A.M. Best rating (currently "A" or Excellent) as the Mutual Company, which Southern might not achieve without this agreement in place.

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, 2002, all debt securities were rated investment grade with the exception of one unrated obligation of $252,500, 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, 2002:

	DECEMBER 31, 2002	
RATING(1)	AMOUNT	PERCENT
	(dollars in thousands)	
U.S. Treasury and U.S. agency securities(2)	$99,183	35.24%
Aaa or AAA	90,469	32.15
Aa or AA	51,870	18.43
A	19,979	7.10
BBB	19,679	6.99
Not rated (3)	253	.09
Total	$281,433	100.00%

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

(2) Includes mortgage-backed securities of $28,254,582.

(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 41.0%, 30.9% and 33.0% of the debt securities investment portfolio at December 31, 2002, 2001 and 2000, respectively.

The following table shows the classification of the investments (at carrying value) of DGI and its subsidiaries at December 31, 2002, 2001 and 2000.

	DECEMBER 31,					
	2002		2001		2000	
	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	$ 12,641	3.8%	$ 23,809	7.9%	$ 38,779	13.4%
Canadian government obligation	499	0.2	499	0.2	499	0.2
Obligations of states and political subdivisions	33,892	10.2	24,982	8.3	66,831	23.1
Corporate securities	29,552	8.9	27,423	9.1	21,621	7.5
Mortgage-backed securities	10,118	3.0	8,610	2.9	15,452	5.3
Total held to maturity	86,702	26.1	85,323	28.4	143,182	49.5
Available for sale:						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	58,287	17.5	68,975	23.0	67,901	23.5
Obligations of states and political subdivisions	81,446	24.5	55,147	18.3	18,256	6.3
Corporate securities	36,863	11.1	34,807	11.6	22,908	7.9
Mortgage-backed securities	18,136	5.5	14,790	4.9	5,546	1.9
Total available for sale	194,732	58.6	173,719	57.8	114,611	39.6
Total fixed maturities	281,434	84.7	259,042	86.2	257,793	89.1
Equity securities(2)	21,836	6.6	17,517	5.8	12,112	4.2
Short-term investments(3)	29,029	8.7	24,074	8.0	19,440	6.7
Total investments	$332,299	100.0%	$300,633	100.0%	$289,345	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 $89,785,318 at December 31, 2002, $86,939,393 at December 31, 2001 and $144,662,436 at December 31, 2000. The amortized cost of fixed maturities available for sale was $187,495,949 at December 31, 2002, $170,269,584 at December 31, 2001 and $114,524,472 at December 31, 2000.

(2) Equity securities are valued at fair value. Total cost of equity securities was $21,587,317 at December 31, 2002, $16,630,618 at December 31, 2001 and $12,500,558 at December 31, 2000.

(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, 2002, December 31, 2001 and December 31, 2000.

	DECEMBER 31,					
	2002		2001		2000	
	AMOUNT	PERCENT OF TOTAL	AMOUNT	PERCENT OF TOTAL	AMOUNT	PERCENT OF TOTAL
	(dollars in thousands)					
Due in(1):						
One year or less	$ 47,034	15.1%	$ 37,120	13.1%	$ 37,731	13.6%
Over one year through three years	47,367	15.3	44,845	15.8	35,426	12.8
Over three years through five years	66,655	21.5	69,585	24.6	41,995	15.1
Over five years through ten years	64,271	20.7	96,642	34.1	112,396	40.6
Over ten years through fifteen years ..	52,517	16.9	7,573	2.7	22,243	8.0
Over fifteen years	4,365	1.4	3,950	1.4	6,445	2.3
Mortgage-backed securities	28,254	9.1	23,401	8.3	20,997	7.6
	$310,463	100.0%	$283,116	100.0%	$277,233	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 $28.3 million at December 31, 2002. Included in these investments are

collateralized mortgage obligations ("CMOs") with a carrying value of $4.7 million at December 31, 2002. The Company has attempted to reduce the prepayment risks associated with mortgage-backed securities by investing approximately 100%, as of December 31, 2002, 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 current interest rates (which may be lower) 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, 2002, 2001 and 2000 are shown in the following table:

	YEAR ENDED DECEMBER 31,		
	2002	2001	2000
	(dollars in thousands)		
Invested assets(1)	$319,066	$294,989	$278,678
Investment income(2)	14,581	15,886	16,395
Average yield	4.6%	5.3%	5.9%

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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

Currently, the A.M. Best rating of the Mutual Company, Atlantic States and Southern is "A" (Excellent), based upon their respective current financial conditions and historical statutory results of operations and retrocessional agreements. Management believes that this A.M. Best rating is an important factor in marketing DGI's products to its agents and customers. A.M. 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. A.M. 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). A.M. Best's ratings are based upon factors relevant to policyholders and are not directed toward the protection of investors. According to A.M. Best, an "excellent" rating is assigned to those companies which, in A.M. 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 relate 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 that 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 that 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, the National Association of Insurance Commissioners (the "NAIC") has established 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, 2002, DGI's insurance subsidiaries and the Mutual Company each exceeded the required levels of capital. There can be no assurance that the capital requirements applicable to DGI's insurance subsidiaries will not increase in the future.

The states in which Atlantic States (Pennsylvania, Maryland, Delaware, Connecticut, Ohio and New York), the Mutual Company (Pennsylvania, Ohio, Maryland, New York, Virginia, Delaware and North Carolina) and Southern (Virginia, Alabama, Arkansas, Georgia, Illinois, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee and Pennsylvania) are licensed to 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. Atlantic States, the Mutual Company and Southern have made accruals for their portion of assessments related to such insolvencies based upon the most current information furnished by the guaranty associations. During 2002, 2001 and 2000, the Company incurred assessments totaling $486,190, $1,286,578 and $813,000, respectively, from the Pennsylvania Insurance Guaranty Association relating to the insolvencies of three medical malpractice insurers and Reliance Insurance 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 the Company's 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. Pursuant to an order issued in July 2001, the Pennsylvania Insurance Department has approved the Mutual Company's ownership of up to 65% of the outstanding Class A Common Stock and up to 100% of the outstanding Class B Common Stock of DGI. The Mutual Company has filed an application with the Insurance Department seeking approval of an amendment to the order to permit the Mutual Company to own up to 70% of the outstanding Class A Common Stock of DGI. 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, 2002, amounts available for payment of dividends in 2003 without the prior approval of the various insurance commissioners were $10,646,804 from Atlantic States and $2,493,398 from Southern. See Note 12 to the Consolidated Financial Statements incorporated by reference herein.

THE MUTUAL COMPANY

The Mutual Company, which was organized in 1889, has an A.M. Best rating of A (Excellent). At December 31, 2002, the Mutual Company had admitted assets of $192,066,638 and policyholders' surplus of $75,613,870. At December 31, 2002, the Mutual Company had no debt and, of its total liabilities of $116,452,768, reserves for net losses and loss expenses accounted for $59,084,662 and unearned premiums accounted for $29,660,560. Of the Mutual Company's investment portfolio of $115,505,220 at December 31, 2002, investment-grade bonds accounted for $20,855,377 and mortgages accounted for $6,295,933. At December 31, 2002, the Mutual Company owned 4,031,912 shares, or approximately 66.0%, of the Company's Class A Common Stock, which were carried on the Mutual Company's books at $46,366,987, and 1,852,088 shares, or approximately 62.0%, of the Company's Class B Common Stock, which were carried on the Mutual Company's books at $21,299,012. The foregoing financial information is presented on the statutory basis of accounting required by the NAIC Accounting Practices and Procedures Manual. The Mutual Company does not, nor is it required to, prepare financial statements in accordance with GAAP.

EMPLOYEES

The Company has no employees. As of December 31, 2002, the Mutual Company had 410 employees. The Mutual Company's employees provide a variety of services to DGI, Atlantic States and Southern, as well as to the Mutual Company.

CAUTIONARY NOTICE REGARDING FORWARD LOOKING STATEMENTS

Certain statements contained in or incorporated by reference in this Report are forward-looking in nature. These statements can be identified by the use of forward-looking words such as "believes," "expects," "may," "will," "should," "intends," "plans" or "anticipates," or the negative thereof or comparable terminology, or by discussions of strategy. The Company's business and operations are subject to a variety of risks and uncertainties and, consequently, the Company's actual results may materially differ from those projected by any forward-looking statements. Certain of these risks and uncertainties are discussed below under "Risk Factors."

RISK FACTORS

Unless otherwise specified or unless the context otherwise requires, the following risks not only apply to the Company but also to the Mutual Company.

RISKS RELATING TO THE PROPERTY AND CASUALTY BUSINESS OF THE COMPANY

THE COMPANY CONDUCTS BUSINESS IN ONLY 14 STATES WITH A CONCENTRATION OF BUSINESS IN MARYLAND, VIRGINIA AND, PARTICULARLY, PENNSYLVANIA. ANY SINGLE CATASTROPHE OCCURRENCE OR OTHER CONDITION DISPROPORTIONATELY AFFECTING LOSSES IN THESE STATES COULD ADVERSELY AFFECT THE COMPANY'S RESULTS OF OPERATIONS.

The Company conducts business in only 14 states primarily in the Mid-Atlantic and Southeastern portions of the United States. A substantial portion of this business is private passenger and commercial automobile, homeowners and workers' compensation insurance in Maryland, Virginia and, particularly, Pennsylvania. As a result, a single catastrophe occurrence, destructive weather pattern, general economic trend, terrorist attack, regulatory development or other condition disproportionately affecting one or more of the states in which the Company conducts substantial business could materially adversely affect the results of operations of the Company. Common catastrophe events include hurricanes, earthquakes, tornadoes, wind and hail storms, fires and explosions. The Company and the Mutual Company maintain reinsurance against catastrophic losses in excess of $3.0 million per occurrence and the Company's insurance subsidiaries maintain various catastrophe reinsurance with the Mutual Company to minimize the liability of the insurance subsidiaries in any one occurrence.

THE BUSINESS AND RESULTS OF OPERATIONS OF THE COMPANY WILL BE ADVERSELY AFFECTED IF THE INDEPENDENT AGENTS THAT MARKET THE COMPANY'S PRODUCTS DO NOT MAINTAIN THEIR CURRENT LEVELS OF PREMIUM WRITING, FAIL TO COMPLY WITH ESTABLISHED UNDERWRITING GUIDELINES OR OTHERWISE IMPROPERLY MARKET THE COMPANY'S PRODUCTS.

The Company markets its insurance products solely through a network of over 1,500 independent insurance agencies. As a result, the Company is wholly dependent upon these

agencies, each of which has the authority to bind the Company to insurance contracts. To the extent that these agencies' marketing efforts cannot be maintained at their current levels of volume and quality or they bind the Company to unacceptable insurance risks, fail to comply with established underwriting guidelines or otherwise improperly market the Company's products, the results of operations and business of the Company will suffer.

THE BUSINESS OF THE COMPANY MAY NOT CONTINUE TO GROW AND MAY BE MATERIALLY ADVERSELY AFFECTED IF THE COMPANY CANNOT RETAIN EXISTING, AND ATTRACT NEW, INDEPENDENT AGENCIES OR IF INSURANCE CONSUMERS INCREASE USE OF OTHER INSURANCE DELIVERY SYSTEMS.

The continued growth of the business of the Company is partially dependent upon the Company's ability to retain existing, and attract new, independent agencies. The following factors are among those that may cause the growth and retention in the number of independent agencies of the Company, and thereby its growth in revenue to be slower than it otherwise would have been:

- There is significant competition to attract independent agencies;

- The Company's process to select a new independent agency is intensive and typically requires from two to six months;

- The Company has stringent criteria for new independent agencies and requires adherence by independent agencies to consistent underwriting standards; and

- The Company may be required to reduce agents' commissions, bonuses and other incentives, thereby reducing its attractiveness to agencies, to compete with other insurance delivery systems.

The Company sells insurance solely through its network of independent agencies. Many of the Company's competitors sell insurance through a variety of delivery methods, including independent agencies, captive agencies, the Internet and direct sales. To the extent that business migrates to a delivery system other than independent agencies because of changing consumer preferences, the Company's business will be adversely affected.

IF RATINGS FOR FINANCIAL STRENGTH ASSIGNED TO THE COMPANY'S INSURANCE SUBSIDIARIES BY INDUSTRY RATING ORGANIZATIONS WERE SIGNIFICANTLY DOWNGRADED, THE COMPETITIVE POSITION OF THE COMPANY'S INSURANCE SUBSIDIARIES WOULD BE ADVERSELY AFFECTED.

Ratings are a factor in establishing the competitive position of insurance companies. The Company's insurance subsidiaries receive ratings from A.M. Best & Company, Inc., which are industry-accepted measures of an insurance company's financial strength and are specifically designed to provide an independent opinion of an insurance company's financial health and ability to meet ongoing obligations to policyholders.

THE COMPANY COMPETES WITH MANY INSURERS THAT ARE FINANCIALLY STRONGER THAN THE COMPANY.

The property and casualty insurance industry is intensely competitive. Competition is based on many factors, including the perceived financial strength of the insurer, premiums charged, policy terms and conditions, policyholder service, reputation and experience. The Company competes with many regional and national property and casualty insurance companies, including direct sellers of insurance products, insurers having their own agency organizations and other insurers represented by independent agents. Many of these insurers are better capitalized than the Company, have substantially greater financial, technical and operating resources and have equal or higher ratings from A.M. Best Company.

The superior capitalization of many of the Company's competitors enables them to withstand lower profit margins and, therefore, to market their products more aggressively, to take advantage more quickly of new marketing opportunities and to offer lower premium rates. Moreover, if the Company's competitors price their premiums more aggressively and the Company meets their pricing, the Company's profit margins and revenues may be reduced and its ratios of claims and expenses to premiums may increase.

The Company's competition may become increasingly better capitalized in the future as the traditional barriers between insurance companies and banks and other financial institutions erode and as the property and casualty industry continues to consolidate. The Company's ability to compete against its larger, better capitalized competitors depends largely on its ability to provide superior policyholder service and to maintain its historically strong relationships with independent insurance agents, on whom the Company is entirely dependent to generate premium volume.

There is no assurance that the Company will maintain its current competitive position in the markets in which it operates, or that it will be able to expand its operations into new markets. If it fails to do so, its business could be materially adversely affected.

RISKS RELATING TO THE PROPERTY AND CASUALTY INSURANCE INDUSTRY

THE COMPANY FACES SIGNIFICANT EXPOSURE TO TERRORISM.

Although the Company did not incur any losses as a result of the tragic World Trade Center terrorist attack, that attack resulted in staggering losses for the insurance industry and has caused uncertainty in the insurance and reinsurance markets. Accordingly, the industry has been compelled to re-examine policy language and to address the potential for future threats of terrorist events and losses. The Company's personal and commercial property and casualty insurance policies were not priced to cover the risk of terrorist attacks and losses such as those suffered in the World Trade Center terrorist attack. Therefore, exposure to terrorism exists under several lines, including personal lines and workers' compensation, and, in most states, losses caused by an ensuing fire. The recently enacted Terrorism Risk Insurance Act of 2002 established a program for commercial property and casualty losses, including workers' compensation, resulting from foreign acts of terrorism. The Terrorism Risk Insurance Act requires commercial insurers to make terrorism coverage available and provides limited federal

protection above individual company retention levels, based upon a percentage of direct earned premium, and above aggregate industry retention levels that range from $10 billion in the first year to $15 billion in the third year. The federal government will pay 90% of covered terrorism losses that exceed retention levels. The Terrorism Risk Insurance Act is scheduled to expire on December 31, 2005. Personal lines are not included under the protection of the Terrorism Risk Insurance Act, and state regulators have not approved exclusions for acts of terrorism in personal lines policies. The Company could incur large unexpected losses if future terrorist attacks occur.

INCREASED LITIGATION AGAINST THE INDUSTRY, WILLINGNESS OF COURTS TO EXPAND COVERED CAUSES OF LOSS, RISING JURY AWARDS, INCREASING MEDICAL COSTS AND THE ESCALATION OF LOSS SEVERITY MAY CONTRIBUTE TO INCREASED COSTS AND TO THE DETERIORATION OF THE COMPANY'S RESERVES.

Loss severity continues to increase, principally driven by larger court judgments and increasing medical costs in recent years. In addition, many legal actions and proceedings have been brought on behalf of classes of complainants, which can increase the size of judgments. The propensity of policyholders to litigate and the willingness of courts to expand causes of loss and the size of awards may render loss reserves inadequate for current and future losses. Loss reserves are liabilities established by insurers and reinsurers to reflect the estimated cost of loss payments and the related loss adjustment expenses that the insurer or reinsurer will ultimately be required to pay in respect of insurance or reinsurance it has written.

The Company has exposure to mold claims for which there has recently been a sharp increase in the industry generally. Sometimes referred to as "sick building syndrome," tenants claiming to suffer illnesses caused by mold may seek financial compensation from building owners. Businesses also may claim loss-of-use business income interruption losses. Homeowners have also been submitting claims based on mold that has occurred from water damage. The Company's exposure to mold, to date, including known and expected claims, has been insignificant.

CHANGES IN APPLICABLE INSURANCE LAWS, REGULATIONS OR CHANGES IN THE WAY REGULATORS ADMINISTER THOSE LAWS OR REGULATIONS COULD MATERIALLY ADVERSELY CHANGE THE COMPANY'S OPERATING ENVIRONMENT AND INCREASE ITS EXPOSURE TO LOSS OR PUT IT AT A COMPETITIVE DISADVANTAGE.

Property and casualty insurers are subject to extensive supervision in the states in which they do business. This regulatory oversight includes, by way of example, matters relating to licensing and examination, rate setting, market conduct, policy forms, limitations on the nature and amount of certain investments, claims practices, mandated participation in involuntary markets and guaranty funds, reserve adequacy, insurer solvency, transactions between affiliates, the amount of dividends that may be paid and restrictions on underwriting standards. Such regulation and supervision are primarily for the benefit and protection of policyholders and not for the benefit of stockholders. For instance, the Company is subject to involuntary participation in specified markets in various states in which it operates, and the rate levels the Company is permitted to charge do not always correspond with the underlying costs associated with the coverage issued.

The NAIC and state insurance regulators are re-examining existing laws and regulations, specifically focusing on insurance company investments, issues relating to the solvency of

insurance companies, risk-based capital guidelines, interpretations of existing laws and the development of new laws. Changes in state laws and regulations, as well as changes in the way state regulators view related party transactions in particular, could materially change the operating environment for the Company and significantly increase the amount of loss to which the Company is exposed after an insurance policy has been issued.

The state insurance regulatory framework recently has come under increased federal scrutiny. Congress is considering legislation that would create an optional federal charter for insurers. Federal chartering has the potential to create an uneven playing field for insurers. Federally chartered companies could be subject to different regulatory requirements than state chartered insurers in areas such as market conduct oversight, solvency regulation, guaranty fund participation and premium tax burdens. If this occurs, federally chartered insurers may obtain a competitive advantage over state licensed carriers. Federal chartering also raises the specter of a matrix of regulation and costly duplicative, or conflicting, federal and state requirements. Specific federal regulatory developments include the potential repeal of the McCarran-Ferguson Act. The repeal of the McCarran-Ferguson Act and its partial exemption for the insurance industry from federal antitrust laws would make it extremely difficult for insurers to compile and share loss data, develop standard policy forms and manuals and predict future loss costs. The ability of the industry, under the exemption permitted in the McCarran-Ferguson Act, to collect loss cost data and build a credible database as a means of predicting future loss costs is an extremely important part of cost-based pricing. If the ability to collect this data were removed, then the predictability of future loss costs, and hence, the reliability of pricing would be greatly undermined.

IF CERTAIN STATE REGULATORS, LEGISLATORS AND SPECIAL INTEREST GROUPS ARE SUCCESSFUL IN ATTEMPTS TO REDUCE, FREEZE OR SET RATES FOR INSURANCE POLICIES, ESPECIALLY AUTOMOBILE POLICIES, AT LEVELS THAT DO NOT, IN OUR MANAGEMENT'S VIEW, CORRESPOND WITH UNDERLYING COSTS, THE COMPANY'S RESULTS OF OPERATIONS WILL BE ADVERSELY AFFECTED.

From time to time, the automobile insurance industry in particular has been under pressure from certain state regulators, legislators and special interest groups to reduce, freeze or set rates at levels that do not, in the view of the Company's management, correspond with underlying costs, including initiatives to roll back automobile and other personal lines rates. This activity may in the future adversely affect the profitability of the Company's automobile insurance line of business in various states because increasing costs of litigation and medical treatment, combined with rising automobile repair costs, continue to increase the costs of providing automobile insurance coverage. Adverse legislative and regulatory activity constraining the Company's ability to price automobile insurance coverage adequately may occur in the future. The impact of the automobile insurance regulatory environment on the results of operations of the Company in the future is not predictable.

THE COMPANY IS SUBJECT TO ASSESSMENT, DEPENDING UPON ITS MARKET SHARE OF A GIVEN LINE OF BUSINESS, TO ASSIST IN THE PAYMENT OF UNPAID CLAIMS AND RELATED COSTS OF INSOLVENT INSURANCE COMPANIES; SUCH ASSESSMENTS COULD SIGNIFICANTLY AFFECT THE COMPANY'S FINANCIAL CONDITION.

