

SECURITIES AND EXCHANGE COMMISSION  
 WASHINGTON, D.C. 20549  
 FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 of the Securities Exchange Act of 1934

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 1999

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 No. 0-15341

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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, P.O. BOX 302, MARIETTA, PA 17547-0302

(Address of principal executive offices, including zip code)

(717) 426-1931

(Registrant's telephone number, including area code)

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

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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required by Sections 12, 13, or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes  No

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 8,392,279 shares of Common Stock, \$1.00 par value, outstanding on November 10, 1999.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

DONEGAL GROUP INC. AND SUBSIDIARIES  
 CONSOLIDATED BALANCE SHEET

ASSETS	SEPTEMBER 30, 1999	DECEMBER 31, 1998
	-----	-----
Investments	(Unaudited)	
Fixed maturities		
Held to maturity, at amortized cost	\$125,111,853	\$127,183,788
Available for sale, at market value	94,785,484	90,525,855
Equity securities, available for sale at market	8,333,115	6,763,943
Short-term investments, at cost, which approximates market	11,559,414	30,521,887
Total Investments	----- 239,789,866	----- 254,995,473
Cash	2,324,706	8,227,042
Accrued investment income	3,053,761	3,164,599
Premiums receivable	19,511,481	19,824,894
Reinsurance receivable	52,536,049	48,339,223

Deferred policy acquisition costs	11,586,691	11,334,301
Federal income tax receivable	2,290,970	227,841
Deferred federal income taxes	5,258,575	3,536,692
Prepaid reinsurance premiums	33,376,756	27,203,111
Property and equipment, net	6,166,332	5,920,420
Accounts receivable - securities	--	329,299
Other	749,266	2,128,611
	-----	-----
Total Assets	\$376,644,453	\$385,231,506
	=====	=====

LIABILITIES AND STOCKHOLDERS' EQUITY

LIABILITIES

Losses and loss expenses	\$147,748,276	\$141,409,008
Unearned premiums	101,397,903	94,722,785
Accrued expenses	6,437,589	4,821,594
Drafts payable	862,716	1,394,373
Reinsurance balances payable	1,321,326	1,785,914
Cash dividend declared to stockholders	--	708,513
Line of credit	15,000,000	37,500,000
Accounts payable - securities	1,096,813	503,840
Other	563,571	884,392
Due to affiliate - Other	3,157,279	870,083
	-----	-----
Total Liabilities	277,585,473	284,600,502
	-----	-----

STOCKHOLDERS' EQUITY

Preferred stock, \$1.00 par value, authorized 1,000,000 shares; none issued		
Common stock, \$1.00 par value, authorized 10,000,000 shares, issued 8,484,854 and 8,325,221 shares and outstanding 8,362,566 and 8,202,933 shares	8,484,854	8,325,221
Additional paid-in capital	42,953,834	41,271,322
Accumulated other comprehensive income (loss)	(1,625,623)	1,315,425
Retained earnings	50,137,671	50,610,792
Treasury stock	(891,756)	(891,756)
	-----	-----
Total Stockholders' Equity	99,058,980	100,631,004
	-----	-----
Total Liabilities and Stockholders' Equity	\$376,644,453	\$385,231,506
	=====	=====

See accompanying notes to consolidated financial statements.

DONEGAL GROUP INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF INCOME  
(Unaudited)

FOR THE THREE MONTHS ENDED SEPTEMBER 30, 1999 AND 1998

	THREE MONTHS ENDED SEPTEMBER 30, 1999 ----	1998 ----
<b>REVENUES:</b>		
Premiums earned	\$53,173,772	\$42,214,525
Premiums ceded	17,218,216	14,149,761
	-----	-----
Net premiums earned	35,955,556	28,064,764
Investment income, net of investment expenses	3,238,862	2,825,718
Realized gains (losses)	(82,852)	147,659
Lease income	209,777	188,888
Service fees	480,891	427,707
	-----	-----
Total Revenues	39,802,234	31,654,736
	-----	-----
<b>EXPENSES:</b>		
Losses and loss expenses	39,853,059	32,826,321
Reinsurance recoveries	13,403,097	12,391,787
	-----	-----
Net losses and loss expenses	26,449,962	20,434,534
Amortization of deferred policy acquisition costs	5,020,000	4,835,000
Other underwriting expenses	11,584,127	5,693,443
Policy dividends	325,842	478,736
Interest	279,658	210,749
Other expenses	352,535	417,335
	-----	-----
Total Expenses	44,012,124	32,069,797
	-----	-----
Loss before income taxes	(4,209,890)	(415,061)
Income tax benefit	(1,767,010)	(459,475)
	-----	-----
Net income (loss)	\$ (2,442,880)	\$ 44,414
	=====	=====
<b>Earnings (loss) per common share</b>		
Basic	\$ (.29)	\$.01
	=====	=====
Diluted	\$ (.29)	\$.01
	=====	=====