The Company is obligated to pay assessments under the guaranty fund laws of the various states in which it is licensed. Generally, under these laws, an insurer is subject to assessment, depending upon its market share of a given line of business, to assist in the payment of unpaid claims and related costs of insolvent insurance companies. The number and magnitude of future insurance company failures in the states in which the Company does business cannot be predicted, but resulting assessments could significantly affect the financial condition of the Company. The Company believes that it is likely it will receive an assessment in the next year relating to the insolvency of The Pennsylvania Hospital Insurance Company (PHICO), the amount of which cannot currently be estimated.

PREMIUM RATES AND RESERVES MUST BE ESTABLISHED BY THE COMPANY FROM FORECASTS OF THE ULTIMATE COSTS EXPECTED TO ARISE FROM RISKS UNDERWRITTEN DURING THE POLICY PERIOD; THE COMPANY'S PROFITABILITY COULD BE ADVERSELY AFFECTED TO THE EXTENT ITS PREMIUM RATES OR RESERVES ARE TOO LOW.

One of the distinguishing features of the property and casualty insurance industry in general is that its products are priced before its costs are known, as premium rates are generally determined before losses are reported. Accordingly, premium rates must be established from forecasts of the ultimate costs expected to arise from risks underwritten during the policy period and may not prove to be adequate. Further, property and casualty insurers establish reserves for losses and loss adjustment expenses based upon estimates, and it is possible that the ultimate liability will exceed these estimates because of the future development of known losses, the existence of losses that have occurred but are currently unreported and larger than historical settlements on pending and unreported claims. The process of estimating reserves is inherently judgmental and can be influenced by factors that are subject to variation. If pricing or reserves established by the Company is not sufficient, its profitability may be adversely impacted.

THE CYCLICAL NATURE OF THE PROPERTY AND CASUALTY INSURANCE INDUSTRY MAY REDUCE THE COMPANY'S REVENUES AND PROFIT MARGINS.

The property and casualty insurance industry is highly cyclical, and individual lines of business experience their own cycles within the overall industry cycle. Premium rate levels are related to the availability of insurance coverage, which varies according to the level of surplus in the industry. The level of surplus in the industry varies with returns on invested capital and regulatory barriers to withdrawal of surplus. Increases in surplus have generally been accompanied by increased price competition among property and casualty insurers. If the Company finds it necessary to reduce premiums or limit premium increases due to these competitive pressures on pricing, the Company may experience a reduction in profit margins and revenues, an increase in its ratios of claims and expenses to premiums and, therefore, lower profitability.

Volatile and unpredictable developments also offset significantly the cyclical trends in the industry and the industry's profitability. These developments include natural disasters (such as storms, earthquakes, hurricanes, floods and fires), terrorism risks, fluctuations in interest rates

and other changes in the investment environment that affect the market prices of the Company's investments and the income from those investments, inflationary pressures that affect the size of losses and judicial decisions that affect its liabilities. The occurrence of these developments may adversely affect the Company's business and financial condition.

RISKS RELATING TO THE COMPANY'S RELATIONSHIP WITH THIRD PARTIES

THE REINSURANCE AGREEMENTS ON WHICH THE COMPANY RELIES DO NOT RELIEVE THE COMPANY FROM LIABILITY TO ITS POLICYHOLDERS.

The Company relies on 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. Each reinsurance agreement satisfies all applicable regulatory requirements. Reinsurance, however, does not relieve the Company 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 its reinsurance agreement with the Company, the Company remains liable 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 that, in the opinion of the Company's 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 or that the reinsurance might not be renewed.

THE MUTUAL COMPANY IS THE COMPANY'S LARGEST SHAREHOLDER AND PROVIDES IT WITH FACILITIES AND SERVICES.

The Mutual Company currently owns approximately 66% of the Company's outstanding Class A Common Stock and approximately 62% of the Company's outstanding Class B Common Stock. Accordingly, the Mutual Company controls the election of members of the Company's Board of Directors. Although the Mutual Company could exercise its control in ways that are contrary to the interests of the Company's stockholders other than the Mutual Company, the Company and the Mutual Company have established a Coordinating Committee consisting of two outside directors from each company who do not also serve as directors of the other company. Under the Company's and the Mutual Company's By-laws, any new agreement between the Company and the Mutual Company and any proposed change in any existing agreement between the Company and the Mutual Company must first be submitted for approval by the respective Boards of Directors of the Company and the Mutual Company and, if approved, submitted to the Coordinating Committee for approval. The proposed new agreement or change in an existing agreement will receive Coordinating Committee approval only if both of the Company's Coordinating Committee members conclude the new agreement or change in an existing agreement is fair to the Company and its stockholders and if both of the Mutual Company's Coordinating Committee members conclude the agreement or change in an existing agreement is fair and equitable to the Mutual Company and its policyholders. The decisions of the Coordinating Committee are binding on the Company and the Mutual Company. The purpose of this provision is to protect the interests of the stockholders of the Company and the interests of the policyholders of the Mutual Company.

The Company is dependent upon the Mutual Company for the retention of agents and the underwriting of insurance, the servicing of policyholder claims and all other aspects of the Company's operations. All of the Company's officers are officers and employees of the Mutual Company. The Mutual Company also provides all of the facilities and data processing and administrative services required to conduct the Company's business, for which the Company pays a pro rata portion of the cost.

BECAUSE THE COMPANY PARTICIPATES IN AN INSURANCE POOLING ARRANGEMENT WITH THE MUTUAL COMPANY, THE COMPANY'S RESULTS OF OPERATIONS ARE DEPENDENT UPON THE FINANCIAL SUCCESS OF THE MUTUAL COMPANY.

The Company's insurance subsidiary, Atlantic States, participates in an intercompany pooling arrangement with the Mutual Company, under which the parties share the premiums earned and underwriting results on substantially all of the property and casualty insurance business written by both companies. Under the terms of the intercompany pooling agreement, Atlantic States cedes all of its insurance business to the Mutual Company and assumes from the Mutual Company 70% of the total pooled insurance business of the Mutual Company and Atlantic States. 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 Company's ability to raise capital for Atlantic States.

Because of the pooled business the Company assumes, the Company's insurance operations are interrelated with the insurance operations of the Mutual Company and the Company's results of operations are dependent upon the financial success of the Mutual Company. Although the underwriting pool is intended to produce a more uniform and stable underwriting result from year to year for the participants in the pool than they would experience individually and to spread the risk of loss among all the participants, if the Mutual Company experiences unusually severe or frequent losses or does not adequately price its premiums, the Company's results of operations could suffer. The Company's results of operations also may suffer if the Mutual Company did not participate in the pooling arrangement because the pool participants would then be limited to policy exposures of a size commensurate with their own capital and surplus instead of having at their disposal the capacity of the entire pool.

THE COMPANY IS DEPENDENT ON DIVIDENDS FROM ITS SUBSIDIARIES FOR THE PAYMENT OF ITS OPERATING EXPENSES, ITS DEBT SERVICE AND DIVIDENDS TO STOCKHOLDERS.

As a holding company, the Company relies primarily on its subsidiaries for dividends and other permitted payments to meet its obligations for corporate expenses. Payment of dividends by the Company's subsidiaries is subject to regulatory restrictions and depends on the surplus of the subsidiaries. From time to time, the NAIC and various state insurance regulators consider modifying the method of determining the amount of dividends that may be paid by an insurance company without prior regulatory approval.

ITEM 2. PROPERTIES.

DGI and Atlantic States share headquarters with the Mutual Company's headquarters 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 has approximately 172,600 square feet of office space. Southern has a facility of approximately 10,000 square feet in Glen Allen, Virginia, which it owns. Province Bank leases approximately 3,600 square feet of a building located in Marietta, Pennsylvania owned by the Mutual Company. The Mutual Company charges Province Bank annual rent based on an independent appraisal.

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 Class A Common Stock and/or Class B Common Stock during the fourth quarter of 2002.

EXECUTIVE OFFICERS OF THE COMPANY

The following table sets forth information regarding the persons who served as executive officers of DGI on March 24, 2003:

NAME	AGE	POSITION
Donald H. Nikolaus	60	President and Chief Executive Officer since 1981
Ralph G. Spontak	50	Senior Vice President since 1991; Chief Financial Officer and Vice President since 1983; Secretary since 1988
Cyril J. Greenya	58	Senior Vice President-Commercial Underwriting since 1997; Vice President-Commercial Underwriting for five years prior thereto; Manager-Commercial Underwriting for nine years prior thereto
Robert G. Shenk	50	Senior Vice President-Claims since 1997; Vice President-Claims for five years prior thereto
Daniel J. Wagner	42	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 response to this Item is incorporated in part by reference to page 30 of the Company's Annual Report to Stockholders for the year ended December 31, 2002, which is included as Exhibit (13) to this Form 10-K Report. As of March 20, 2003, the Company had approximately 613 holders of record of its Class A Common Stock and 513 holders of record of its Class B Common Stock. The Company declared dividends of $.40 per share on its Class A Common Stock and $.36 per share on its Class B Common Stock in 2002, and $.40 per share on its Class A Common Stock and $.36 per share on its Class B Common Stock in 2001.

ITEM 6. SELECTED FINANCIAL DATA.

The response to this Item is incorporated by reference to page 1 of the Company's Annual Report to Stockholders for the year ended December 31, 2002, 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 response to this Item is incorporated by reference to pages 10 through 13 of the Company's Annual Report to Stockholders for the year ended December 31, 2002, which is included as Exhibit (13) to this Form 10-K Report.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The response to this Item is incorporated by reference to pages 14 through 29 of the Company's Annual Report to Stockholders for the year ended December 31, 2002, 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 REGISTRANT.

The response to this Item with respect to the Company's directors is incorporated by reference to page 5 and pages 7 through 8 of the Company's proxy statement relating to the Company's annual meeting of stockholders to be held April 17, 2003. 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 response to this Item is incorporated by reference to pages 9 through 13 of the Company's proxy statement relating to the Company's annual meeting of stockholders to be held April 17, 2003, except for the Report of Compensation Committee, the Performance Graph and the Report of the Audit Committee, which are not incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

The response to this Item is incorporated by reference to pages 3 through 4 of the Company's proxy statement relating to the Company's annual meeting of stockholders to be held April 17, 2003.

The following table sets forth information regarding equity compensation plans of the Company.

Equity Compensation Plan Information

PLAN CATEGORY	NUMBER OF SECURITIES (CLASS) TO BE ISSUED UPON EXERCISE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS	WEIGHTED-AVERAGE EXERCISE PRICE OF OUTSTANDING OPTIONS WARRANTS AND RIGHTS	NUMBER OF SECURITIES (CLASS) REMAINING AVAILABLE FOR FUTURE ISSUANCE UNDER EQUITY COMPENSATION PLANS (EXCLUDING SECURITIES REFLECTED IN COLUMN (A))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	1,080,101 (Class A) 313,900 (Class B)	$13.52 (Class A) $13.12 (Class B)	1,228,900 (Class A) -- (Class B)
Equity compensation plans not approved by security holders	--	--	--
Total	1,394,001	$13.43	1,228,900

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

The response to this Item is incorporated by reference to pages 5 through 6 and page 15 of the Company's proxy statement relating to the Company's annual meeting of stockholders to be held April 17, 2003.

ITEM 14. CONTROLS AND PROCEDURES.

Within the 90 days prior to the date of this Form 10-K Report, the Company carried out an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures. This evaluation was performed under the supervision and with the participation of management, including the Company's President and Chief Executive Officer and the Company's Chief Financial Officer.

Under the rules of the Securities and Exchange Commission, the term "disclosure controls and procedures" means controls and other procedures of the Company that are designed to ensure that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Company in such reports is accumulated and communicated to the Company's management, including the President and Chief Executive Officer and the Chief Financial Officer, as appropriate to permit management to make timely decisions regarding required disclosure.

Based on this evaluation, the Company's President and Chief Executive Officer and the Company's Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective for gathering, analyzing and disclosing the information that the Company is required to disclose in the reports it files under the Securities Exchange Act of 1934, within the time periods specified in the rules and forms of the Securities and Exchange Commission. Subsequent to the date of this evaluation, there have been no significant changes in the Company's internal controls or in other factors that could significantly affect internal controls.

A control system, no matter how well-designed and operated, cannot provide absolute assurance that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K.

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

(1) Consolidated Financial Statements

	PAGE*
Report of Independent Auditors	29
Donegal Group Inc. and Subsidiaries:	
Consolidated Balance Sheets as of December 31, 2002 and 2001	14
Consolidated Statements of Income and Comprehensive Income for the three years ended December 31, 2002, 2001 and 2000	15
Consolidated Statements of Stockholders' Equity for the three years ended December 31, 2002, 2001 and 2000	16
Consolidated Statements of Cash Flows for the three years ended December 31, 2002, 2001 and 2000	17
Notes to Consolidated Financial Statements	18-28

(2) Financial Statement Schedules

		PAGE
Donegal Group Inc. and Subsidiaries		
Independent Auditors' Consent and Report on Schedules		Exhibit 23
Schedule I.	Summary of Investments - Other Than Investments in Related Parties	
Schedule II.	Condensed Financial Information of Parent Company	
Schedule III.	Supplementary Insurance Information	
Schedule IV.	Reinsurance	
Schedule VI.	Supplemental Insurance Information Concerning Property and Casualty Subsidiaries	

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 2002 Annual Report to Stockholders. The Consolidated Financial Statements and Notes to Consolidated Financial Statements and Auditor's Report thereon on pages 14 through 28 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 hereof, 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, as amended.	(a)
(3)(ii)	Amended and Restated By-laws of Registrant.	(b)
	MANAGEMENT CONTRACTS AND COMPENSATORY PLANS OR ARRANGEMENTS	
(10)(A)	Donegal Group Inc. Amended and Restated 1996 Equity Incentive Plan.	(c)
(10)(B)	Donegal Group Inc. 2001 Equity Incentive Plan for Employees.	(d)
(10)(C)	Donegal Group Inc. 2001 Equity Incentive Plan for Directors.	(d)
(10)(D)	Donegal Group Inc. 2001 Employee Stock Purchase Plan, as amended.	(e)
(10)(E)	Donegal Group Inc. Amended and Restated 2001 Agency Stock Purchase Plan.	(f)
(10)(F)	Donegal Mutual Insurance Company 401(k) Plan.	(g)
(10)(G)	Amendment No. 1 effective January 1, 2000 to Donegal Mutual Insurance Company 401(k) Plan.	(g)
(10)(H)	Amendment No. 2 effective January 6, 2000 to Donegal Mutual Insurance Company 401(k) Plan.	(b)
(10)(I)	Amendment No. 3 effective July 23, 2001 to Donegal Mutual Insurance Company 401(k) Plan.	(b)
(10)(J)	Amendment No. 4 effective January 1, 2002 to Donegal Mutual Insurance Company 401(k) Plan.	(b)
(10)(K)	Amendment No. 5 effective December 31, 2001 to Donegal Mutual Insurance Company 401(k) Plan.	(b)
(10)(L)	Amendment No. 6 effective July 1, 2002 to Donegal Mutual Insurance Company 401(k) Plan.	Filed herewith

EXHIBIT NO.	DESCRIPTION OF EXHIBITS	REFERENCE
(10)(M)	Donegal Mutual Insurance Company Executive Restoration Plan.	(h)
	OTHER MATERIAL CONTRACTS	
(10)(N)	Tax Sharing Agreement dated September 29, 1986 between Donegal Group Inc. and Atlantic States Insurance Company.	(i)
(10)(O)	Services Allocation Agreement dated September 29, 1986 between Donegal Mutual Insurance Company, Donegal Group Inc. and Atlantic States Insurance Company.	(i)
(10)(P)	Proportional Reinsurance Agreement dated September 29, 1986 between (i) Donegal Mutual Insurance Company and Atlantic States Insurance Company.	
(10)(Q)	Amendment dated October 1, 1988 to Proportional Reinsurance Agreement between Donegal Mutual Insurance Company and Atlantic States Insurance Company.	(j)
(10)(R)	Multi-Line Excess of Loss Reinsurance Agreement effective January 1, 2002 among Donegal Mutual Insurance Company, Dorinco Reinsurance Company and Erie Insurance Group.	Filed herewith
(10)(S)	Amendment dated July 16, 1992 to Proportional Reinsurance Agreement between Donegal Mutual Insurance Company and Atlantic States Insurance Company.	(k)
(10)(T)	Amendment dated as of December 21, 1995 to Proportional Reinsurance Agreement between Donegal Mutual Insurance Company and Atlantic States Insurance Company.	(l)
(10)(U)	Reinsurance and Retrocession Agreement dated May 21, 1996 between Donegal Mutual Insurance Company and Southern Insurance Company of Virginia.	
(10)(V)	Amended and Restated Credit Agreement dated as of July 27, 1998 among Donegal Group Inc., the banks and other financial institutions from time to time party thereto and Fleet National Bank, as agent.	(m)
(10)(W)	First Amendment and Waiver to the Amended and Restated Credit Agreement dated as of December 31, 1999.	(g)

EXHIBIT NO.	DESCRIPTION OF EXHIBITS	REFERENCE
(10)(X)	Amendment dated as of April 20, 2000 to Proportional Reinsurance Agreement between Donegal Mutual Insurance Company and Atlantic States Insurance Company.	(n)
(10)(Y)	Lease Agreement dated as of September 1, 2000 between Donegal Mutual Insurance Company and Province Bank FSB.	(d)
(10)(Z)	Aggregate Excess of Loss Reinsurance Agreement dated as of January 1, 2001 between Donegal Mutual Insurance Company and Atlantic States Insurance Company (as successor-in-interest to Pioneer Insurance Company).	(d)
(13)	2002 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 17, 2003; provided, however, that the Report of the Compensation Committee, the Performance Graph and the Report of the Audit Committee shall not be deemed filed as part of this Form 10-K Report.	(o)
(21)	Subsidiaries of Registrant.	Filed herewith
(23)	Consent of Independent Auditors.	Filed herewith
(99.1)	Statement of Chief Executive Officer Pursuant to Section 1350 of the United States Code.	Filed herewith
(99.2)	Statement of Chief Financial Officer Pursuant to Section 1350 of the United States Code.	Filed herewith

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(a) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form S-3 Registration Statement No. 333-59828 filed April 30, 2001.

(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, 2001.

(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, 1998.

EXHIBIT NO.	DESCRIPTION OF EXHIBITS	REFERENCE

(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, 2000.

(e) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form S-8 Registration Statement No. 333-62974 filed June 14, 2001.

(f) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form S-2 Registration Statement No. 333-63102 declared effective February 8, 2002.

(g) 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, 1999.

(h) 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.

(i) 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.

(j) 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.

(k) 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.

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

(m) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 8-K Report dated November 17, 1998.

(n) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 8-K Report dated May 31, 2000.

(o) Such exhibit is hereby incorporated by reference to the Registrant's definitive proxy statement filed March 24, 2003.

(b) Reports on Form 8-K:

None.

DONEGAL GROUP INC. AND SUBSIDIARIES

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

($ in thousands)

December 31, 2002

	COST	FAIR VALUE	AMOUNT AT WHICH SHOWN IN THE BALANCE SHEET
Fixed Maturities:			
Held to maturity:			
United States government and Governmental agencies and authorities	$ 12,641	$ 13,049	$ 12,641
Obligations of states and political subdivisions	33,892	34,400	33,892
Canadian government obligation	499	540	499
All other corporate bonds	29,552	31,285	29,522
Mortgage-backed securities	10,118	10,511	10,118
Total fixed maturities held to maturity	86,702	89,785	86,702
Available for sale:			
United States government and Governmental agencies and authorities	56,344	58,287	58,287
Obligations of states and political subdivisions	78,516	81,446	81,446
All other corporate bonds	34,849	36,863	36,863
Mortgage-backed securities	17,787	18,136	18,136
Total fixed maturities available for sale	187,496	194,732	194,732
Total fixed maturities	274,198	284,517	281,434
Equity Securities:			
Preferred stocks:			
Public utilities	227	254	254
Banks	9,001	9,190	9,190
Industrial and miscellaneous	1,639	1,663	1,663
Total preferred stocks	10,867	11,107	11,107
Common stocks:			
Banks and insurance companies	3,673	4,176	4,176
Industrial and miscellaneous	7,047	6,553	6,553
Total common stocks	10,720	10,729	10,729
Total equity securities	21,587	21,836	21,836
Short-term investments	29,029	29,029	29,029
Total investments	$324,814	$335,382	$332,299

DONEGAL GROUP INC. AND SUBSIDIARIES

SCHEDULE III - SUPPLEMENTARY INSURANCE INFORMATION

($ in thousands)

Years Ended December 31, 2002, 2001 and 2000

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, 2002						
Personal lines	$119,838	$ --	$ 87,790	$ 19,005	$ 16,335	$125,777
Commercial lines	66,003	--	41,478	10,468	8,997	68,727
Investments	--	14,581	--	--	--	--
	$185,841	$ 14,581	$129,268	$ 29,473	$ 25,332	$194,504
Year Ended December 31, 2001						
Personal lines	$104,893	$ --	$ 72,534	$ 17,002	$ 16,881	$111,623
Commercial lines	62,877	--	45,644	10,192	10,119	65,405
Investments	--	15,886	--	--	--	--
	$167,770	$ 15,886	$118,178	$ 27,194	$ 27,000	$177,028
Year Ended December 31, 2000						
Personal lines	$ 97,065	$ --	$ 68,003	$ 16,206	$ 14,950	$100,517
Commercial lines	54,581	--	36,380	9,113	9,113	59,605
Investments	--	16,395	--	--	--	--
	$151,646	$ 16,395	$104,383	$ 25,319	$ 25,319	$160,122

DONEGAL GROUP INC. AND SUBSIDIARIES

SCHEDULE III - SUPPLEMENTARY INSURANCE INFORMATION, CONTINUED

($ in thousands)

	At December 31,			
SEGMENT	DEFERRED POLICY ACQUISITION COSTS	LIABILITY FOR LOSSES AND LOSS EXPENSES	UNEARNED PREMIUMS	OTHER POLICY CLAIMS AND BENEFITS PAYABLE
2002				
Personal lines	$ 9,423	$106,096	$ 78,273	$ --
Commercial lines	5,144	104,596	42,729	--
Investments	--	--	--	--
	$ 14,567	$210,692	$121,002	$ --
2001				
Personal lines	$ 8,394	$ 84,726	$ 70,388	$ --
Commercial lines	5,210	95,114	43,691	--
Investments	--	--	--	--
	$ 13,604	$179,840	$114,079	$ --

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, 2002					
Property and casualty premiums	$110,412,498	$58,817,518	$134,246,213	$185,841,193	72%
Year Ended December 31, 2001					
Property and casualty premiums	$105,214,059	$64,220,420	$126,776,215	$167,769,854	76%
Year Ended December 31, 2000					
Property and casualty premiums	$ 95,671,588	$54,981,016	$110,955,627	$151,646,199	73%

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,				
2002	$14,567,070	$210,691,752	$--	$121,002,447
2001	$13,604,215	$179,839,905	$--	$114,079,264
2000	$12,284,214	$156,476,124	$--	$ 99,940,381

(continued)

DONEGAL GROUP INC. AND SUBSIDIARIES

SCHEDULE VI - SUPPLEMENTARY INSURANCE INFORMATION
CONCERNING PROPERTY AND CASUALTY SUBSIDIARIES, CONTINUED

Years ended December 31, 2002, 2001 and 2000

			LOSSES AND LOSS EXPENSES RELATED TO	
	NET EARNED PREMIUMS	INVESTMENT INCOME	CURRENT YEAR	PRIOR YEARS
Year Ended December 31, 2002	$185,841,193	$ 14,581,252	$122,433,653	$ 6,834,033
Year Ended December 31, 2001	$167,769,854	$ 15,885,544	$110,142,467	$ 8,035,082
Year Ended December 31, 2000	$151,646,199	$ 16,394,747	$103,671,401	$ 711,775

	ACQUISITION COST	AMORTIZATION OF DEFERRED POLICY AND LOSS EXPENSES	NET PAID LOSSES PREMIUMS WRITTEN	NET
Year Ended December 31, 2002	$ 29,473,000	$114,525,368	$194,503,847	
Year Ended December 31, 2001	$ 27,194,000	$106,342,848	$177,027,654	
Year Ended December 31, 2000	$ 25,319,000	$100,907,860	$160,122,420	

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 28, 2003

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 28, 2003
s/Ralph G. Spontak Ralph G. Spontak	Senior Vice President, Chief Financial Officer and Secretary (principal financial and accounting officer)	March 28, 2003
s/Robert S. Bolinger Robert S. Bolinger	Director	March 28, 2003
s/Patricia A. Gilmartin Patricia A. Gilmartin	Director	March 28, 2003
s/Philip H. Glatfelter Philip H. Glatfelter	Director	March 28, 2003
John J. Lyons	Director	March , 2003
R. Richard Sherbahn	Director	March , 2003

CERTIFICATION

I, Donald H. Nikolaus, President of Donegal Group Inc., certify that:

1. I have reviewed this annual report on Form 10-K for the year ended December 31, 2002 of Donegal Group Inc.;

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

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

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

(a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

(b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

(c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

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

(a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 28, 2003

s/Donald H. Nikolaus

Donald H. Nikolaus, President

CERTIFICATION

I, Ralph G. Spontak, Senior Vice President, Chief Financial Officer and Secretary of Donegal Group Inc., certify that:

1. I have reviewed this annual report on Form 10-K for the year ended December 31, 2002 of Donegal Group Inc.;

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

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

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

(a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

(b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

(c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

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

(a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 28, 2003

s/Ralph G. Spontak

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

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

EXHIBIT NO.	DESCRIPTION OF EXHIBITS	REFERENCE
(3)(i)	Certificate of Incorporation of Registrant, as amended.	(a)
(3)(ii)	Amended and Restated By-laws of Registrant.	(b)
	MANAGEMENT CONTRACTS AND COMPENSATORY PLANS OR ARRANGEMENTS	
(10)(A)	Donegal Group Inc. Amended and Restated 1996 Equity Incentive Plan.	(c)
(10)(B)	Donegal Group Inc. 2001 Equity Incentive Plan for Employees.	(d)
(10)(C)	Donegal Group Inc. 2001 Equity Incentive Plan for Directors.	(d)
(10)(D)	Donegal Group Inc. 2001 Employee Stock Purchase Plan, as amended.	(e)
(10)(E)	Donegal Group Inc. Amended and Restated 2001 Agency Stock Purchase Plan.	(f)
(10)(F)	Donegal Mutual Insurance Company 401(k) Plan.	(g)
(10)(G)	Amendment No. 1 effective January 1, 2000 to Donegal Mutual Insurance Company 401(k) Plan.	(g)
(10)(H)	Amendment No. 2 effective January 6, 2000 to Donegal Mutual Insurance Company 401(k) Plan.	(b)
(10)(I)	Amendment No. 3 effective July 23, 2001 to Donegal Mutual Insurance Company 401(k) Plan.	(b)
(10)(J)	Amendment No. 4 effective January 1, 2002 to Donegal Mutual Insurance Company 401(k) Plan.	(b)
(10)(K)	Amendment No. 5 effective December 31, 2001 to Donegal Mutual Insurance Company 401(k) Plan.	(b)
(10)(L)	Amendment No. 6 effective July 1, 2002 to Donegal Mutual Insurance Company 401(k) Plan.	Filed herewith
(10)(M)	Donegal Mutual Insurance Company Executive Restoration Plan.	(h)

EXHIBIT NO.	DESCRIPTION OF EXHIBITS	REFERENCE
	OTHER MATERIAL CONTRACTS	
(10)(N)	Tax Sharing Agreement dated September 29, 1986 between Donegal Group Inc. and Atlantic States Insurance Company.	(i)
(10)(O)	Services Allocation Agreement dated September 29, 1986 between Donegal Mutual Insurance Company, Donegal Group Inc. and Atlantic States Insurance Company.	(i)
(10)(P)	Proportional Reinsurance Agreement dated September 29, 1986 between (i) Donegal Mutual Insurance Company and Atlantic States Insurance Company.	
(10)(Q)	Amendment dated October 1, 1988 to Proportional Reinsurance Agreement between Donegal Mutual Insurance Company and Atlantic States Insurance Company.	(j)
(10)(R)	Multi-Line Excess of Loss Reinsurance Agreement effective January 1, 2002 among Donegal Mutual Insurance Company, Dorinco Reinsurance Company and Erie Insurance Group.	Filed herewith
(10)(S)	Amendment dated July 16, 1992 to Proportional Reinsurance Agreement between Donegal Mutual Insurance Company and Atlantic States Insurance Company.	(k)
(10)(T)	Amendment dated as of December 21, 1995 to Proportional Reinsurance Agreement between Donegal Mutual Insurance Company and Atlantic States Insurance Company.	(l)
(10)(U)	Reinsurance and Retrocession Agreement dated May 21, 1996 between Donegal (h) Mutual Insurance Company and Southern Insurance Company of Virginia.	
(10)(V)	Amended and Restated Credit Agreement dated as of July 27, 1998 among Donegal Group Inc., the banks and other financial institutions from time to time party thereto and Fleet National Bank, as agent.	(m)
(10)(W)	First Amendment and Waiver to the Amended and Restated Credit Agreement dated as of December 31, 1999.	(g)
(10)(X)	Amendment dated as of April 20, 2000 to Proportional Reinsurance Agreement between Donegal Mutual Insurance Company and Atlantic States Insurance Company.	(n)

EXHIBIT NO.	DESCRIPTION OF EXHIBITS	REFERENCE
(10)(Y)	Lease Agreement dated as of September 1, 2000 between Donegal Mutual Insurance Company and Province Bank FSB.	(d)
(10)(Z)	Aggregate Excess of Loss Reinsurance Agreement dated as of January 1, 2001 between Donegal Mutual Insurance Company and Atlantic States Insurance Company (as successor-in-interest to Pioneer Insurance Company).	(d)
(13)	2002 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 17, 2003; provided, however, that the Report of the Compensation Committee, the Performance Graph and the Report of the Audit Committee shall not be deemed filed as part of this Form 10-K Report.	(o)
(21)	Subsidiaries of Registrant. Filed herewith	
(23)	Consent of Independent Auditors.	Filed herewith
(99.1)	Statement of Chief Executive Officer Pursuant to Section 1350 of the United States Code.	Filed herewith
(99.2)	Statement of Chief Financial Officer Pursuant to Section 1350 of the United States Code.	Filed herewith

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(a) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form S-3 Registration Statement No. 333-59828 filed April 30, 2001.

(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, 2001.

(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, 1998.

(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, 2000.

EXHIBIT NO.	DESCRIPTION OF EXHIBITS	REFERENCE

(e) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form S-8 Registration Statement No. 333-62974 filed June 14, 2001.

(f) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form S-2 Registration Statement No. 333-63102 declared effective February 8, 2002.

(g) 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, 1999.

(h) 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.

(i) 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.

(j) 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.

(k) 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.

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

(m) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 8-K Report dated November 17, 1998.

(n) Such exhibit is hereby incorporated by reference to the like-described exhibit in Registrant's Form 8-K Report dated May 31, 2000.

(o) Such exhibit is hereby incorporated by reference to the Registrant's definitive proxy statement filed March 24, 2003.

AMENDMENT NO. 6

Donegal Mutual Insurance Company
401 (K) Plan ("Plan")

In accordance with Section 8.1 of the Plan, the Plan is hereby amended effective July 1, 2002 as follows:

1. The second sentence of subsection (a) of Section 3.4 is deleted and the following substituted therefore:

   "The amount of Elective Contributions may not be less than 1% nor more than 100% of the Participant's compensation as elected by the Participant in units of 1% points on forms provided by the Plan Committee, which notwithstanding this sentence, may limit the amount of the Participant's Elective Contribution if at any time it determines that such limitation is necessary to satisfy the requirements of IRC Section 401(k)."

2. There is hereby added at the end of subsection (b) of Section 3.11 the following sentence:

   "Rollover amount also does not include after tax contributions of the Employee from whatever source derived."

IN WITNESS WHEREOF and as evidence of the adoption of this Amendment No. 6, Donegal Mutual Insurance Company has caused its duly authorized officers to execute this document on its behalf and under its seal this ______ day of __________, 2002.

Donegal Mutual Insurance Company

ATTEST:

By: ______________________________
Donald H. Nikolaus, President

- ----------------------------
Ralph G. Spontak, Secretary

(Corporate Seal)

MULTI-LINE EXCESS OF LOSS REINSURANCE AGREEMENT

between

DONEGAL MUTUAL INSURANCE COMPANY
(Marietta, PA)
SOUTHERN INSURANCE COMPANY OF VIRGINIA
(Glen Allen, VA)
SOUTHERN HERITAGE INSURANCE COMPANY
(Duluth, Georgia)
ATLANTIC STATES INSURANCE COMPANY
(Marietta, PA)
PIONEER INSURANCE COMPANY
(Greenville, NY)
PIONEER INSURANCE COMPANY
(Greenville, OH)
DELAWARE ATLANTIC INSURANCE COMPANY
(Wilmington, DE)

(hereinafter collectively called the "Reinsured")

and

The Reinsurers subscribing to the respective Interests and Liabilities Contract to which this Agreement is attached (hereinafter called the "Reinsurer")

ARTICLE 1 BUSINESS COVERED

This Agreement, subject to the terms and conditions herein contained, is to indemnify the Reinsured in respect of the net excess liability as herein provided and specified which may accrue to the Reinsured as a result of any loss or losses which may occur or claims which may be made during the term of this Agreement arising out of any and all binders, policies, and contracts of insurance (hereinafter referred to as "policy" or "policies") heretofore or hereafter issued or entered into by or on behalf of the Reinsured and classified by the Reinsured as Property and Casualty, to include Property, Multi-Peril Policies, General Liability, Workers' Compensation and Automobile.

ARTICLE 2 TERRITORY

This Agreement shall cover wherever the Reinsured's policies cover.

ARTICLE 3 EXCLUSIONS

This Agreement shall not cover business classified by the Reinsured as:

1. Pools, Associations, or Syndicates, including State Insurance Guaranty Associations. However, such operations which the Reinsured is obliged to cover by reason of membership in the National Workers' Compensation Reinsurance Pool or any state Workers' Compensation Assigned Risk Pool or Plan or participation in any Automobile Assigned Risk Pool, Plan or Facility are not to be excluded. Furthermore, this exclusion shall not apply to any Inter-Company Pooling.

2. Insurance on Growing and/or Standing Crops.

3. Reinsurance of any kind assumed by the Reinsured, except local agency reinsurance accepted in the normal course of business.

4. War, as defined in the original policy.

5. Bridges, tunnels and art collections valued at over $1,000,000.

6. Loss or liability excluded by the provisions of:

   a. Nuclear Incident Exclusion Clause - Physical Damage - Reinsurance

   b. Nuclear Incident Exclusion Clause - Liability - Reinsurance

   c. Nuclear Incident Exclusion Clause - Physical Damage and Liability (Boiler and Machinery Policies) - Reinsurance

   as per clauses attached hereto.

7. Boiler and Machinery with the exception of that business covered under a standard multiple peril policy.

8. Stevedoring.

9. United States Longshoremen and Harbor Workers Act Exposure.

10. Jones Act Exposure.

11. Workers' Compensation on all mining operations.

12. Workers' Compensation on operations employing the process of nuclear fission or fusion or handling of radioactive material.

13. Long haul trucking.

14. Vehicles used as a public or livery conveyance for passengers except courtesy cars and civic, charitable or welfare organization buses.

15. Medical Malpractice.

16. Professional liability, except Druggists, Morticians, Beauty Shops, Pastoral, Opticians, Condominium Directors and Officers Liability and Employee Benefits Liability.

17. Aviation and Ocean Marine.

18. Fidelity, Surety, Credit, Title, Insolvency and Financial Guaranty with the exception of that business covered under a standard multiple peril policy.

19. Insolvency Funds, as per clause attached.

20. Manufacturing of pharmaceuticals and/or chemicals.

21. Railroad Operations.

22. Racing or speed contests.

23. Earthquake and flood when written as such.

24. Difference in conditions insurance.

25. Asbestos manufacturing.

26. Transportation of liquified petroleum gas and/or explosives.

27. Commercial ambulance service.

28. Manufacture of firearms.

Other than as respects risks excluded in 1-6, 11, 12, 15, 17-28 above, the exclusions listed in this Article shall not be considered applicable when the excluded Class constitutes an incidental part of the insured's regular business operations.

In the event the Reinsured is bound on any risk excluded above without the knowledge of and/or contrary to the instructions of the Reinsured's supervisory underwriting personnel, the reinsurance provided under this Agreement shall apply until terminated or first anniversary whichever should first occur.

ARTICLE 4 TERM AND CANCELLATION

A. This Agreement shall become effective on January 1, 2002 at 12:01 A.M., Standard Time. It is unlimited as to its duration and may be terminated as of any January 1st at 12:01 A.M., Standard Time by either party upon giving to the other party hereto no less than ninety (90) days' notice of cancellation in writing by mail. In the event either party terminates in accordance with the above, the Reinsurer shall continue to participate in all reinsurances coming within the terms of this Agreement granted or renewed by the Reinsured within the said ninety (90) days.

In the event of termination the Reinsurer shall (1) remain liable for losses occurring or claims made prior to such termination date and (2) at the option of the Reinsured, shall remain liable at the same terms and conditions with respect to policies in force at the date of termination until the expiration, cancellation or next anniversary of such acceptance, whichever first occurs, but not for any more than twelve months following the date of termination plus odd time, if any, not to exceed eighteen months in all.

B. This Agreement shall apply as follows:

(1) As respects all policies written on a claims-made basis, claims made during the term of this Agreement. The date of loss, for purposes of this Agreement, shall be understood to mean the date that the claim was made against the Reinsured or the date as otherwise provided under the original claims-made policy.

In the event the Reinsured provides an Extended Reporting Period which becomes effective during the term of this Agreement the Reinsurer shall continue to be liable for claims received by the Reinsured or original insured under the reporting provisions of the original claims-made policy during such Extended Reporting Period, provided always that the loss which results in any such claim takes place prior to the effective date of the Extended Reporting Period. For purposes hereof, the date of loss for claims received during the Extended Reporting Period shall be the expiration, anniversary or cancellation date of the policy to which the Extended Reporting Period was attached.

(2) As respects all other business covered hereunder, losses arising during the term of this Agreement.

C. In the event of a loss involving one or more policies the following shall apply:

(1) Where one or more occurrence policies are involved in the same loss, the date of the loss shall determine the recovery hereon.

(2) Where one or more claims-made policies are involved in the same loss, the date of the first claim reported during the treaty period, including those reported under an Extended Reporting Period which became effective during the treaty period, shall determine the recovery hereon. Any further claims reported during and subsequent to the annual treaty period relating to the same loss will go toward the retention in the treaty year in which the first claim was made.

(3) Where one or more claims-made policies and one or more occurrence policies are involved in the same loss, the date of loss under the occurrence policy shall determine the recovery hereon. Any further claims reported during and subsequent to the annual treaty period relating to the same loss will go toward the retention in the treaty year in which the first claim was made.

ARTICLE 5 DEFINITION OF LOSS OCCURRENCE

As respects Casualty:

The term "loss occurrence", as used herein, shall mean any one occurrence or series of occurrences arising out of one event. Occupational Disease under Workers' Compensation policies shall be deemed to be an occurrence within the meaning of this Agreement and each case of an employee contracting any disease for which the Company may be held liable shall be considered as constituting a separate or distinct occurrence. The date of such occurrence shall be deemed to be the following:

(1) If the case is compensable under the Workers' Compensation Law, the date of the beginning of the disability for which compensation is payable.

(2) If the case is not compensable under the Workers' Compensation Law, the date that disability due to said disease actually began.

(3) If the claim is made after employment has ceased, the date of cessation of such employment.

As respects Property:

The term "Loss Occurrence" as used herein shall mean the sum of all individual losses occasioned by any one disaster, accident or loss or series of disasters, accidents or losses arising out of one event which occurs within the area of one state of the United States or province of Canada and states or provinces contiguous thereto and to one another. However, the duration and extent of any one "Loss Occurrence" shall be limited to all individual losses sustained by the Reinsured occurring during any period of 168 consecutive hours arising out of and directly occasioned by the same event except that the term "Loss Occurrence" shall be further defined as follows:

i) As regards windstorm, hail, tornado, hurricane, cyclone, including ensuing collapse and water damage, all individual losses sustained by the Reinsured occurring during any period of 72 consecutive hours and arising out of and directly occasioned by the same event. However, the event need not be limited to one state or province or states or provinces contiguous thereto.

ii) As regards riot, riot attending a strike, civil commotion, vandalism and malicious mischief, all individual losses sustained by the Reinsured occurring during any period of 72 consecutive hours within the area of one municipality or county and the municipalities or counties contiguous thereto arising out of and directly occasioned by the same event. The maximum duration of 72 consecutive hours may be extended in respect of individual losses which occur beyond such 72 consecutive hours during the continued occupation of an assured's premises by strikers, provided such occupation commenced during the aforesaid period.

iii) As regards earthquake (the epicenter of which need not necessarily be within the territorial confines referred to in the opening paragraph of this article) and fire following directly occasioned by the earthquake, only those individual fire losses which commence during the period of 168 consecutive hours may be included in the Reinsured's "Loss Occurrence".

iv) As regards "Freeze", only individual losses directly occasioned by collapse, breakage of glass and water damage (caused by bursting of frozen pipes and tanks) may be included in the Reinsured's "Loss Occurrence".

Except for those "Loss Occurrences" referred to in (i) and (ii) the Reinsured may choose the date and time when any such period of consecutive hours commences

provided that it is not earlier than the date and time of the occurrence of the first recorded individual loss sustained by the Reinsured arising out of that

disaster, accident or loss and provided that only one such period of 168 consecutive hours shall apply with respect to one event.

However, as respects those "Loss Occurrences" referred to in (i) and (ii), if the disaster, accident or loss occasioned by the event is of greater duration than 72 consecutive hours, then the Reinsured may divide that disaster, accident or loss into two or more "Loss Occurrences" provided no two periods overlap and no individual loss is included in more than one such period and provided that no period commences earlier than the date and time of the occurrence of the first recorded individual loss sustained by the Reinsured arising out of that disaster, accident or loss.