STATEMENT OF COMPREHENSIVE INCOME  
(Unaudited)

	1999 ----	1998 ----
Net Income (loss)	\$ (2,442,880)	\$ 44,414
	-----	-----
Other comprehensive income (loss), net of tax		
Unrealized gains (losses) on securities:		
Unrealized holding loss arising during the period	(776,043)	(109,774)
Less: Reclassification adjustment for (gains) losses included in net income	54,682	( 97,455)
	-----	-----
Other comprehensive loss	(721,361)	(207,229)
	-----	-----
Comprehensive income (loss)	\$ (3,164,241)	\$ 162,815
	=====	=====

See accompanying notes to consolidated financial statements.

DONEGAL GROUP INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF INCOME  
(Unaudited)

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 1999 AND 1998

	NINE MONTHS ENDED SEPTEMBER 30, 1999 ----	1998 ----
<b>REVENUES:</b>		
Premiums earned	\$157,663,660	\$123,953,613
Premiums ceded	49,784,318	41,106,048
	-----	-----
Net premiums earned	107,879,342	82,847,565
Investment income, net of investment expenses	9,763,940	8,439,124
Realized gains (losses)	(67,437)	494,894
Lease income	612,138	560,072
Service charge income	1,512,228	1,232,251
	-----	-----
Total Revenues	119,700,211	93,573,906
	-----	-----
<b>EXPENSES:</b>		
Losses and loss expenses	112,959,768	86,186,915
Reinsurance recoveries	37,895,855	30,725,338
	-----	-----
Net losses and loss expenses	75,063,913	55,461,577
Amortization of deferred policy acquisition costs	18,376,000	14,560,000
Other underwriting expenses	23,105,011	13,840,760
Policy dividends	955,854	1,298,860
Interest	974,089	594,364
Other expenses	1,213,493	1,240,927
	-----	-----
Total Expenses	119,688,360	86,996,488
	-----	-----
Income before income taxes	11,851	6,577,418
Income tax expense (benefit)	(997,372)	1,323,459
	-----	-----
Net income	\$ 1,009,223	\$ 5,253,959
	=====	=====
<b>Earnings per common share</b>		
Basic	\$.12	\$.64
	=====	=====
Diluted	\$.12	\$.63
	=====	=====

STATEMENT OF COMPREHENSIVE INCOME  
(Unaudited)

	1999 ----	1998 ----
Net Income	\$ 1,009,223	\$ 5,253,959
	-----	-----
Other comprehensive income (loss), net of tax		
Unrealized gains on securities:		
Unrealized holding gains (losses) arising during the period	(2,985,556)	563,544
Less: Reclassification adjustment for Reclassification adjustment for (gains) losses included in net income	44,508	(326,630)
	-----	-----
Other comprehensive income (loss)	(2,941,048)	236,914
	-----	-----
Comprehensive income (loss)	\$(1,931,825)	\$ 5,490,873
	=====	=====

See accompanying notes to consolidated financial statements.

DONEGAL GROUP INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
(Unaudited)  
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 1999

	COMMON STOCK -----		ADDITIONALLY PAID-IN CAPITAL -----	ACCUMULATED OTHER COM- PREHENSIVE INCOME (LOSS) -----	RETAINED EARNINGS -----	TREASURY STOCK -----	TOTAL STOCK- HOLDERS' EQUITY -----
	SHARES -----	AMOUNT -----					
BALANCE, DECEMBER 31, 1998	8,325,221	\$8,325,221	\$41,271,322	\$1,315,425	\$50,610,792	\$(891,756)	\$100,631,004
ISSUANCE OF COMMON STOCK	159,633	159,633	1,682,512				1,842,145
NET INCOME					1,009,223		1,009,223
CASH DIVIDEND					(1,482,344)		(1,482,344)
OTHER COMPREHENSIVE LOSS				(2,941,048)			(2,941,048)
BALANCE, SEPTEMBER 30, 1999	8,484,854 =====	\$8,484,854 =====	\$42,953,834 =====	\$(1,625,623) =====	\$50,137,671 =====	\$(891,756) =====	\$99,058,980 =====

See accompanying notes to consolidated financial statements.