No individual losses occasioned by an event that would be covered by 72 hours clauses may be included in any "Loss Occurrence" claimed under the 168 hours provision.

Losses directly or indirectly occasioned by:

i) loss of, alteration of, or damage to

or

ii) a reduction in the functionality, availability or operation of

a computer system, hardware, program, software, data, information repository, microchip, integrated circuit or similar device in computer equipment or non-computer equipment, whether the property of the policyholder of the Reinsured or not, do not in and of themselves constitute an event unless arising out of one or more of the following perils:

> fire, lightning, explosion, aircraft or vehicle impact, falling objects, windstorm, hail, tornado, cyclone, hurricane, earthquake, volcano, tsunami, flood, freeze or weight of snow.

ARTICLE 6 NET RETAINED LINES

This Agreement applies only to that portion of any insurance or reinsurance covered by this Agreement which the Reinsured retains net for its own account, and in calculating the amount of any loss hereunder and also in computing the amount in excess of which this Agreement attaches, only loss or losses in respect of that portion of any insurance or reinsurance which the Reinsured retains net for its own account shall be included, it being understood and agreed that the amount of the Reinsurer's liability hereunder in respect of any

loss or losses shall not be increased by reason of the inability of the Reinsured to collect from any other reinsurers, whether specific or general, any amounts which may have become due from them whether such inability arises from the insolvency of such other reinsurers or otherwise.

It is understood and agreed that any inter-company pooling shall be disregarded for purposes of determining the Net Retained Lines hereunder.

ARTICLE 7 ULTIMATE NET LOSS

The term "Ultimate Net Loss" shall be understood to mean the actual loss or losses paid or to be paid by the Reinsured under its policies, including 90% of any losses in Excess of Original Policy Limits, as defined in Article 8, and 90% of any Extra Contractual Obligations, as defined in Article 9, such loss or losses to include expenses of litigation, if any, interest accrued where such interest is part of the judgment and all other loss expenses of the Reinsured including legal expenses and costs incurred in connection with coverage and validity questions and legal actions connected thereto which are allocable only to a specific claim or action on policies covered hereunder (including a pro rata share of salaries and expenses of the Reinsured's field employees while adjusting such claims or losses and expenses of the Reinsured's officials incurred in connection with claims or losses, but no salaries of the Reinsured's officials or any normal overhead charges such as rent, postal, lighting, cleaning, heating, etc., shall be included) less proper deductions for all recoveries (including amounts recoverable under other reinsurance except reinsurance, if any, inuring to the benefit of the Reinsured) and salvages actually made by the Reinsured; provided always that nothing in this Article shall be construed to mean that losses under this Agreement are not recoverable until the Reinsured's ultimate net loss has been ascertained.

All salvages, recoveries and payments recovered or received subsequent to a loss settlement under this Agreement shall be applied as if recovered or received prior to the said settlement and all necessary adjustments shall be made by the parties hereto.

ARTICLE 8 EXCESS OF ORIGINAL POLICY LIMITS

This Agreement shall protect the Reinsured, within the limits hereof, in connection with ultimate net loss in excess of the limit of its original policy, such loss in excess of the limit having been incurred because of failure by it to settle within the policy limit or by reason of alleged or actual negligence,

fraud or bad faith in rejecting an offer of settlement or in the preparation of the defense or in the trial of any action against its Insured or Reassured or in the preparation or prosecution of an appeal consequent upon such action.

However, this Article shall not apply where the loss has been incurred due to the fraud of a member of the Board of Directors or a corporate officer of the Reinsured acting individually or collectively or in collusion with any individual or corporation or any other organization or party involved in the presentation, defense or settlement of any claim covered hereunder.

For the purposes of this Article, the word "loss" shall mean any amounts for which the Reinsured would have been contractually liable to pay had it not been for the limit of the original policy.

Furthermore, if any provision of this Article shall be rendered illegal or unenforceable by the laws, regulations or public policy of any state, such provision shall be considered void in such state, but this shall not affect the validity or enforceability of any other provision of this Agreement or the enforceability of such provision in any other jurisdiction.

ARTICLE 9 EXTRA CONTRACTUAL OBLIGATIONS CLAUSE

This Agreement shall protect the Reinsured within the limits hereof, where the ultimate net loss includes any Extra Contractual Obligations. "Extra Contractual Obligations" are defined as those liabilities not covered under any other provision of this Agreement and which arise from the handling of any claim on business covered hereunder, such liabilities arising because of, but not limited to, the following: Failure by the Reinsured to settle within the policy limit, or by reason of alleged or actual negligence, fraud or bad faith in rejecting an offer of settlement or in the preparation of the defense or in the trial of any action against its Insured or Reassured or in the preparation or prosecution of an appeal consequent upon such action.

The date on which an Extra Contractual Obligation is incurred by the Reinsured shall be deemed, in all circumstances, to be the date of the original accident, casualty, disaster or loss occurrence.

However, this Article shall not apply where the loss has been incurred due to the fraud of a member of the Board of Directors or a corporate officer of the Reinsured acting individually or collectively or in collusion with any

individual or corporation or any other organization or party involved in the presentation, defense or settlement of any claim covered hereunder.

Furthermore, if any provision of this Article shall be rendered illegal or unenforceable by the laws, regulations or public policy of any state, such provision shall be considered void in such state, but this shall not affect the validity or enforceability of any other provision of this Agreement or the enforceability of such provision in any other jurisdiction.

ARTICLE 10 LIMITS AND RETENTIONS

(A) As respects business classified by the Reinsured as Property:

No claim shall be made upon the Reinsurer unless and until the Reinsured shall have first sustained an ultimate net loss in excess of $300,000 each risk each loss and then the Reinsurer shall be liable for the ultimate net loss sustained by the Reinsured in excess of $300,000 in respect of each risk each loss. The limit of liability of the Reinsurer in respect of each risk each loss shall be $700,000 and $2,800,000 in respect of each occurrence.

The Reinsured shall be the sole judge as to what constitutes any one risk.

(B) As respects business classified by the Reinsured as Casualty:

No claim shall be made upon the Reinsurer unless and until the Reinsured shall have first sustained an ultimate net loss in excess of $300,000 each and every loss occurrence and then the Reinsurer shall be liable for the ultimate net loss sustained by the Reinsured in excess of $300,000 in respect of each such loss occurrence. The limit of liability of the Reinsurer in respect of any one such loss occurrence shall be $700,000.

Notwithstanding the foregoing paragraphs, where the original policy or policies of the Reinsured provide for aggregate limits of liability, this Agreement shall cover excess of $300,000 ultimate net loss in the aggregate for such aggregate liability any one original policy year, but such sums recoverable hereunder shall not exceed $700,000 ultimate net loss in the aggregate any one policy year.

"Policy year" shall mean "each separate original policy period of not exceeding twelve months commencing at the inception, anniversary or renewal date as and from January 1, 2002."

"Aggregate" shall mean "ultimate net loss incurred in the aggregate during any one policy year".

(C) In respect of a combination loss involving both (A) and (B) above, the

limit of the Reinsurer shall be $1,700,000 ultimate net loss and the amount retained by the Reinsured shall be $300,000 each loss occurrence.

It is agreed, however, that not more than one property risk shall be included in any such combination accident or occurrence.

Recoveries from a loss or losses caused by Terrorism (as defined in this Agreement) shall be limited to $2, 100,000 during each 12 month period (January 1 through December 31) this Agreement remains in effect.

ARTICLE 11 DEFINITION OF TERRORISM

An act of terrorism includes any act or preparation in respect of action, or threat of action designed to influence the government de jure or de factor of any nation or any political division thereof, or in pursuit of political, religious, ideological, or similar purposes to intimidate the public or a section of the public of any nation by any person or group(s) of persons whether acting alone or on behalf of or in connection with any organization(s) or government(s) de jure or de factor, and which:

i) involves violence against one or more persons; or
ii) involves damage to property; or
iii) endangers life other than that of the person committing the action; or
iv) creates a risk to health or safety of the public or a section of the public; or
v) is designed to interfere with or to disrupt an electronic system.

An act of terrorism also includes loss, damage, cost or expense directly or indirectly caused by, contributed to by resulting from, or arising out of or in connection with any action in controlling, preventing, suppressing, retaliating against, or responding to any act of terrorism.

ARTICLE 12 RATE AND PREMIUM

The Reinsured shall pay to the Reinsurer during each annual period of this Agreement premium calculated by applying a rate of 3.50% to the gross net earned premium income of the Reinsured during such period in respect of business the subject matter of this Agreement.

The term "gross net earned premium income" as used herein shall be understood to mean gross premiums earned by the Reinsured less premiums paid for reinsurances which inure to this Agreement. It is understood that 50% of Automobile Physical Damage premiums, other than collision, shall be deducted for theft during the period for which computation is being made.

The Reinsured shall pay to the Reinsurer an annual deposit premium of $7,150,000. Said deposits shall be payable in quarterly installments of $1,787,500 at each January 1, April 1, July 1 and October 1.

As soon as practicable after each January 1, 2003, the Reinsured shall submit a statement showing the actual premium due for the term calculated in accordance with the first paragraph of this Article, and the debtor party shall remit to the other the amount due, if any, by which the actual premium differs from the deposit premium, subject to the annual minimum premium of $5,720,000.

ARTICLE 13 CURRENCY

All premiums and losses paid under this Agreement shall be made in United States currency.

ARTICLE 14 NOTICE OF LOSS AND LOSS SETTLEMENTS

In the event of a loss occurrence which either results in or appears to be of serious enough nature as probably to result in a loss involving this Agreement, the Reinsured shall give notice as soon as reasonably practicable to the Reinsurer and the Reinsured shall keep the Reinsurer advised of all subsequent developments in connection therewith.

The Reinsurer agrees to abide by the loss settlements of the Reinsured, such settlements to be considered as satisfactory proof of loss, and amounts falling to the share of the Reinsurer shall be immediately payable to the Reinsured by them upon reasonable evidence of the amount paid or to be paid by the Reinsured.

ARTICLE 15 ACCESS TO RECORDS

The Reinsurer, by its duly appointed representatives, shall have the right at any reasonable time, to examine all papers in the possession of the Reinsured referring to business effected hereunder.

ARTICLE 16 STATISTICS

The Reinsured shall furnish the Reinsurer such quarterly and annual statistics as may be necessary to comply with statutory requirements and in such form as may be mutually agreed upon.

ARTICLE 17 ERRORS AND OMISSIONS

Any inadvertent delay, omission or error shall not be held to relieve either party hereto from any liability which would attach to it hereunder if such delay, omission or error had not been made. Such delay, omission or error shall be rectified immediately upon discovery.

ARTICLE 18 TAXES

In consideration of the terms under which this Agreement is issued, the Reinsured undertakes not to claim any deduction in respect of the premium hereon when making tax returns other than Income or Profits Tax returns to any State or Territory or the District of Columbia.

ARTICLE 19 FEDERAL EXCISE TAX

(Applies only to those Reinsurers, excepting Underwriters at Lloyd's, London and other Reinsurers exempt from the Federal Excise Tax, who are domiciled outside the United States of America.)

The Reinsurer has agreed to allow for the purpose of paying the Federal Excise Tax the percentage specified by United States law of the premium payable hereon to the extent such premium is subject to Federal Excise Tax.

In the event of any return of premium becoming due hereunder the Reinsurer will deduct the percentage specified by United States law from the amount of the return and the Reinsured or its agent should take steps to recover the Tax from the U.S. Government.

ARTICLE 20 LOSS RESERVES

(This Clause is applicable to any Reinsurer who does not qualify for credit by states having jurisdiction over the Reinsured.)

At annual intervals (or more frequently as determined by the Reinsured, but not more frequently than quarterly) the Reinsured will submit to the Reinsurer a

statement showing the proportion of losses, as defined below, applicable to the Reinsurer.

The Reinsurer will apply for, and secure delivery thereof to the Reinsured, a clean, irrevocable and unconditional Letter of Credit in an amount equal to the Reinsurer's share of said losses. The Letter of Credit shall be issued by a United States bank which is a member of the Federal Reserve System and which is acceptable to the Insurance Departments of such states.

If, as of a statement date, the Reinsurer's share of losses under this Agreement shall exceed the then available balance of the Letter of Credit, the Reinsurer shall, within thirty (30) days after receiving such statement, secure delivery to the Reinsured of an amendment to the clean, irrevocable and unconditional Letter of Credit increasing the balance of the Letter of Credit available by the amount of such difference.

If the Reinsurer's share of losses under this Agreement shall be less than the then available balance of the Letter of Credit, the Reinsured shall, within thirty (30) days after receipt of written request of Reinsurer, release such excess amount by agreeing to consent to an amendment to the Letter of Credit reducing the balance of the Letter of Credit available by the amount of such excess.

The Reinsured undertakes to use and apply any amounts which it may draw upon the Letter of Credit, without diminution because of the insolvency of the Reinsured or Reinsurer, notwithstanding any other provision in this contract, only for one or more of the following purposes:

(1) To pay or reimburse itself for the Reinsurer's share of losses paid by the Reinsured for which the Reinsurer is obligated to reimburse the Reinsured, if not otherwise paid by the Reinsurer.

(2) To obtain a cash deposit of the Reinsurer's share under this contract of losses, if the clean, irrevocable and unconditional Letter of Credit is not renewed at least thirty (30) days before the expiration thereof, and the Reinsurer shall continue thereafter to have a share in such losses.

(3) To pay any other amounts the Reinsured claims are due under this reinsurance contract.

The Reinsured will immediately return to the Reinsurer any amounts drawn down on the Letter of Credit that are subsequently determined not to be due.

The term "losses" as used in this Article shall include:

losses and allocated loss adjustment expenses paid by the Reinsured but not recovered (in proportion) from the Reinsurer,

reserves for losses reported and outstanding, losses incurred but not reported, and allocated loss adjustment expenses.

ARTICLE 21 INSOLVENCY

In the event of the insolvency of the Reinsured, this reinsurance shall be payable directly to the Reinsured, or to its liquidator, receiver, conservator or statutory successor on the basis of the liability of the Reinsured without diminution because of the insolvency of the Reinsured or because the liquidator, receiver, conservator or statutory successor of the Reinsured has failed to pay all or a portion of any claim. It is agreed, however, that the liquidator, receiver, conservator or statutory successor of the Reinsured shall give written notice to the Reinsurer of the pendency of a claim against the Reinsured indicating the policy or bond reinsured which claim would involve a possible liability on the part of the Reinsurer within a reasonable time after such claim is filed in the conservation or liquidation proceeding or in the receivership, and that during the pendency of such claim, the Reinsurer may investigate such claim and interpose, at its own expense, in the proceeding where such claim is to be adjudicated any defense or defenses that they may deem available to the Reinsured or its liquidator, receiver, conservator or statutory successor. The expense thus incurred by the Reinsurer shall be chargeable subject to the approval of the court, against the Reinsured as part of the expense of conservation or liquidation to the extent of a pro rata share of the benefit which may accrue to the Reinsured solely as a result of the defense undertaken by the Reinsurer.

Where two or more Reinsurers are involved in the same claim and a majority in interest elect to interpose defense to such claim, the expense shall be apportioned in accordance with the terms of the reinsurance agreement as though such expense had been incurred by the Reinsured.

The reinsurance shall be payable by the Reinsurer to the Reinsured or to its liquidator, receiver, conservator or statutory successor, except as provided by subsection a of Section 4118 of the New York Insurance Law or except (a) where the Agreement specifically provides another payee of such reinsurance in the event of the insolvency of the Reinsured, or (b) where the Reinsurer with the

consent of the direct insured or insureds has assumed such policy obligations of the Reinsured as direct obligations of the Reinsurer to the payees under such policies and in substitution for the obligations of the Reinsured to such payees.

However, in the event of insolvency of any one of the Reinsureds, each party agrees to honor the terms set forth herein as if this Agreement were a separate agreement between the Reinsurer and each individually named Reinsured. Balances payable or recoverable by any Reinsurer or each individually named Reinsurer or individually named Reinsured shall not serve to offset any balances payable or recoverable to or from any other Reinsured party to this Agreement. Reports and remittances made to the Reinsurer in accordance with Articles 11 and 14 are to be in sufficient detail to identify both the Reinsurer's loss obligations due each Reinsured and each Reinsured's premium remittance under the report. In the event that the policies of two or more individually named Reinsureds are involved in the same casualty loss occurrence, the retention shall be $300,000 as respects the Ultimate Net Loss for all Reinsureds added together, and the loss recoverable for each individually named Reinsured shall be in the same proportion that the individually named Reinsured's loss bears to the total Ultimate Net Loss. However, regardless of the number of individually named Reinsureds involved in one loss occurrence, in no event will the Reinsurer be liable for more than $700,000 each risk each loss and $2,800,000 in respect of each occurrence as respects property, $700,000 each and every loss occurrence as respects casualty and $1,700,000 each loss occurrence as respects a combined property and casualty loss.

ARTICLE 22 ARBITRATION

As a precedent to any right of action hereunder, if any dispute shall arise between the Reinsured and the Reinsurer with reference to the interpretation of this Agreement or their rights with respect to any transaction involved, whether such dispute arises before or after termination of this Agreement, such dispute upon the written request of either party, shall be submitted to three arbitrators, one to be chosen by each party, and the third by the two so chosen. If either party refuses or neglects to appoint an arbitrator within thirty days after the receipt of written notice from the other party requesting it to do so, the requesting party may appoint two arbitrators. If the two arbitrators fail to agree in the selection of a third arbitrator within thirty days of their appointment, each of them shall name two, of whom the other shall decline one and the decision shall be made by drawing lots. All arbitrators shall be active or retired executive officers of insurance or reinsurance companies not under the control of either party to this Agreement.

The Arbitrators shall interpret the Agreement and make their decision with regard to the custom and usage of the insurance and reinsurance business. They shall issue their decision in writing based upon a hearing in which evidence may be introduced without following strict rules of evidence, but in which cross examination and rebuttal shall be allowed. They shall make their award with a view to effecting the general purpose of this Agreement in a reasonable manner rather than in accordance with a literal interpretation of the language.

The decision in writing of any two arbitrators, when filed with the parties hereto, shall be final and binding on both parties. Judgment may be entered upon

the final decision of the arbitrators in any court having jurisdiction. Each party shall bear the expense of its own arbitrator and shall jointly and equally bear with the other party the expense of the third arbitrator and of the arbitration. Said arbitration shall take place in Marietta, Pennsylvania unless some other place is mutually agreed upon by the Reinsured and the Reinsurer.

ARTICLE 23 SERVICE OF SUIT

(Applies only to those Reinsurers who are domiciled outside the United States and/or unauthorized in any state, territory, or district of the United States having jurisdiction over the Reinsured.)

In the event of the failure of the Reinsurer hereon to pay any amount claimed to be due hereunder the Reinsurer hereon, at the request of the Reinsured, will submit to the jurisdiction of any court of competent jurisdiction within the United States and will comply with all requirements necessary to give such court jurisdiction and all matters arising hereunder shall be determined in accordance with the law and practice of such court.

Service of process in such suit may be made upon Messrs. Mendes and Mount, 750 Seventh Avenue, New York, New York 10019-6829, and that any suit instituted against any one of them under this Agreement, the Reinsurer will abide by the final decision of such court or of any Appellate Court in the event of an appeal.

The above-named are authorized and directed to accept service of process on behalf of the Reinsurer in any such suit and/or upon the request of the Reinsured to give a written undertaking to the Reinsured that they will enter a general appearance upon the Reinsurer's behalf in the event such suit shall be instituted. Further, pursuant to any statute of any state, territory or district of the United States which makes provision therefor, the Reinsurer hereon hereby

designates the Superintendent, Commissioner or Director of Insurance or other officer specified for that purpose in the statute, or his successor or successors in office, as their true and lawful attorney upon whom may be served any lawful process in any action, suit or proceeding instituted by or on behalf of the Reinsured or any beneficiary hereunder arising out of this Agreement and hereby designate the above-named as the person to whom the said officer is authorized to mail such process or a true copy thereof.

ARTICLE 24 WRITTEN AGREEMENT

There are no other agreements between the Reinsurer and the Reinsured regarding the reinsurance provided by this Agreement, including but not limited to agreements which directly or indirectly guarantee a profit under this Agreement for either party.

ARTICLE 25 INTERMEDIARY

John P. Woods Co., Inc., is hereby recognized as the intermediary through whom all communications relating hereto (including but not limited to notices, statements, premiums, return premiums, commissions, taxes, losses, loss adjustment expenses, salvage and loss settlement) shall be transmitted to both parties. It is understood, as regards remittances due either party hereunder, that payment by the Reinsured to John P. Woods Co., Inc. shall constitute payment to the Reinsurer, but payment by the Reinsurer to John P. Woods Co., Inc., shall only constitute payment to the Reinsured to the extent such payments are actually received by the Reinsured.

NUCLEAR INCIDENT EXCLUSION CLAUSE -
PHYSICAL DAMAGE - REINSURANCE

1. This Reinsurance does not cover any loss or liability accruing to the Reinsured, directly or indirectly, and whether as Insurer or Reinsurer, from any Pool of Insurers or Reinsurers formed for the purpose of covering Atomic or Nuclear Energy risks.

2. Without in any way restricting the operation of paragraph (1) of this Clause, this Reinsurance does not cover any loss or liability accruing to the Reinsured, directly or indirectly and whether as Insurer or Reinsurer, from any insurance against Physical Damage (including business interruption or consequential loss arising out of such Physical Damage) to:

I. Nuclear reactor power plants including all auxiliary property on the site, or

II. Any other nuclear reactor installation, including laboratories handling radioactive materials in connection with reactor installations, and "critical facilities" as such, or

III. Installations for fabricating complete fuel elements or for processing substantial quantities of "special nuclear material", and for reprocessing, salvaging,

chemically separating, storing or disposing of "spent" nuclear fuel or waste materials, or

IV. Installations other than those listed in paragraph (2) III above using substantial quantities of radioactive isotopes or other products of nuclear fission.

3. Without in any way restricting the operations of paragraphs (1) and (2) hereof, this Reinsurance does not cover any loss or liability by radioactive contamination accruing to the Reinsured, directly or indirectly, and whether as Insurer or Reinsurer, from any insurance on property which is on the same site as a nuclear reactor power plant or other nuclear installation and which normally would be insured therewith except that this paragraph (3) shall not operate

(a) where Reinsured does not have knowledge of such nuclear reactor power plant or nuclear installation, or

(b) where said insurance contains a provision excluding coverage for damage to property caused by or resulting from radioactive contamination, however caused. However on and after 1st January 1960 this sub-paragraph (b) shall only apply provided the said radioactive contamination exclusion provision has been approved by the Governmental Authority having jurisdiction thereof.

4. Without in any way restricting the operations of paragraphs (1), (2) and (3) hereof, this Reinsurance does not cover any loss or liability by radioactive contamination accruing to the Reinsured, directly or indirectly, and whether as Insurer or Reinsurer, when such radioactive contamination is a named hazard specifically insured against.

5. It is understood and agreed that this Clause shall not extend to risks using radioactive isotopes in any form where the nuclear exposure is not considered by the Reinsured to be the primary hazard.

6. The term "special nuclear material" shall have the meaning given it in the Atomic Energy Act of 1954, or by any law amendatory thereof.

7. Reinsured to be sole judge of what constitutes:
(a) substantial quantities, and
(b) the extent of installation, plant or site.

NOTE: Without in any way restricting the operation of paragraph (1) hereof, it is understood and agreed that

(a) all policies issued by the Reinsured on or before 31st December 1957 shall be free from the application of the other provisions of this Clause until expiry date or 31st December 1960 whichever first occurs whereupon all the provisions of this Clause shall apply.

(b) with respect to any risk located in Canada policies issued by the Reinsured on or before 31st December 1958 shall be free from the application of the other provisions of this Clause until expiry date or 31st December 1960 whichever first occurs whereupon all the provisions of this Clause shall apply.

NUCLEAR INCIDENT EXCLUSION CLAUSE - LIABILITY - REINSURANCE, U.S.A.

(1) This reinsurance does not cover any loss or liability accruing to the Reinsured as a member of, or subscriber to, any association of insurers or reinsurers formed for the purpose of covering nuclear energy risks or as a direct or indirect reinsurer of any such member, subscriber or association.

(2) Without in any way restricting the operation of paragraph (1) of this Clause it is understood and agreed that for all purposes of this reinsurance all the original policies of the Reinsured (new, renewal and replacement) of the classes specified in Clause II of this paragraph (2) from the time specified in Clause III in this paragraph (2) shall be deemed to include the following provision (specified as the Limited Exclusion Provision):

Limited Exclusion Provision.*

I. It is agreed that the policy does not apply under any liability coverage, to [injury, sickness, disease, death or destruction, bodily injury or property damage] with respect to which an insured under the policy is also an insured under a nuclear energy liability policy issued by Nuclear Energy Liability Insurance Association, Mutual Atomic Energy Liability Underwriters or Nuclear Insurance Association of Canada, or would be an insured under any such policy but for its termination upon exhaustion of its limit of liability.

II. Family Automobile Policies (liability only), Special Automobile Policies (private passenger automobiles, liability only), Farmers Comprehensive Personal Liability Policies

(liability only), Comprehensive Personal Liability Policies (liability only) or policies of a similar nature; and the liability portion of combination forms related to the four classes of policies stated above, such as the Comprehensive Dwelling Policy and the applicable types of Homeowners Policies.

III. The inception dates and thereafter of all original policies as described in II above, whether new, renewal or replacement, being policies which either

(a) become effective on or after 1st May, 1960, or

(b) become effective before that date and contain the Limited Exclusion Provision set out above;

provided this paragraph (2) shall not be applicable to Family Automobile Policies, Special Automobile Policies, or policies or combination policies of a similar nature, issued by the Reinsured on New York risks, until 90 days following approval of the Limited Exclusion Provision by the Governmental Authority having jurisdiction thereof.

(3) Except for those classes of policies specified in Clause II of paragraph (2) and without in any way restricting the operation of paragraph (1) of this Clause, it is understood and agreed that for all purposes of this reinsurance the original liability policies of the Reinsured (new, renewal and replacement) affording the following coverages:

Owners, Landlords and Tenants Liability, Contractual Liability, Elevator Liability, Owners or Contractors (including railroad) Protective Liability, Manufacturers and Contractors Liability, Product Liability, Professional and Malpractice Liability, Storekeepers Liability, Garage Liability, Automobile Liability (including Massachusetts Motor Vehicle or Garage Liability)

shall be deemed to include, with respect to such coverages, from the time specified in Clause V of this paragraph (3), the following provision (specified as the Broad Exclusion Provision):

Broad Exclusion Provision.*

It is agreed that the policy does not apply:

I. Under any Liability Coverage, to [injury, sickness, disease, death or destruction, bodily injury or property damage]

(a) with respect to which an insured under the policy is also an insured under a nuclear energy liability policy issued by Nuclear Energy Liability Insurance Association, Mutual Atomic Energy Liability Underwriters or Nuclear Insurance Association of Canada, or would be an insured under any such policy but for its termination upon exhaustion of its limit of liability; or

(b) resulting from the hazardous properties of nuclear material and with respect to which (1) any person or organization is required to maintain financial

protection pursuant to the Atomic Energy Act of 1954, or any law amendatory thereof, or (2) the insured is, or had this policy not been issued would be, entitled to Indemnity from the United States of America, or any agency thereof, under any agreement entered into by the United States of America, of any agency thereof, with any person or organization.

II. Under any Medical Payments Coverage, or under any Supplementary payments Provision relating to [immediate medical or surgical relief, first aid,] to expenses incurred with respect to [bodily injury, sickness, disease, death or bodily injury] resulting from the hazardous properties of nuclear material and arising out of the operation of a nuclear facility by any person or organization.

III. Under any Liability Coverage, to [injury, sickness, disease, death or destruction, bodily injury or property damage] resulting from the hazardous properties of nuclear material, if

(a) the nuclear material (1) is at any nuclear facility owned by, or operated by or on behalf of, an insured or (2) has been discharged or dispersed therefrom;

(b) the nuclear material is contained in spent fuel or waste at any time possessed, handled, used, processed stored, transported or disposed of by or on behalf of an insured; or

(c) the [injury, sickness, disease, death or destruction bodily injury or property damage] arises out of the furnishing by an insured of services, materials, parts or equipment in connection with the planning, construction, maintenance, operation or use of any nuclear facility, but if such facility is located within the United States of America, its territories, or possessions or Canada, this exclusion (c) applies only to [injury to or destruction of property at such nuclear facility] property damage to such nuclear facility and any property thereat.

IV. As used in this endorsement:

"hazardous properties" include radioactive, toxic or explosive properties; "nuclear material" means source material, special

nuclear material or byproduct material; "source material", "special nuclear material", and "byproduct material" have the meanings given them in the Atomic Energy Act of 1954 or in any law amendatory thereof; "spent fuel" means any fuel element or fuel component, solid or liquid, which has been used or exposed to radiation in a nuclear reactor; "waste" means any waste material (1) containing byproduct material other than the tailings or wastes produced by the extraction or concentration of uranium or thorium from any ore processed primarily for its source material content and (2) resulting from the operation by any person or organization of any nuclear facility included within the definition of nuclear facility under paragraph (a) or (b) thereof; "nuclear facility" means

(a) any nuclear reactor,
(b) any equipment or device designed or used for (1) separating the isotopes of uranium or plutonium, (2) processing or utilizing spent fuel, or (3) handling, processing or packaging waste,
(c) any equipment or device used for the processing, fabricating or alloying of special nuclear material if at any time the total amount of such material in the custody of the insured at the premises where such equipment or device is located consist of or contains more than 25 grams of plutonium or uranium 233 or any combination thereof, or more than 250 grams of uranium 235,
(d) any structure, basin, excavation, premises or place prepared or used for the storage or disposal of waste,

and includes the site on which any of the foregoing is located, all operations conducted on such site and all premises used for such operations; "nuclear reactor" means any apparatus designed or used to sustain nuclear fission in a self-supporting chain reaction or to contain a critical mass of fissionable material; [With respect to injury to or destruction of property, the word "injury" or "destruction"] "property damage" includes all forms of radioactive contamination of property. [includes all forms of radioactive contamination of property.]

V. The inception dates and thereafter of all original policies affording coverages specified in this paragraph (3), whether new, renewal or replacement, being policies which become

effective on or after 1st May, 1960, provided this paragraph (3) shall not be applicable to

(i) Garage and Automobile Policies issued by the Reinsured on New York risks, or

(ii) statutory liability insurance required under Chapter 90, General Laws of Massachusetts,

until 90 days following approval of the Broad Exclusion Provision by the Governmental Authority having jurisdiction thereof.

(4) Without in any way restricting the operation of paragraph (1) of this Clause, it is understood and agreed that paragraphs (2) and (3) above are not applicable to original liability policies of the Reinsured in Canada and that with respect to such policies this Clause shall be deemed to include the Nuclear Energy Liability Exclusion Provisions adopted by the Canadian Underwriters' Association or the Independent Insurance Conference of Canada.

*NOTE. The words printed in brackets in the Limited Exclusion Provision and in the Broad Exclusion Provision shall apply only in relation to original liability policies which include a Limited Exclusion Provision or a Broad Exclusion Provision containing those words.

NUCLEAR INCIDENT EXCLUSION CLAUSE
PHYSICAL DAMAGE AND LIABILITY
(BOILER AND MACHINERY POLICIES) REINSURANCE, U.S.A.

1. This reinsurance does not cover any loss or liability accruing to the Reinsured as a member of, or subscriber to, any association of insurers or reinsurers formed for the purpose of covering nuclear energy risks or as a direct or indirect reinsurer of any such member, subscriber or association.

2. Without in any way restricting the operation of paragraph (1) of this Clause it is understood and agreed that for all purposes of this reinsurance all original Boiler and Machinery Insurance or Reinsurance contracts of the Reinsured shall be deemed to include the following provisions of this paragraph;

This Policy does not apply to "loss", whether it be direct or indirect, proximate or remote

(a) from an Accident caused directly or indirectly by nuclear reaction, nuclear radiation or radioactive contamination, all whether controlled or uncontrolled; or

(b) from nuclear reaction, nuclear radiation or radioactive contamination, all whether controlled or uncontrolled, caused directly or indirectly by, contributed to or aggravated by an Accident.

3. However, it is agreed that loss arising out of the use of Radioactive Isotopes in any form is not hereby excluded from reinsurance protection.

4. Without in any way restricting the operation of paragraph (1) hereof, it is understood and agreed that

(a) all policies issued by the Reinsured effective on or before 30th April, 1958, shall be free from the application of the other provisions of this Clause until expiry date or 30th April, 1961, whichever first occurs, whereupon all the provisions of this Clause shall apply.

(b) with respect to any risk located in Canada policies issued by the Reinsured effective on or before 30th June, 1958, shall be free from the application of the other provisions of this Clause until expiry date of 30th June, 1961, whichever first occurs, whereupon all the provisions of this Clause shall apply.

INSOLVENCY FUNDS EXCLUSION CLAUSE

This Agreement excludes all liability of the Company arising, by contract, operation of law, or otherwise, from its participation or membership, whether voluntary or involuntary, in any insolvency fund. "Insolvency fund" includes any guaranty fund, insolvency fund, plan, pool, association, fund or other arrangement, howsoever denominated, established or governed; which provides for any assessment of or payment or assumption by the Company of part or all of any claim, debt, charge, fee, or other obligation of an insurer, or its successors or assigns, which has been declared by any competent authority to be insolvent, or which is otherwise deemed unable to meet any claim, debt, charge, fee or other obligation in whole or in part.

NOTES: Wherever used herein the terms:

"Company"	shall be understood to mean "Company", "Reinsured", "Reassured" or whatever other term is used in the attached reinsurance contract to designate the reinsured company or companies.
"Agreement"	shall be understood to mean "Agreement", "Contract", "Policy" or whatever other term is used to designate the attached reinsurance document.
"Reinsurers"	shall be understood to mean "Reinsurers", "Underwriters" or whatever other term is used in the attached reinsurance contract to designate the reinsurer or reinsurers.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

OVERVIEW

Donegal Group Inc. ("DGI" or the "Company") is a regional insurance holding company doing business in the Mid-Atlantic and Southern states through its two wholly owned property-casualty insurance subsidiaries, Atlantic States Insurance Company ("Atlantic States") and Southern Insurance Company of Virginia ("Southern") (collectively "Insurance Subsidiaries"). The Company has three operating segments: the investment function, the personal lines of insurance and the commercial lines of insurance. Products offered in the personal lines of insurance consist primarily of homeowners and private passenger automobile policies. Products offered in the commercial lines of insurance consist primarily of commercial automobile, commercial multiple peril and workers' compensation policies. 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 64% of the outstanding common shares of the Company as of December 31, 2002.

Atlantic States participates in an intercompany pooling arrangement with the Mutual Company and assumes 70% of the pooled business. As of January 1, 2002, the Company's results of operations include 100% of the business written by Southern. Prior to January 1, 2002, Southern ceded 50% of its business to the Mutual Company. Because the Mutual Company placed substantially all of the business assumed from Southern into the pool, from which the Company has a 70% allocation, the Company's results of operations included approximately 85% of the business written by Southern prior to January 1, 2002.

During 2000, the Company acquired 45% of the outstanding stock of Donegal Financial Services Corporation ("DFSC"), a thrift holding company. The remaining 55% of the outstanding stock of DFSC is owned by the Mutual Company.

On January 1, 2001, the Company purchased all of the outstanding stock of Pioneer Insurance Company of New York ("Pioneer-New York") from the Mutual Company. The purchase price was $4,441,311, representing Pioneer-New York's adjusted statutory equity at December 31, 2000. The acquisition has been accounted for as a reorganization of entities under common control, similar to a pooling of interests, as both Pioneer-New York and the Company are under the common management and control of the Mutual Company. As such, the Company's financial statements have been restated to include Pioneer-New York as a consolidated subsidiary. In connection with the transaction, the Company issued the Mutual Company a $4,441,311 note, which bore a 6% rate and was due in January 2002. The 6% rate was based upon commercial market rates in effect as of January 1, 2001. The date was subsequently extended to January 2004, and the rate adjusted to 5.5%, based upon commercial market rates in effect as of January 1, 2003.

Southern Heritage Insurance Company ("Southern Heritage"), previously a wholly owned subsidiary, was merged into Southern on May 1, 2002. Pioneer Insurance Company of Ohio ("Pioneer-Ohio") and Delaware Atlantic Insurance Company ("Delaware"), previously wholly owned subsidiaries, and Pioneer-New York were merged into Atlantic States on May 1, 2002, August 1, 2001, and September 30, 2001, respectively. The mergers were accounted for as statutory mergers and had no financial impact on the consolidated entity.

TRANSACTIONS WITH AFFILIATES

The Company's Insurance Subsidiaries have various reinsurance arrangements with the Mutual Company, which include a pooling agreement with Atlantic States, catastrophe reinsurance agreements with each of the Insurance Subsidiaries, an excess of loss reinsurance agreement with Southern, and, prior to January 1, 2002, a 50% quota share contract with Southern. The Mutual Company also has a 100% retrocessional agreement with Southern. A Coordinating Committee exists that is comprised of two board members of the Company and two board members of the Mutual Company who do not serve on the other board. All agreements and all changes to existing agreements between the Company's subsidiaries and the Mutual Company are subject to approval by the Coordinating Committee. In order to approve an agreement or a change in an agreement, the Company's members on the Coordinating Committee must conclude that the agreement or change is fair to the Company and its stockholders, and the Mutual Company's members on the Committee must conclude that the agreement or change is fair to the Mutual Company and its policyholders.

The pooling agreement between the Mutual Company and Atlantic States is

intended to produce a more uniform and stable underwriting result from year to year for the participants in the pool than they would experience individually and to spread the risk of loss among the participants based on their relative amounts of surplus and relative access to capital. Each company participating in the pool has at its disposal the capacity of the entire pool, rather than being limited to policy exposure of a size commensurate with its own capital and surplus. In addition, the ability of the Company to raise capital, and infuse that capital into Atlantic States, provides the participants of the pool with an ability to grow their total direct premiums at a greater rate than would be possible without the existence of the pool. Premiums, losses, loss expenses and underwriting expenses are shared proportionately by each of the participants, with Atlantic States currently assuming 70% of the pooled business and the Mutual Company retaining 30% of the pooled business.

The excess of loss and catastrophe reinsurance agreements are intended to lessen the effects of a single large loss, or an accumulation of losses arising from one event, to a level that is more in line with each company's size, underwriting profile and surplus position. The retention levels of these contracts are less than the retention levels included within reinsurance contracts with outside reinsurers, where the retention levels are appropriate for the insurance companies taken as a whole but would be too great a level of risk for an individual company within the group.

Prior to January 1, 2002, the 50% quota share reinsurance contract between Southern and the Mutual Company provided additional capacity for direct premium growth to Southern during periods of growth that exceeded Southern's ability to support that growth through its own surplus. Premiums, losses and loss expenses were shared equally by the participants with the Mutual Company paying commissions to Southern to reimburse its costs related to the underwriting process.

The 100% retrocessional contract is intended to provide Southern with the same A.M. Best rating (currently "A") as the Mutual Company, which Southern could not achieve without this contract in place.

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 $28,586,888, $29,298,569 and $26,985,080 for 2002, 2001 and 2000, respectively.

CRITICAL ACCOUNTING POLICIES

The Company's financial statements are combined with those of the Insurance Subsidiaries and presented on a consolidated basis in accordance with U.S. generally accepted accounting principles.

The Company uses estimates and assumptions that can have a significant effect on the amounts that are reported in its financial statements. The Company believes the following accounting policies are the most significant as they may require a higher degree of judgment and estimation.

LIABILITY FOR LOSSES AND LOSS EXPENSES

The most significant estimates relate to reserves for losses and loss expenses. The liability represents estimates of the ultimate unpaid cost of claims incurred, including claims incurred but not reported to the Company as of the close of the reporting period. The estimates of losses for reported claims are based on reviews of the individual claims considering known information and the policy provisions relating to the loss. Estimates of losses and loss expenses for claims incurred but not reported to the Company are established based on historical data by line of insurance as adjusted for current conditions. Significant components of estimates used to establish reserves for both reported claims and unreported claims include a variety of factors such as medical cost inflation trends, regulatory and judicial rulings, legal settlements, property replacement and repair cost trends, the propensity of policyholders to litigate and the willingness of courts to expand causes of loss and the size of awards. In recent years, certain of these component costs such as medical inflation trends and legal settlements have experienced significant volatility that contribute to incurred amounts higher than our original estimates. The Company continually reviews and analyzes these trends and factors them into its loss estimates. The Company believes its estimates are appropriate but the ultimate amounts may differ from the estimates provided.

INVESTMENTS

The Company regularly monitors estimates related to the valuation of its investment portfolio and the recognition of other than temporary declines in the value of those investments. All investments are individually monitored for other than temporary declines. When a decline in value of an individual investment is considered to be other than temporary, the investment is written down to its estimated net realizable value and reflected as a realized loss in the statement of income. The Company makes judgments about when there are other than temporary declines in its investments. Generally, if an individual equity security has depreciated in value by more than 20% from its cost basis and has been in such unrealized loss position for more than six months, or if it is likely that contractual payments will not be received on debt securities, the Company assumes there has been an other than temporary decline in value. In addition, the Company may write-down other securities in an unrealized loss position depending on the existence of certain other factors such as the significance of the decline in fair value to the cost basis, deterioration in financial condition of the issuer, downgrades in the ratings of securities or specific industry events.

POLICY ACQUISITION COSTS

Policy acquisition costs, consisting primarily of commissions, premium taxes and certain other underwriting costs that vary with and are directly related to the production of business, are deferred and amortized over the period in which the premiums are earned. The method followed in computing deferred policy acquisition costs limits the amount of such deferred costs to their estimated realizable value, which gives effect to the premium to be earned, related investment income, losses and loss expenses, and certain other costs expected to be incurred as the premium is earned.

RESULTS OF OPERATIONS 2002 COMPARED TO 2001

Total revenues for 2002 were $203,803,561, which were $18,639,938, or 10.1%, greater than 2001. Net premiums earned increased to $185,841,193, an increase of $18,071,339, or 10.8%, over 2001. Direct premiums written of the combined pool of Atlantic States and the Mutual Company increased $22,510,292 or 11.0%. A 3.3% increase in the direct premiums written of Southern accounted for the majority of the remaining change. The Company reported net realized investment gains of $144,190 in 2002 compared to net realized investment losses of $880,254 in 2001. During 2002 and 2001, certain investments trading below cost had declined on an

other-than-temporary basis. Losses of $378,672 and $1,462,913 were included in net realized investment gains (losses) for these investments in 2002 and 2001, respectively. The remaining realized gains and losses in both years resulted from normal turnover of the Company's investment portfolio. As of December 31, 2002, 93.3% of the Company's bond portfolio was classified as Class 1 (highest quality) by the National Association of Insurance Commissioners' Securities Valuation Office. Investment income decreased $1,304,292 in 2002 compared to 2001. In 2002, an increase in average invested assets from $294,988,999 to $316,466,225 was more than offset by a decrease in the average yield to 4.6% in 2002 from 5.3% in 2001.

The GAAP combined ratio of the Insurance Subsidiaries was 99.6% in 2002, compared to 103.8% in 2001. The combined ratio is the sum of the ratios of incurred losses and loss expenses to premiums earned (loss ratio), underwriting expenses to premiums earned (expense ratio) and policyholder dividends to premiums earned (dividend ratio). The loss ratio in 2002 was 69.6% compared to 70.5% in 2001. The commercial lines loss ratio decreased significantly to 61.5% in 2002 compared to 72.7% in 2001. The personal lines loss ratio increased from 69.2% in 2001 to 73.3% in 2002. The commercial automobile and workers' compensation loss ratios showed considerable improvement in 2002 with the commercial automobile loss ratio decreasing to 61.6% in 2002 compared to 85.0% in 2001 and the workers' compensation loss ratio decreasing to 73.1% in 2002 compared to 82.5% in 2001. Net losses and loss expenses for 2002 and 2001 included adverse development of prior accident year losses amounting to $6.8 million and $8.0 million, respectively. In 2001, the adverse loss development was primarily in commercial lines of business with workers' compensation representing $3.2 million, commercial auto liability $1.7 million and commercial multi-peril $1.3 million of the total loss development. Included in those amounts were $4.2 million of reserve strengthening primarily in the workers' compensation and commercial auto lines of business. In 2002, the adverse loss developments in commercial lines were lower with workers' compensation representing $1.6 million, commercial multi- peril $1.4 million and commercial auto liability $0.1 million of the total loss development. Private passenger auto liability's loss development worsened in 2002, representing $2.2 million of the development in 2002 compared to $1.3 million in 2001, with auto physical damage representing approximately $1 million in 2002 compared to $0.2 million in 2001. The loss development in 2002 resulted principally from accident year 2001 claims and resulted primarily from the normal claims review process and not from any change in key assumptions or changes in reserving philosophy. The expense ratio for 2002 was 29.5% compared to 32.3% in 2001, primarily due to the Company's cost reduction program, with the dividend ratio decreasing slightly to 0.6% in 2002 compared to 1.0% in 2001. The expense ratio in 2001 included a guaranty fund assessment of approximately $543,000 resulting from the insolvency of Reliance Insurance Company. This assessment also contributed to the change in the expense ratio from 2001 to 2002.

Income tax expense was $4,491,862, an effective rate of 27.2%, compared to $1,273,598, or an effective rate of 18.0% in 2001. Tax exempt interest represented a smaller proportion of net income before taxes in 2002 compared to 2001, and accounted for most of this difference.

RESULTS OF OPERATIONS 2001 COMPARED TO 2000

Total revenues for 2001 were $185,163,623, which were $14,582,036, or 8.5%, greater than 2000. Net premiums earned increased to $167,769,854, an increase of $16,123,655, or 10.6%, over 2000. The change in Atlantic State's share of the pooling arrangement with the Mutual Company from 65% to 70% effective July 1, 2000, accounted for $4,273,297 of the increase in net premiums earned in 2001. Direct premiums written of the combined pool of Atlantic States and the Mutual Company increased $23,152,222 or 13.2% in 2001. A 4.0% increase in the direct premiums written of Southern, an 8.6% increase in the direct premiums written of Pioneer-Ohio and a 9.6% increase in the direct premiums written of Southern Heritage accounted for the majority of the remaining change. The Company reported net realized investment losses of $880,254 in 2001, compared to net realized investment gains of $170,852 in 2000. During 2001 and 2000, certain investments trading below cost had declined on an other-than-temporary basis. Losses of $1,462,913 and $436,943 were included in net realized investment gains (losses) for these investments in 2001 and 2000, respectively. The remaining realized gains and losses in both years resulted from normal turnover of the Company's investment portfolio. As of December 31, 2001, 100.0% of the Company's bond portfolio was classified as Class 1 (highest quality) by the National Association of Insurance Commissioners' Securities Valuation Office. Investment income decreased $509,203 in 2001 compared to 2000. An increase in the average invested assets from $278,677,748 to $294,988,999 was more than offset by a decrease in the average yield to 5.3% from 5.9% in 2000, and accounted for the change.

The GAAP combined ratio of the Insurance Subsidiaries was 103.8% in 2001, compared to 101.8% in 2000. The combined ratio is the sum of the ratios of incurred losses and loss expenses to premiums earned (loss ratio), underwriting expenses to premiums earned (expense ratio) and policyholder dividends to premiums earned (dividend ratio). The loss ratio in 2001 was 70.5% compared to 68.8% in 2000. The increased loss ratio reflected the impact of loss and loss expense reserve strengthening of approximately $4.2 million. The commercial lines loss ratio increased significantly to 72.7% in 2001 compared to 67.0% in 2000. The personal lines loss ratio decreased from 70.3% in 2000 to 69.2% in 2001. The commercial automobile and workers' compensation loss ratios showed considerable deterioration in 2001 with the commercial automobile loss ratio increasing to 85.0% in 2001 compared to 78.1% in 2000 and the workers' compensation loss ratio increasing to 82.5% in 2001 compared to 64.2% in 2000. Net losses and loss expenses for 2001 included adverse loss development of prior accident year losses amounting to $8.0 million compared to $0.7 million in 2000. In 2001, the loss development was primarily in commercial lines of business with workers' compensation representing $3.2 million, commercial auto liability $1.7 million and commercial multi-peril $1.3 million of the total loss development. Those amounts included $4.2 million of reserve strengthening primarily in workers' compensation and commercial auto lines of business and due primarily to severity. The expense ratio for 2001 was 32.3% compared to 32.1% in 2000, with the dividend ratio increasing slightly to 1.0% in 2001 compared to 0.9% in 2000. The expense ratio in 2001 included a guaranty fund assessment of approximately $543,000 resulting from the insolvency of Reliance Insurance Company. This assessment accounted for most of the increase in the expense ratio in 2001 compared to 2000.

Income tax expense was $1,273,598 for 2001, an effective rate of 18.0%, compared to $2,906,248, or an effective rate of 24.7% in 2000. Tax exempt

interest represented a larger proportion of net income before taxes in 2001
compared to 2000, and accounted for most of this difference.

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, 2002, the Company had no material commitments 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, 2002, pursuant to a credit agreement dated December 29, 1995, and amended as of July 27, 1998, with Fleet National Bank, the Company had unsecured borrowings of $19.8 million. Such borrowings were made in connection with the acquisitions of Delaware, Pioneer-Ohio and Southern Heritage and various capital contributions to the subsidiaries. As of December 31, 2002, the Company may borrow up to $24 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, 2002, the interest rates were 3.45% on an outstanding Eurodollar rate balance of $4.8 million and 3.46% on another Eurodollar rate balance of $15 million. In addition, the Company pays a fee of 3/10 of 1% per annum on the average daily unused portion of the bank's commitment. On each July 27, the credit line is reduced by $8 million. Any outstanding loan in excess of the remaining credit line, after such reduction, is then payable.

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 that may further impact their ability to pay dividends. At December 31, 2002, the Insurance Subsidiaries' statutory capital and surplus were substantially above the RBC requirements. Amounts available for distribution as dividends to DGI without prior approval of the insurance regulatory authorities in 2003 are $10,646,804 from Atlantic States and $2,493,398, from Southern.

Net unrealized gains resulting from fluctuations in the fair value of investments reported in the balance sheet at fair value (net of applicable federal income tax) were $4,911,953 and $2,861,765 at December 31, 2002, and 2001, respectively.

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 major authorized reinsurers, as described in Note 8 of the financial statements. The Company monitors the financial strength of its unaffiliated reinsurers, requiring that companies rated by A.M. Best Company maintain a rating of A- or higher and that foreign reinsurers not rated by A.M. Best Company maintain a level of financial strength equivalent to companies qualifying for an A.M. Best Company rating of A- or higher.

IMPACT OF INFLATION

Property and casualty insurance premiums are established before the amount of losses and loss 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.

QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

INTEREST RATE RISK

The Company's exposure to market risk for changes in interest rates is concentrated in its investment portfolio and, to a lesser extent, its debt obligations. The Company monitors this exposure through periodic reviews of asset and liability positions. Estimates of cash flows and the impact of interest rate fluctuations relating to the investment portfolio are modeled regularly.

Principal cash flows and related weighted-average interest rates by expected maturity dates for financial instruments sensitive to interest rates at December 31, 2002 are as follows:

	PRINCIPAL CASH FLOWS	WEIGHTED-AVERAGE INTEREST RATE
Fixed maturities and short-term investments:		
2003	$ 46,729,420	2.85%
2004	15,700,000	5.81%
2005	30,250,156	5.27%
2006	37,872,512	5.63%

2007	36,687,380	5.49%
Thereafter	132,547,410	5.37%
Total	$299,786,878	
Market value	$313,546,396	
Debt		
2003	$ 3,800,000	3.46%
2004	8,000,000	3.46%
2005	8,000,000	3.46%
Total	$ 19,800,000	
Fair value	$ 19,800,000	

Actual cash flows from investments may differ from those stated as a result of calls and prepayments.

EQUITY PRICE RISK

The combined total of realized and unrealized equity investment losses were $515,320, $131,146, and $650,229 in 2002, 2001, and 2000, respectively. During these three years, the largest total equity investment gain and (loss) in a quarter was $829,914 and $(440,947), respectively.

Donegal Group Inc.

CONSOLIDATED BALANCE SHEETS

DECEMBER 31,	2002	2001
ASSETS		
Investments		
Fixed maturities		
Held to maturity, at amortized cost (fair value $89,785,318 and $86,939,393)	$ 86,701,556	$ 85,322,965
Available for sale, at fair value (amortized cost $187,495,949 and $170,269,584)	194,731,660	173,718,844
Equity securities, available for sale, at fair value (cost $21,587,317 and $16,630,618)	21,836,460	17,517,346
Short-term investments, at cost, which approximates fair value	29,029,418	24,074,200
Total investments	332,299,094	300,633,355
Cash	1,124,604	4,075,288
Accrued investment income	3,815,449	3,765,076
Premiums receivable	26,286,482	24,143,531
Reinsurance receivable	83,207,272	67,853,174
Deferred policy acquisition costs	14,567,070	13,604,215
Federal income taxes receivable	--	292,618
Deferred tax asset, net	6,955,707	7,474,730
Prepaid reinsurance premiums	27,853,996	29,593,467
Property and equipment, net	4,430,394	4,568,652
Accounts receivable--securities	146,507	50,023
Other	531,589	578,243
Total assets	$ 501,218,164	$ 456,632,372
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Losses and loss expenses	$ 210,691,752	$ 179,839,905
Unearned premiums	121,002,447	114,079,264
Accrued expenses	6,583,825	7,186,107
Reinsurance balances payable	1,100,443	839,156
Federal income taxes payable	357,547	--
Cash dividend declared to stockholders	887,315	869,877
Borrowings under line of credit	19,800,000	27,600,000
Accounts payable--securities	2,121,619	--
Due to affiliate	4,080,415	4,015,074
Other	1,409,951	1,274,640
Total liabilities	368,035,314	335,704,023
Stockholders' Equity		
Preferred stock, $1.00 par value, authorized 2,000,000 shares; none issued	--	--
Class A common stock, $.01 par value, authorized 30,000,000 shares, issued 6,269,093 and 6,097,214 shares and outstanding 6,187,569 and 6,015,690 shares	62,691	60,972
Class B common stock, $.01 par value, authorized 10,000,000 shares, issued 3,024,742 and 3,021,965 shares and outstanding 2,983,980 and 2,981,203 shares	30,247	30,220
Additional paid-in capital	60,651,751	58,887,715
Accumulated other comprehensive income	4,911,953	2,861,765
Retained earnings	68,417,956	59,979,425
Treasury stock, at cost	(891,748)	(891,748)
Total stockholders' equity	133,182,850	120,928,349
Total liabilities and stockholders' equity	$ 501,218,164	$ 456,632,372

See accompanying notes to consolidated financial statements.

Donegal Group Inc.

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

YEAR ENDED DECEMBER 31,	2002	2001	2000
STATEMENTS OF INCOME			
Revenues			
Net premiums earned (includes affiliated reinsurance of $86,195,962, $71,989,136 and $63,989,424)	$ 185,841,193	$ 167,769,854	$ 151,646,199
Investment income, net of investment expenses	14,581,252	15,885,544	16,394,747
Installment payment fees	2,447,229	1,587,396	1,532,792
Lease income	789,697	801,083	836,997
Net realized investment gains (losses)	144,190	(880,254)	170,852
Total revenues	203,803,561	185,163,623	170,581,587
Expenses			
Net losses and loss expenses (includes affiliated reinsurance of $54,684,955, $50,283,481 and $36,767,436)	129,267,686	118,177,549	104,383,176
Amortization of deferred policy acquisition costs	29,473,000	27,194,000	25,319,000
Other underwriting expenses	25,331,777	27,000,485	23,355,781
Policy dividends	1,056,790	1,691,759	1,330,330
Interest	1,119,204	2,247,465	3,285,036
Other	1,060,520	1,760,636	1,165,236
Total expenses	187,308,977	178,071,894	158,838,559
Income before income tax expense	16,494,584	7,091,729	11,743,028
Income tax expense	4,491,862	1,273,598	2,906,248
Net income	$ 12,002,722	$ 5,818,131	$ 8,836,780
Net income per common share			
Basic	$ 1.32	$ .65	$ 1.01
Diluted	$ 1.31	$ .64	$ 1.01
STATEMENTS OF COMPREHENSIVE INCOME			
Net income	$ 12,002,722	$ 5,818,131	$ 8,836,780
Other comprehensive income, net of tax			
Unrealized gains on securities:			
Unrealized holding gain arising during the period, net of income tax expense of $1,148,224, $1,277,504, and $1,057,179	2,144,813	2,479,860	2,020,267
Reclassification adjustment for (gains) losses included in net income, net of income tax expense (benefit) of $49,565, $(299,286), and $58,090	(94,625)	580,968	(112,762)
Other comprehensive income	2,050,188	3,060,828	1,907,505
Comprehensive income	$ 14,052,910	$ 8,878,959	$ 10,744,285

See accompanying notes to consolidated financial statements.

Donegal Group Inc.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	COMMON STOCK					
	PRIOR SHARES	CLASS A SHARES	CLASS B SHARES	PRIOR AMOUNT	CLASS A AMOUNT	CLASS B AMOUNT
Balance, January 1, 2000	8,574,210			$8,574,210	$ --	$ --
Issuance of common stock	406,767			406,767		
Net income						
Other comprehensive income						
Grant of stock options						
Cash dividends						
Balance, December 31, 2000	8,980,977			$8,980,977	$ --	$ --
Issuance of common stock	61,830	60,144	3,758	61,830	601	38
Recapitalization	(9,042,807)	6,027,975	3,013,987	(9,042,807)	60,280	30,140
Net income						
Cash dividends						
Exercise of stock options		9,095	4,220		91	42
Grant of stock options						
Other comprehensive income						
Balance, December 31, 2001	--	6,097,214	3,021,965	$ --	$ 60,972	$ 30,220
Issuance of common stock		166,972			1,670	
Net income						
Cash dividends						
Exercise of stock options		4,907	2,777		49	27
Grant of stock options						
Other comprehensive income						
Balance, December 31, 2002	--	6,269,093	3,024,742	--	$ 62,691	$ 30,247

	ADDITIONAL PAID-IN CAPITAL	ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)	RETAINED EARNINGS	TREASURY STOCK	TOTAL STOCKHOLDERS' EQUITY
Balance, January 1, 2000	$44,595,437	$ (2,106,568)	$53,621,011	$(891,756)	$103,792,334
Issuance of common stock	2,349,773				2,756,540
Net income			8,836,780		8,836,780
Other comprehensive income		1,907,505			1,907,505
Grant of stock options	24,630		(24,630)		--
Cash dividends			(3,163,568)		(3,163,568)
Balance, December 31, 2000	$46,969,840	$ (199,063)	$59,269,593	$(891,756)	$114,129,591
Issuance of common stock	1,200,202				1,262,671
Recapitalization	8,949,361			8	(3,018)
Net income			5,818,131		5,818,131
Cash dividends			(3,466,947)		(3,466,947)
Exercise of stock options	126,960				127,093
Grant of stock options	1,641,352		(1,641,352)		--
Other comprehensive income		3,060,828			3,060,828
Balance, December 31, 2001	$58,887,715	$ 2,861,765	$59,979,425	$(891,748)	$120,928,349
Issuance of common stock	1,641,547				1,643,217
Net income			12,002,722		12,002,722
Cash dividends			(3,526,157)		(3,526,157)
Exercise of stock options	84,455				84,531
Grant of stock options	38,034		(38,034)		--
Other comprehensive income		2,050,188			2,050,188
Balance, December 31, 2002	$60,651,751	$4,911,953	$68,417,956	$(891,748)	$133,182,850

See accompanying notes to consolidated financial statements.

Donegal Group Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

YEAR ENDED DECEMBER 31,	2002	2001	2000
Cash Flows from Operating Activities:			
Net income	$ 12,002,722	$ 5,818,131	$ 8,836,780
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	1,236,592	1,127,510	982,926
Realized investment (gains) losses	(144,190)	880,254	(170,852)
Changes in Assets and Liabilities:			
Losses and loss expenses	30,851,847	23,363,781	12,296,118
Unearned premiums	6,923,183	14,138,883	7,788,243
Accrued expenses	(602,282)	1,308,632	(165,997)
Premiums receivable	(2,142,951)	(2,385,029)	(3,296,815)
Deferred policy acquisition costs	(962,855)	(1,320,001)	(316,463)
Deferred income taxes	(579,654)	(1,360,633)	499,976
Reinsurance receivable	(15,354,098)	(13,309,290)	(8,970,330)
Accrued investment income	(50,373)	237,388	(455,059)
Amounts due to/from affiliate	65,341	(513,922)	350,639
Reinsurance balances payable	261,287	(795,819)	262,686
Prepaid reinsurance premiums	1,739,471	(4,881,083)	(3,156,232)
Current income taxes	650,165	(32,656)	374,620
Change in pooling participation	--	--	3,322,031
Other, net	181,965	(271,364)	268,316
Net adjustments	22,073,448	16,186,651	9,613,807
Net cash provided by operating activities	34,076,170	22,004,782	18,450,587
Cash Flows from Investing Activities:			
Purchase of fixed maturities			
Held to maturity	(35,867,577)	(45,201,470)	(17,340,175)
Available for sale	(75,783,783)	(71,700,918)	(30,355,507)
Purchase of equity securities	(18,325,041)	(12,440,994)	(28,286,533)
Sale of fixed maturities			
Held to maturity	415,000	--	--
Available for sale	461,965	16,250,109	8,719,165
Maturity of fixed maturities			
Held to maturity	34,967,828	51,313,296	13,490,715
Available for sale	58,798,825	50,781,533	11,928,622
Sale of equity securities	13,394,123	7,089,532	24,572,288
Net purchase of property and equipment	(552,005)	(161,269)	(275,982)
Net sales (purchases) of short-term investments	(4,955,218)	(4,634,695)	(2,850,343)
Net cash used in investing activities	(27,445,883)	(8,704,876)	(20,397,750)
Cash Flows from Financing Activities:			
Issuance of common stock	1,727,748	1,386,746	2,756,540
Borrowings (payments) under line of credit, net	(7,800,000)	(12,400,000)	3,000,000
Cash dividends paid	(3,508,719)	(3,394,352)	(3,126,959)
Net cash provided by (used in) financing activities	(9,580,971)	(14,407,606)	2,629,581
Net increase (decrease) in cash	(2,950,684)	(1,107,700)	682,418
Cash at beginning of year	4,075,288	5,182,988	4,500,570
Cash at end of year	$ 1,124,604	$ 4,075,288	$ 5,182,988

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION AND BUSINESS

Donegal Group Inc. ("DGI" or the "Company") was organized as a regional insurance holding company by Donegal Mutual Insurance Company (the "Mutual Company") and operates in the Mid-Atlantic and Southern states through its wholly owned stock insurance companies, Atlantic States Insurance Company ("Atlantic States") and Southern Insurance Company of Virginia ("Southern") (collectively "Insurance Subsidiaries"). The Company has three operating segments: the investment function, the personal lines of insurance and the commercial lines of insurance. Products offered in the personal lines of insurance consist primarily of homeowners and private passenger automobile policies. Products offered in the commercial lines of insurance consist primarily of commercial automobile, commercial multiple peril and workers' compensation policies. 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 70% of the pooled business. Prior to January 1, 2002, Southern ceded 50% of its business to the Mutual Company. At December 31, 2002, the Mutual Company held 64% of the outstanding common stock of the Company.

During 2000, the Company acquired 45% of the outstanding stock of Donegal Financial Services Corporation ("DFSC"), a bank holding company, for $3,042,000 in cash. The remaining 55% of the outstanding stock of DFSC is owned by the Mutual Company.

On January 1, 2001, the Company purchased all of the outstanding stock of Pioneer Insurance Company of New York ("Pioneer-New York") from the Mutual Company. The purchase price was $4,441,311, representing Pioneer-New York's adjusted statutory equity at December 31, 2000. The acquisition was accounted for as a reorganization of entities under common control, similar to a pooling of interests, as both Pioneer-New York and the Company were under the common management and control of the Mutual Company. As such, the Company's financial statements were restated to include Pioneer-New York as a consolidated subsidiary. In connection with the transaction, the Company issued the Mutual Company a $4,441,311 note, which bears a 5.5% rate and is due in January 2004. The Company classifies this note in Due to Affiliate.

Pioneer Insurance Company of Ohio ("Pioneer-Ohio"), Delaware Atlantic Insurance Company ("Delaware") and Pioneer-New York, previously wholly owned subsidiaries, were merged into Atlantic States on May 1, 2002, August 1, 2001 and September 30, 2001, respectively. Southern Heritage Insurance Company, previously a wholly owned subsidiary, was merged into Southern on May 1, 2002. The mergers were accounted for as statutory mergers and had no financial impact on the consolidated entity.

BASIS OF CONSOLIDATION

The consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America, include the accounts of DGI 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.

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 changes 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 held to maturity; 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 below amortized cost which is other than temporary, the cost basis for such investments in the held to maturity and available for sale categories is reduced to fair value. Such decline in cost basis 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.

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.

Borrowings Under Line of Credit--The carrying amounts reported in the balance sheet for the line of credit approximate 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.

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.

STOCK-BASED COMPENSATION

Effective July 1, 2000, the Company adopted Financial Accounting Standards Board

Interpretation No. 44 (FIN No. 44), "Accounting for Certain Transactions involving Stock Compensation," and Emerging Issues Task Force Issue No. 00-23 (EITF 00-23), "Issues Related to the Accounting for Stock Compensation under Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and FIN No. 44, Accounting for Certain Transactions involving Stock Compensation." FIN No. 44 states that APB Opinion No. 25 does not apply in the separate financial statements of a subsidiary to the accounting for stock compensation granted by the subsidiary to employees of the parent or another subsidiary. EITF 00-23 states that when employees of a controlling entity are granted stock compensation, the entity granting the stock compensation should measure the fair value of the award at the grant date and recognize that fair value as a dividend to the controlling entity. These provisions apply to the Company, as the Mutual Company is the employer of record for all employees that provide services to the Company.

Through June 30, 2000, the Company applied APB Opinion No. 25 in accounting for its stock-based compensation plans. Accordingly, no compensation cost has been recognized for grants prior to that date for its fixed stock option plans and certain of its stock purchase plans. 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:

	2002	2001	2000
Net income:			
As reported	$12,002,722	$ 5,818,131	$ 8,836,780
Pro-forma	11,767,787	5,617,773	8,071,825
Basic earnings per share:			
As reported	1.32	.65	1.01
Pro-forma	1.30	.63	.92
Diluted earnings per share:			
As reported	1.31	.64	1.01
Pro-forma	1.28	.62	.92

The weighted-average grant date fair value of options granted for the various plans during 2000 was $2.23.

The fair values above were calculated based upon risk-free interest rates of 5.75% for the Stock Purchase Plans and 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 54% for 2000 and an expected dividend yield of 4.5% for 2000.

EARNINGS PER SHARE

Basic earnings per share are calculated by dividing net income 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.

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 70% (65% prior to July 1, 2000) of the Mutual Company's total pooled insurance business, including that assumed from Atlantic States and substantially all of the business assumed by the Mutual Company from Southern (prior to January 1, 2002) and Delaware (prior to January 1, 2000). The Mutual Company and Atlantic States write business with different risk profiles. Through the pooling arrangement, each is able to share proportionately in the results of all policies written by the other. Atlantic States ceded premiums earned of $45,229,457, $37,345,259 and $30,414,395 and ceded losses and loss expenses incurred of $34,471,381, $29,094,804 and $22,966,106 under this arrangement during 2002, 2001 and 2000, respectively. It also assumed premiums earned of $134,236,778, $126,769,521 and $110,943,962 and assumed losses and loss expenses incurred of $96,517,930, $93,470,958 and $75,007,089 under this arrangement during 2002, 2001 and 2000, respectively. Atlantic States had prepaid reinsurance premiums of $26,517,322, $20,942,093 and $16,251,612 and a ceded liability for losses and loss expenses of $47,862,627, $39,321,214 and $31,068,101 under this arrangement as of December 31, 2002, 2001 and 2000, respectively. It also had assumed unearned premiums of $69,208,310, $63,636,858 and $54,578,621 and an assumed liability for losses and loss expenses of $113,850,952, $99,664,285 and $84,805,937 under this arrangement at December 31, 2002, 2001 and 2000, respectively.

Prior to January 1, 2002, the Mutual Company and Southern had a quota share agreement whereby Southern ceded 50% of its direct business, less reinsurance, to the Mutual Company. The business assumed by the Mutual Company from Southern became part of the pooling arrangement between the Mutual Company and Atlantic States. Southern ceded premiums earned of $0, $14,995,606 and $14,413,261 and ceded losses and loss expenses incurred of $488,055, $9,898,422 and $9,885,436 under this agreement during 2002, 2001 and 2000, respectively. Southern had prepaid reinsurance premiums of $0, $7,310,471 and $7,084,729 and a ceded liability for losses and loss expenses of $6,399,727, $10,068,604 and $7,924,750 under this agreement at December 31, 2002, 2001 and 2000, respectively. This agreement was terminated as of January 1, 2002.

Atlantic States and Southern each have a catastrophe reinsurance agreement with the Mutual Company which limits the maximum liability under any one catastrophic occurrence to $400,000 and $450,000, respectively, and $1,000,000 for a catastrophe involving both of the companies. Prior to merging into Atlantic States, Pioneer-Ohio, Delaware and Pioneer-New York each had a catastrophe reinsurance agreement with the Mutual Company which limited the maximum liability under any one catastrophic occurrence to $200,000, $300,000 and $400,000, respectively. Prior to merging into Southern, Southern Heritage had a catastrophe reinsurance agreement with the Mutual Company which limited the maximum liability under any one catastrophic occurrence to $400,000. Prior to merging into Atlantic States, Delaware and the Mutual Company had an excess of loss reinsurance agreement in which the Mutual Company assumed up to $250,000 of losses in excess of $50,000 and prior to January 1, 2000, a workers' compensation quota share agreement whereby Delaware ceded 70% of that business. Prior to merging into Atlantic States, Pioneer-Ohio and the Mutual Company had an excess of loss reinsurance agreement in which the Mutual Company assumed up to $250,000 ($200,000 in 2000) of losses in excess of $50,000. The Mutual Company and Southern have an excess of loss reinsurance agreement in which the

Mutual Company assumes up to $175,000 ($50,000 in 2001 and $25,000 in 2000) of losses in excess of $125,000 ($100,000 in 2001 and 2000). Prior to merging into Atlantic States, Pioneer-New York and the Mutual Company had an excess of loss reinsurance agreement in which the Mutual Company assumed up to $250,000 ($200,000 in 2000) of losses in excess of $50,000. Effective October 1, 2000 and prior to merging into Southern, Southern Heritage and the Mutual Company had an excess of loss reinsurance agreement in which the Mutual Company assumed up to $175,000 ($125,000 in 2000) of losses in excess of $125,000. The Mutual Company has agreements in place

with Southern (and Pioneer-Ohio and Delaware prior to merging into Atlantic States) to reallocate the loss results of workers' compensation business written by those companies as part of commercial accounts primarily written by the Mutual Company or Atlantic States. These agreements provide for the workers' compensation loss ratios of Southern to be no worse than the average workers' compensation loss ratio for all of the companies combined. The Mutual Company and Pioneer-New York also had an aggregate excess of loss reinsurance agreement, entered into as part of the sale of Pioneer-New York from the Mutual Company to DGI, in which the Mutual Company agreed to assume the adverse loss development of claims with dates of loss prior to December 31, 2000, as developed through December 31, 2002, and to assume losses in excess of a 60% loss ratio through December 31, 2002. The subsidiaries ceded premiums earned of $2,811,359, $2,439,520 and $2,126,882 and ceded losses and loss expenses incurred of $6,873,539, $4,194,251 and $5,388,111 under these various agreements during 2002, 2001 and 2000, respectively. The subsidiaries had a ceded liability for losses and loss expenses of $6,397,326, $5,395,528 and $4,941,116 under these various agreements at December 31, 2002, 2001, and 2000, respectively.

Southern (and Delaware, Pioneer-Ohio, Southern Heritage and and Pioneer-New York prior to mergers) has an agreement with the Mutual Company under which it cedes, and then reassumes back, 100% of its business net of reinsurance. The primary purpose of the agreement is to provide Southern with the same A.M. Best rating (currently "A") as the Mutual Company, which this subsidiary could not achieve without this contract in place. This agreement does not transfer insurance risk. While these subsidiaries ceded and reassumed amounts received from policyholders of $48,921,377, $41,142,936 and $25,790,126 and claims of $28,859,644, $23,348,952 and $15,325,638 under these agreements in 2002, 2001 and 2000, respectively, the amounts are not reflected in the consolidated financial statements. The aggregate liabilities ceded and reassumed under these agreements were $43,541,766 and $36,494,487 at December 31, 2002, and 2001, 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 $28,586,888, $29,298,569 and $26,985,080 for 2002, 2001 and 2000, respectively.

C. LEASE AGREEMENT

The Company leases office equipment and automobiles to the Mutual Company under a 10-year lease dated January 1, 2000.

D. LEGAL SERVICES

Donald H. Nikolaus, President and a director of the Company, is also a partner in the law firm of Nikolaus & Hohenadel. Such firm has served as general counsel 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.

E. PROVINCE BANK

As of December 31, 2002, the Company had $122,295 in checking accounts with Province Bank, a wholly owned subsidiary of DFSC. The Company earned $39,118 in interest on these accounts during 2002.

3--INVESTMENTS

The amortized cost and estimated fair values of fixed maturities and equity securities at December 31, 2002 and 2001, are as follows:

	2002			
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	$ 12,641,126	$ 407,958	$ --	$ 13,049,084
Canadian government obligation	499,250	40,750	--	540,000
Obligations of states and political subdivisions	33,891,385	574,768	66,463	34,399,690
Corporate securities	29,551,491	1,745,990	12,103	31,285,378
Mortgage-backed securities	10,118,304	393,857	995	10,511,166
Totals	$ 86,701,556	$ 3,163,323	$ 79,561	$ 89,785,318

AVAILABLE FOR SALE	2002 AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIMATED FAIR VALUE
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 56,344,340	$ 1,943,229	$ 337	$ 58,287,232
Obligations of states and political subdivisions	78,515,340	3,083,256	152,996	81,445,600
Corporate securities	34,848,807	2,016,526	2,783	36,862,550
Mortgage-backed securities	17,787,462	363,649	14,833	18,136,278
Equity securities	21,587,317	1,007,030	757,887	21,836,460
Totals	$209,083,266	$ 8,413,690	$ 928,836	$216,568,120

HELD TO MATURITY	2001 AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIMATED FAIR VALUE
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 23,808,841	$ 336,288	$ 27,500	$ 24,117,629
Canadian government obligation	498,894	36,106	--	535,000
Obligations of states and political subdivisions	24,981,562	690,700	53,312	25,618,950
Corporate securities	27,423,039	659,961	121,021	27,961,979
Mortgage-backed securities	8,610,629	113,541	18,335	8,705,835
Totals	$ 85,322,965	$ 1,836,596	$ 220,168	$ 86,939,393

AVAILABLE FOR SALE	2001 AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIMATED FAIR VALUE
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 67,468,897	$ 1,755,874	$ 249,306	$ 68,975,465
Obligations of states and political subdivisions	53,962,895	1,269,340	85,535	55,146,700
Corporate securities	34,094,195	828,344	115,939	34,806,600
Mortgage-backed securities	14,743,597	78,666	32,184	14,790,079
Equity securities	16,630,618	1,270,239	383,511	17,517,346
Totals	$186,900,202	$ 5,202,463	$ 866,475	$191,236,190

The amortized cost and estimated fair value of fixed maturities at December 31, 2002, 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	$ 2,705,133	$ 2,767,000
Due after one year through five years	29,998,375	31,448,150
Due after five years through ten years	19,563,775	20,636,662
Due after ten years	24,315,969	24,422,340
Mortgage-backed securities	10,118,304	10,511,166
Total held to maturity	$ 86,701,556	$ 89,785,318
AVAILABLE FOR SALE		
Due in one year or less	$ 15,008,947	$ 15,298,500
Due after one year through five years	80,418,332	84,023,582
Due after five years through ten years	42,212,603	44,707,600
Due after ten years	32,068,605	32,565,700
Mortgage-backed securities	17,787,462	18,136,278
Total available for sale	$187,495,949	$194,731,660

The amortized cost of fixed maturities on deposit with various regulatory authorities at December 31, 2002 and 2001, amounted to $5,400,597 and $5,667,959, respectively.

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

	2002	2001	2000
Fixed maturities	$14,285,049	$15,145,949	$15,180,008
Equity securities	804,087	546,243	635,049
Short-term investments	564,738	920,538	1,221,724
Other	29,249	255,250	255,250

Investment income	15,683,123	16,867,980	17,292,031
Investment expenses	1,101,871	982,436	897,284
Net investment income	$14,581,252	$15,885,544	$16,394,747

Gross realized gains and losses from investments and the change in the difference between fair value and cost of investments, before applicable income taxes, are as follows:

	2002	2001	2000
Gross realized gains:			
Fixed maturities	$ 128,714	$ 554,560	$ 237,748
Equity securities	911,994	323,451	1,813,242
	1,040,708	878,011	2,050,990
Gross realized losses:			
Fixed maturities	106,789	28,618	20,597
Equity securities	789,729	1,729,647	1,859,541
	896,518	1,758,265	1,880,138
Net realized gains (losses)	$ 144,190	$ (880,254)	$ 170,852
Change in difference between fair value and cost of investments:			
Fixed maturities	$ 5,253,785	$ 3,498,259	$ 7,300,279
Equity securities	(637,585)	1,275,050	(603,930)
	$ 4,616,200	$ 4,773,309	$ 6,696,349

Income taxes (benefit) on realized investment gains (losses) were $49,565, $(299,286), and $58,090 for 2002, 2001 and 2000, respectively. Deferred income taxes applicable to net unrealized investment gains included in shareholders' equity were $2,572,901 and $1,474,242 at December 31, 2002 and 2001, respectively.

During 2002, 2001 and 2000, certain investments trading below cost had declined on an other-than-temporary basis. Losses of $378,672, $1,462,913 and $436,943 were included in net realized investment gains (losses) for these investments in 2002, 2001 and 2000, respectively.

The Company has no derivative instruments or hedging activities. On January 1, 2001, the Company transferred investments with an amortized cost of $51,640,154 and fair value of $52,444,675 from the held to maturity classification to the available for sale classification under the provisions of SFAS No. 133 and 138. The unrealized holding gain of $804,521 at January 1, 2001 was reported in other comprehensive income. The transfer had no impact on net income.

4--DEFERRED POLICY ACQUISITION COSTS

Changes in deferred policy acquisition costs are as follows:

	2002	2001	2000
Balance, January 1	$13,604,215	$12,284,214	$11,445,572
Acquisition costs deferred	30,435,855	28,514,001	26,157,642
Amortization charged to earnings	29,473,000	27,194,000	25,319,000
Balance, December 31	$14,567,070	$13,604,215	$12,284,214

5--PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2002 and 2001, consisted of the following:

	2002	2001	ESTIMATED USEFUL LIFE
Cost--office equipment	$ 5,441,882	$ 5,012,290	5-15 years
automobiles	785,572	992,412	3 years
real estate	3,105,851	3,063,646	15-50 years
software	561,146	561,146	5 years
	9,894,451	9,629,494	
Accumulated depreciation	(5,464,057)	(5,060,842)	
	$ 4,430,394	$ 4,568,652	

Depreciation expense for 2002, 2001, and 2000 amounted to $690,263, $829,100 and $899,750, respectively.

6--LIABILITY FOR LOSSES AND LOSS EXPENSES

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

	2002	2001	2000
Balance at January 1	$179,839,905	$156,476,124	$144,180,006
Less reinsurance recoverable	65,295,790	53,766,710	44,945,908
Net balance at January 1	114,544,115	102,709,414	99,234,098
Incurred related to:			
Current year	122,433,653	110,142,467	103,671,401
Prior years	6,834,033	8,035,082	711,775
Total incurred	129,267,686	118,177,549	104,383,176
Paid related to:			
Current year	67,655,902	63,289,736	61,848,261
Prior years	46,869,466	43,053,112	39,059,599
Total paid	114,525,368	106,342,848	100,907,860
Net balance at December 31	129,286,433	114,544,115	102,709,414
Plus reinsurance recoverable	81,405,319	65,295,790	53,766,710
Balance at December 31	$210,691,752	$179,839,905	$156,476,124

The Company recognized an increase in the liability for losses and loss expenses of prior years of $6.8 million, $8.0 million and $0.7 million in 2002, 2001 and 2000, respectively. These developments are primarily attributable to variations from expected claim severity in the private passenger and commercial automobile liability, workers' compensation and commercial multiple peril lines of business.

7--LINE OF CREDIT

At December 31, 2002 and 2001, pursuant to a credit agreement dated December 29, 1995, and amended as of July 27, 1998, with Fleet National Bank, the Company had unsecured borrowings of $19.8 million and $27.6 million, respectively. Such borrowings were made in connection with the acquisitions of Delaware, Pioneer-Ohio, and Southern Heritage and various capital contributions to the subsidiaries. As of December 31, 2002, the Company may borrow up to $24 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, 2002, the interest rates were 3.45% on an outstanding Eurodollar rate balance of $4.8 million and 3.46% on another Eurodollar rate balance of $15 million. In addition, the Company pays a fee of 3/10 of 1% per annum on the average daily unused portion of the bank's commitment. On each July 27, the credit line is reduced by $8 million. Any outstanding loan in excess of the remaining credit line, after such reduction, is then payable.

8--REINSURERS

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 Company monitors the financial strength of its unaffiliated reinsurers, requiring that companies rated by A.M. Best Company maintain a rating of A- or higher and that foreign reinsurers not rated by A.M. Best Company maintain a level of financial strength equivalent to companies qualifying for an A.M. Best Company rating of A- or higher. The following amounts represent ceded reinsurance transactions with unaffiliated reinsurers during 2002, 2001 and 2000:

	2002	2001	2000
Premiums written	$10,772,473	$ 9,348,853	$ 8,241,416
Premiums earned	$10,776,702	$ 9,440,035	$ 8,026,478
Losses and loss expenses	$13.693,184	$ 6,907,947	$ 3,027,810
Prepaid reinsurance premiums	$ 1,336,674	$ 1,340,903	$ 1,376,043
Liability for losses and loss expenses	$20,745,639	$10,510,444	$ 9,832,743

TOTAL REINSURANCE

The following amounts represent the total of all ceded reinsurance transactions with both affiliated and unaffiliated reinsurers during 2002, 2001 and 2000:

	2002	2001	2000
Premiums earned	$58,817,518	$64,220,420	$54,981,016
Losses and loss expenses	$55,526,159	$50,095,424	$41,267,463
Prepaid reinsurance premiums	$27,853,996	$29,593,467	$24,712,384
Liability for losses and loss expenses	$81,405,319	$65,295,790	$53,766,710

The following amounts represent the effect of reinsurance on premiums written for 2002, 2001 and 2000:

	2002	2001	2000
Direct	$111,767,756	$110,298,533	$ 99,042,235
Assumed	139,814,138	135,830,624	119,217,433
Ceded	57,078,047	69,101,503	58,137,248
Net premiums written	$194,503,847	$177,027,654	$160,122,420

The following amounts represent the effect of reinsurance on premiums earned for 2002, 2001 and 2000:

	2002	2001	2000
Direct	$110,412,498	$105,214,059	$ 95,671,588
Assumed	134,246,213	126,776,215	110,955,627
Ceded	58,817,518	64,220,420	54,981,016
Net premiums earned	$185,841,193	$167,769,854	$151,646,199

9--INCOME TAXES

The provision for income tax consists of the following:

	2002	2001	2000
Current	$ 5,071,516	$ 2,634,231	$ 2,406,272
Deferred	(579,654)	(1,360,633)	499,976
Federal tax provision	$ 4,491,862	$ 1,273,598	$ 2,906,248

The effective tax rate is different than the amount computed at the statutory federal rate of 34% for 2002, 2001 and 2000. The reason for such difference and the related tax effect are as follows:

	2002	2001	2000
Income before income taxes	$ 16,494,584	$ 7,091,729	$ 11,743,028
Computed "expected" taxes at 34%	5,608,159	2,411,188	3,992,630
Tax-exempt interest	(1,304,197)	(1,399,238)	(1,347,959)
Dividends received deduction	(31,830)	(21,908)	(25,423)
Other, net	219,730	283,556	287,000
Federal income tax provision	$ 4,491,862	$ 1,273,598	$ 2,906,248

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2002 and 2001, are as follows:

	2002	2001
Deferred tax assets:		
Unearned premium	$ 6,438,461	$ 5,778,529
Loss reserves	5,786,195	5,433,005
Net operating loss carryforward - Southern Heritage	1,744,081	2,032,094
Other	1,133,488	1,013,899
Total	$15,102,225	$14,257,527
Deferred tax liabilities:		
Depreciation expense	$ 343,362	$ 379,594
Deferred policy acquisition costs	5,007,431	4,625,433
Salvage recoverable	222,824	303,528
Unrealized gain	2,572,901	1,474,242
Total	$ 8,146,518	$ 6,782,797

Net deferred tax assets	$ 6,955,707	$ 7,474,730

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 any deferred tax asset at December 31, 2002, since it is more likely than not that the deferred tax assets will be realized through reversals of existing temporary differences, future taxable income, carryback to taxable income in prior years and the implementation of tax planning strategies.

At December 31, 2002, the Company has a net operating loss carryforward of $5,073,691, which is available to offset taxable income of the Company. Such net operating loss carryforward will expire beginning in 2009. Federal income tax laws limit the amount of net operating loss carryforward that the Company can use in any one year to approximately $1 million.

10--STOCKHOLDERS' EQUITY

On April 19, 2001 the Company's stockholders approved an amendment to the Company's Certificate of Incorporation. Among other things, the amendment reclassified the Company's common stock as Class B common stock and effected a one-for-three reverse split of the Company's Class B common stock effective April 19, 2001. The amendment also authorized a new class of common stock with one-tenth of a vote per share designated as Class A common stock. The Company's Board also approved a dividend of two shares of Class A common stock for each share of Class B common stock, after the one-for-three reverse split, held of record at the close of business April 19, 2001. The effect of the reverse split and the stock dividend taken together is that the Company had the same total number of shares outstanding after the reverse split and the stock dividend as it did before the reverse split and the stock dividend. Therefore, there is no change in the historical earnings per share of the Class A common stock and the Class B common stock after the reverse split and the stock dividend compared to before the reverse split and the stock dividend.

Each share of Class A common stock outstanding at the time of the declaration of any dividend or other distribution payable in cash upon the shares of Class B common stock is entitled to a dividend or distribution payable at the same time and to stockholders of record on the same date in an amount at least 10% greater than any dividend declared upon each share of Class B common stock. In the event of a

merger or consolidation of the Company with or into another entity, the holders of Class A common stock and the holders of Class B common stock are entitled to receive the same per share consideration in such merger or consolidation. In the event of any liquidation, dissolution or winding-up of the Company, any assets available to common stockholders will be distributed pro-rata to the holders of Class A and Class B common stock.

11--STOCK COMPENSATION PLANS

EQUITY INCENTIVE PLANS

During 1996 the Company adopted an Equity Incentive Plan for key employees. During 2001 the Company adopted a nearly identical plan that made a total of 1,500,000 shares of Class A common stock available. Each plan provides 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. 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. No stock appreciation rights have been issued.

During 1996 the Company adopted an Equity Incentive Plan For Directors. During 2001 the Company adopted a nearly identical plan that made 200,000 shares of Class A common stock available. Awards may be made in the form of stock options, and the plan additionally provides for the issuance of 175 shares of restricted stock to each director on the first business day of January in each year. As of December 31, 2002, the Company has 5,000 unexercised options under these plans. Additionally 2,100, 1,947 and 1,947 shares of restricted stock were issued on January 2, 2002, 2001 and 2000, respectively.

All options issued prior to 2001 were converted to options on Class A and Class B common stock as a result of the Company's recapitalization. No further shares are available for plans in effect prior to 2001.

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

	NUMBER OF OPTIONS	WEIGHTED-AVERAGE EXERCISE PRICE PER SHARE
Outstanding at December 31, 1999	1,496,393	$ 13.50
Granted - 2000	59,500	8.05
Exercised - 2000	--	--
Forfeited - 2000	39,555	12.84
Outstanding at December 31, 2000	1,516,338	$ 13.19
Granted - 2001	459,000	13.93
Exercised - 2001	13,315	8.00
Forfeited - 2001	27,556	13.50
Outstanding at December 31, 2001	1,934,467	$ 13.27
Granted - 2002	10,000	14.00
Exercised - 2002	7,684	8.00
Forfeited - 2002	18,334	14.36
Expired - 2002	524,448	$ 13.50
Outstanding at December 31, 2002	1,394,001	$ 13.43
Exercisable at:		
December 31, 2000	1,190,004	$ 16.68
December 31, 2001	1,321,905	$ 13.89
December 31, 2002	1,085,000	$ 13.29

Options available for future grants at December 31, 2002 are 1,228,900.

The following table summarizes information about fixed stock options at December 31, 2002:

EXERCISE PRICE	NUMBER OF OPTIONS OUTSTANDING	WEIGHTED-AVERAGE REMAINING CONTRACTUAL LIFE	NUMBER OF OPTIONS EXERCISABLE
$ 8.00	445,334	2.0 years	445,334
$ 9.00	9,500	3.5 years	5,499
$14.00	457,500	3.5 years	152,500
$18.00	481,667	0.25 years	481,667

EMPLOYEE STOCK PURCHASE PLANS

During 1996 the Company adopted an Employee Stock Purchase Plan. During 2001, the Company adopted a nearly identical plan that made 300,000 shares of Class A common stock available for issuance.

The new 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 1) of the plan or 85% of the fair market value of the Company's common stock on the last day of the subscription period (June 30 and December 31). A summary of plan activity follows:

	SHARES ISSUED	
	PRICE	SHARES
January 1, 2000	$5.41875	23,906
July 1, 2000	$4.88750	21,714
January 1, 2001	$5.95000	16,438
July 1, 2001	$8.71250	11,377
January 1, 2002	$8.84850	12,769
July 1, 2002	$8.77200	10,520

On January 1, 2003, the Company issued an additional 9,425 shares at a price of $9.13750 per share under this plan.

AGENCY STOCK PURCHASE PLANS

On December 31, 1996, the Company adopted an Agency Stock Purchase Plan. During 2001, the Company adopted a nearly identical plan that made 300,000 shares of Class A common stock available for issuance. 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 2002, 2001 and 2000, 16,310, 16,557, and 46,603 shares, respectively, were issued under this plan. Expense recognized under the plan was not material.

12--STATUTORY NET INCOME, CAPITAL AND SURPLUS AND DIVIDEND RESTRICTIONS

The following is selected information, as filed with insurance regulatory authorities, for the Insurance Subsidiaries as determined in accordance with accounting practices prescribed or permitted by such insurance regulatory authorities (restated for mergers):

	2002	2001	2000
ATLANTIC STATES			
Statutory capital and surplus	$ 95,405,603	$ 91,649,362	$ 94,431,695
Statutory unassigned surplus	$ 46,744,739	$ 42,988,498	$ 45,770,831
Statutory net income (loss)	$ 10,646,804	$ (676,125)	$ 7,958,124
SOUTHERN			
Statutory capital and surplus	$ 31,243,897	$ 30,730,757	$ 26,057,758
Statutory unassigned surplus	$ (6,373,688)	$ (6,886,828)	$(11,559,827)
Statutory net income	$ 2,505,891	$ 5,180,964	$ 3,029,826

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 and Southern are also subject to Risk Based Capital (RBC) requirements which may further impact their ability to pay dividends. At December 31, 2002, the companies' statutory capital and surplus were substantially above the RBC requirements. Amounts available for distribution as dividends to DGI without prior approval of insurance regulatory authorities in 2003 are $10,646,804 from Atlantic States and $2,493,398 from Southern.

The National Association of Insurance Commissioners (NAIC) adopted the Codification of Statutory Accounting Principles with an effective date of January 1, 2001. The codified principles are intended to provide a basis of accounting recognized and adhered to in the absence of conflict with, or silence of, state statutes and regulations. The impact of the codified principles on the statutory capital and surplus of the Company's Insurance Subsidiaries as of January 1, 2001 was as follows: Atlantic States - $6,482,380 increase and Southern -$2,254,558 increase.

13--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,		
	2002	2001	2000
Statutory net income of Insurance Subsidiaries	$ 13,152,695	$ 4,504,839	$ 10,987,950
Increases (decreases):			
Deferred policy acquisition costs	962,855	1,320,001	838,642
Deferred federal income taxes	579,654	1,360,633	(499,976)
Salvage and subrogation recoverable	(863,313)	155,088	305,918
Consolidating eliminations and adjustments	(11,264,732)	(13,783,695)	(4,318,624)
Parent-only net income	9,435,563	12,261,265	1,522,870
Net income as reported herein	$ 12,002,722	$ 5,818,131	$ 8,836,780

	DECEMBER 31,		
	2002	2001	2000
Statutory capital and surplus of Insurance Subsidiaries	$ 126,649,500	$ 122,380,119	$ 120,489,453
Increases (decreases):			
Deferred policy acquisition costs	14,567,070	13,604,215	12,284,214
Deferred federal income taxes	(3,499,656)	(820,313)	7,690,886
Salvage and subrogation			

recoverable	7,334,635	8,197,948	8,042,860
Statutory reserves	--	--	2,623,921
Non-admitted assets and other adjustments, net	735,946	334,092	911,370
Fixed maturities	7,517,290	3,793,048	493,055
Consolidating eliminations and adjustments	(40,891,418)	(39,693,089)	(40,973,097)
Parent-only equity	20,769,483	13,132,329	2,566,929
Stockholders' equity as reported herein	$ 133,182,850	$ 120,928,349	$ 114,129,591

14--SUPPLEMENTARY INFORMATION ON STATEMENT OF CASH FLOWS

The following reflects income taxes and interest paid during 2002, 2001 and 2000:

	2002	2001	2000
Income taxes	$4,410,000	$2,666,887	$2,031,652
Interest	$1,047,237	$3,049,844	$2,731,048

15--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, 2002, 2001 and 2000:

	NET INCOME	WEIGHTED-AVERAGE SHARES OUTSTANDING	EARNINGS PER SHARE
2002:			
Basic	$12,002,722	9,085,914	$ 1.32
Effect of stock options	--	107,199	(.01)
Diluted	$12,002,722	9,193,113	$ 1.31
2001:			
Basic	$ 5,818,131	8,941,781	$ .65
Effect of stock options	--	136,669	(.01)
Diluted	$ 5,818,131	9,078,450	$ .64
2000:			
Basic	$ 8,836,780	8,715,899	$ 1.01
Effect of stock options	--	21,011	--
Diluted	$ 8,836,780	8,736,910	$ 1.01

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

	2002	2001	2000
Options excluded from diluted earnings per share	939,167	1,467,782	1,045,338

16--CONDENSED FINANCIAL INFORMATION OF PARENT COMPANY

CONDENSED BALANCE SHEETS
($ in thousands)

DECEMBER 31,	2002	2001
ASSETS		
Investment in subsidiaries (equity method)	$156,684	$152,089
Cash	604	403
Property and equipment	1,640	1,623
Other	99	264
Total assets	$159,027	$154,379
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Cash dividends declared to stockholders	$ 887	$ 870
Line of credit	19,800	27,600
Due to affiliate	4,441	4,441
Other	716	540
Total liabilities	25,844	33,451
Stockholders' equity	133,183	120,928
Total liabilities and stockholders' equity	$159,027	$154,379

CONDENSED STATEMENTS OF INCOME
($ in thousands)

YEAR ENDED DECEMBER 31,	2002	2001	2000
Revenues			
Dividends-subsidiaries	$ 10,400	$ 14,419	$ 3,900
Other	797	824	866
Total revenues	11,197	15,243	4,766
Expenses			
Operating expenses	1,057	1,761	1,165
Interest	1,139	2,288	3,304
Total expenses	2,196	4,049	4,469
Income before income tax benefit and equity in undistributed net income of subsidiaries	9,001	11,194	297
Income tax benefit	(435)	(1,067)	(1,226)
Income before equity in undistributed net income (loss) of subsidiaries	9,436	12,261	1,523
Equity in undistributed			

net income (loss) of subsidiaries	2,567	(6,443)	7,314
Net income	$ 12,003	$ 5,818	$ 8,837

CONDENSED STATEMENTS OF CASH FLOWS
($ in thousands)

YEAR ENDED DECEMBER 31,	2002	2001	2000
Cash flows from operating activities:			
Net income	$ 12,003	$ 5,818	$ 8,837
Adjustments:			
Equity in undistributed net loss (income) of subsidiaries	(2,567)	6,443	(7,314)
Other	788	252	1,123
Net adjustments	(1,779)	6,695	(6,191)
Net cash provided	10,224	12,513	2,646
Cash flows from investing activities:			
Net purchase of property and equipment	(480)	(122)	(262)
Investment in Donegal Financial Services Corp.	--	--	(3,042)
Other	38	38	38
Net cash used	(442)	(84)	(3,266)
Cash flows from financing activities:			
Cash dividends paid	(3,509)	(3,394)	(3,127)
Issuance of common stock	1,728	1,387	2,757
Line of credit, net	(7,800)	(12,400)	3,000
Net cash provided (used)	(9,581)	(14,407)	2,630
Net change in cash	201	(1,978)	2,010
Cash at beginning of year	403	2,381	371
Cash at end of year	$ 604	$ 403	$ 2,381

17--SEGMENT INFORMATION

As an underwriter of property and casualty insurance, the Company has three reportable segments which consist of the investment function, the personal lines of insurance and the commercial lines of insurance. Using independent agents, the Company markets personal lines of insurance to individuals and commercial lines of insurance to small and medium-sized businesses.

The Company evaluates the performance of the personal lines and commercial lines primarily based upon underwriting results as determined under statutory accounting practices (SAP) for the total business of the Company.

Assets are not allocated to the personal and commercial lines and are reviewed in total by management for purposes of decision making. Donegal Group Inc. operates only in the United States and no single customer or agent provides 10 percent or more of revenues.

Financial data by segment is as follows:

	2002	2001	2000
	($ in thousands)		
Revenues:			
Premiums earned:			
Commercial lines	$ 66,003	$ 62,877	$ 54,581
Personal lines	119,838	104,893	97,065
Total premiums earned	185,841	167,770	151,646
Net investment income	14,581	15,886	16,395
Realized investment gains (losses)	144	(880)	171
Other	3,238	2,388	2,370
Total revenues	$ 203,804	$ 185,164	$ 170,582
Income before income taxes:			
Underwriting income (loss):			
Commercial lines	$ 6,326	$ (3,037)	$ 763
Personal lines	(5,056)	(5,090)	(4,649)
SAP underwriting income (loss)	1,270	(8,127)	(3,886)
GAAP adjustments	(558)	1,833	1,144
GAAP underwriting income (loss)	712	(6,294)	(2,742)
Net investment income	14,581	15,886	16,395
Realized investment gains (losses)	144	(880)	171
Other	1,058	(1,620)	(2,081)
Income before income taxes	$ 16,495	$ 7,092	$ 11,743

18--GUARANTY FUND AND OTHER INSURANCE-RELATED ASSESSMENTS

The Company accrues for guaranty-fund and other insurance-related assessments in accordance with Statement of Position (SOP) 97-3, "Accounting by Insurance and Other Enterprises for Insurance-Related Assessments." SOP 97-3 provides guidance for determining when an entity should recognize a liability for guaranty-fund and other insurance-related assessments, how to measure that liability, and when an asset may be recognized for the recovery of such assessments through premium tax offsets or policy surcharges. The Company's liabilities for guaranty-fund and other insurance-related assessments were $2,970,182 and $3,605,090 at December 31, 2002 and 2001, respectively. These liabilities included $538,578 and $676,149 related to surcharges collected by the Company on behalf of regulatory authorities for 2002 and 2001, respectively.

19--INTERIM FINANCIAL DATA (UNAUDITED)

	2002			
	FIRST QUARTER	SECOND QUARTER	THIRD QUARTER	FOURTH QUARTER
Net premiums earned	$ 45,452,260	$ 46,110,512	$ 46,792,748	$ 47,485,673
Total revenues	50,034,046	50,736,803	51,085,417	51,947,295
Net losses and loss expenses	31,297,569	32,136,019	32,423,893	33,410,205
Net income	2,180,716	3,178,834	3,015,676	3,627,496
Net income per common share				
Basic	.24	.35	.33	.40
Diluted	.24	.35	.33	.39

2001

	FIRST QUARTER	SECOND QUARTER	THIRD QUARTER	FOURTH QUARTER
Net premiums earned	$ 40,040,902	$ 41,651,990	$ 42,598,703	$ 43,478,259
Total revenues	44,792,026	46,496,969	46,365,986	47,508,642
Net losses and loss expenses	26,158,684	27,931,189	30,026,448	34,061,228
Net income (loss)	2,954,595	2,697,269	1,023,422	(857,155)
Net income (loss) per common share				
Basic	.33	.30	.11	(.10)
Diluted	.33	.30	.11	(.10)

INDEPENDENT AUDITORS' REPORT

The Stockholders and Board of Directors
Donegal Group Inc.

We have audited the accompanying consolidated balance sheets of Donegal Group Inc. and subsidiaries as of December 31, 2002 and 2001, and the related consolidated statements of income and comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2002. 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 auditing standards generally accepted in the United States of America. 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. and subsidiaries as of December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

Philadelphia, Pennsylvania
February 20, 2003

CORPORATE INFORMATION

ANNUAL MEETING
April 17, 2003 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 corporate address.

MARKET INFORMATION
Donegal Group's Class A common stock and Class B common stock are traded on the Nasdaq National Market under the symbols "DGICA" and "DGICB." The Class A common stock and Class B common stock have traded on the Nasdaq National Market since April 20, 2001. All information given prior to that date relates to the Company's Common Stock, which previously traded on the Nasdaq National Market under the symbol "DGIC." The following table shows the dividends paid per share and the stock price range for each quarter during 2002 and 2001:

Quarter	High	Low	Cash Dividend Declared Per Share
2001 - Class A			
1st	12.750	8.688	--
2nd	14.500	10.000	.10
3rd	14.590	12.170	.10
4th	13.880	9.100	.20
2001 - Class B			
1st	12.750	8.688	--
2nd	12.500	8.750	.09
3rd	13.100	11.010	.09
4th	11.750	9.000	.18
2002 - Class A			
1st	10.770	8.750	--
2nd	12.250	9.050	.10
3rd	10.990	9.120	.10
4th	12.120	9.250	.20
2002 - Class B			
1st	12.800	8.780	--
2nd	11.000	9.750	.09
3rd	11.500	9.510	.09
4th	11.440	9.200	.18

CORPORATE OFFICES
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P.O. Box 302
Marietta, Pennsylvania 17547-0302
(717) 426-1931
E-mail Address: info@donegalgroup.com
Donegal Web Site: www.donegalgroup.com

TRANSFER AGENT
EquiServe Trust Company, N.A.
P.O. Box 2500
Jersey City, New Jersey 07303-2500
(800) 317-4445
Web Site: www.equiserve.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
EquiServe Trust Company, N.A.
P.O. Box 2500
Jersey City, New Jersey 07303-2500

STOCKHOLDERS
The following represent the number of common stockholders of record as of December 31, 2002:

Class A common stock 615
Class B common stock 514

EXHIBIT 21

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

EXHIBIT 23

Independent Auditors' Consent and Report on Schedules

The Board of Directors
Donegal Group Inc.:

The audits referred to in our report dated February 20, 2003 include the related financial statement schedules as of December 31, 2002, and for each of the years in the three-year period ended December 31, 2002, included in the annual report on 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 incorporation by reference in the registration statements (Nos. 333-06681, 333-25541, 333-26693, 333-61095, 333-93785, 333-943301, 333-89644, 333-62970, 333-62972, 333-62974 and 333-62976) on Forms S-8 and registration statement (No. 333-59828) on Form S-3 of Donegal Group Inc. of our reports dated February 20, 2003, relating to the consolidated balance sheets of Donegal Group Inc. as of December 31, 2002 and 2001, and the related consolidated statements of income and comprehensive income, stockholders' equity and cash flows and related financial statement schedules for each of the years in the three-year period ended December 31, 2002, which reports are incorporated by reference or appear in the December 31, 2002 annual report on Form 10-K of Donegal Group Inc.

/s/ KPMG LLP

Philadelphia, Pennsylvania
March 26, 2003

Exhibit 99.1

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

Pursuant to Section 1350 of Title 18 of the United States Code, I, Donald H. Nikolaus, the President of Donegal Group Inc. (the "Company"), hereby certify that, to the best of my knowledge:

1. The Company's Form 10-K Annual Report for the year ended December 31, 2002 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 28, 2003

s/Donald H. Nikolaus

Donald H. Nikolaus

Exhibit 99.2

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

Pursuant to Section 1350 of Title 18 of the United States Code, I, Ralph G. Spontak, the Senior Vice President, Chief Financial Officer and Secretary of Donegal Group Inc. (the "Company"), hereby certify that, to the best of my knowledge:

1. The Company's Form 10-K Annual Report for the year ended December 31, 2002 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 28, 2003

s/Ralph G. Spontak

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