DONEGAL GROUP INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF CASH FLOWS  
(Unaudited)  
FOR THE SIX MONTHS ENDED SEPTEMBER 30, 1999 AND 1998

	SIX MONTHS ENDED SEPTEMBER 30, 1999 ----	1998 ----
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 3,452,103	\$ 5,210,085
	-----	-----
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	545,699	217,046
Realized investment gain	(15,415)	(347,235)
Changes in Assets and Liabilities:		
Losses and loss expenses	2,326,730	4,453,733
Unearned premiums	7,430,128	3,361,271
Premiums receivable	(3,146,764)	(1,707,456)
Deferred policy acquisition costs	(426,936)	(661,694)
Deferred federal income taxes	(171,058)	(16,798)
Reinsurance receivable	(1,975,318)	(2,475,737)
Prepaid reinsurance premiums	(4,548,994)	(528,031)
Accrued investment income	(400,732)	(96,777)
Due from affiliate	1,182,782	(330,314)
Reinsurance balances payable	(337,913)	(70,693)
Federal income taxes receivable	3,200	(402,605)
Other, net	(422,928)	(1,282,787)
	-----	-----
Net adjustments	42,481	111,923
	-----	-----
Net cash provided by operating activities	3,494,584	5,322,008
	-----	-----
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of fixed maturities		
Held to maturity	(8,727,038)	(9,004,828)
Available for sale	(13,639,230)	(14,234,581)
Purchase of equity securities, available for sale	(7,162,651)	(11,878,128)
Maturity of fixed maturities		
Held to maturity	10,150,310	13,307,736
Available for sale	10,154,868	5,248,065
Sale of fixed maturities - available for sale	--	535,765
Sale of equity securities, available for sale	967,504	5,893,013
Purchase of property and equipment	(789,563)	(365,073)
Net sales of short-term investments	22,697,512	9,049,074
	-----	-----
Net cash provided by (used in) investing activities	13,651,712	(1,448,957)
	-----	-----
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Cash dividends paid	(1,442,326)	(1,277,782)
Issuance of common stock	1,263,673	1,317,532
Line of credit, net	(22,500,000)	(5,500,000)
	-----	-----
Net cash used in financing activities	(22,678,653)	(5,460,250)
	-----	-----
Net decrease in cash	(5,532,357)	(1,587,199)
Cash at beginning of year	8,227,042	3,413,315
	-----	-----
Cash at end of quarter	\$ 2,694,685	\$ 1,826,116
	=====	=====
Cash paid during period		
- Interest	\$ 700,279	\$ 58,143
- Income taxes	\$ 595,380	\$ 2,202,337

See accompanying notes to consolidated financial statements.

DONEGAL GROUP INC. AND SUBSIDIARIES  
(UNAUDITED)  
SUMMARY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1 - ORGANIZATION

Donegal Group Inc. (the "Company") was organized as a regional insurance holding company by Donegal Mutual Insurance Company (the "Mutual Company") on August 26, 1986 and operates in the Mid-Atlantic and Southern states through its wholly-owned stock insurance companies, Atlantic States Insurance Company ("Atlantic States"), Southern Heritage Insurance Company ("Southern Heritage"), Southern Insurance Company of Virginia ("Southern"), Delaware Atlantic Insurance Company ("Delaware") and Pioneer Insurance Company ("Pioneer"), (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 examinations by those departments. The Insurance Subsidiaries are also subject to competition from other insurance companies in their operating areas. Atlantic States participates in an inter-company pooling arrangement with the Mutual Company and assumes 65% of the pooled business. Southern cedes 50% of its business to the Mutual Company and Delaware cedes 70% of its Workers' Compensation business to the Mutual Company. At September 30, 1999, the Mutual Company held 60% of the outstanding common stock of the Company.

2 - BASIS OF PRESENTATION

The financial information for the interim period included herein is unaudited; however, such information reflects all adjustments, consisting only of normal recurring adjustments, which, in the opinion of management, are necessary to a fair presentation of the financial position, results of operations and cash flow for the interim period included herein. The results of operations for the nine months ended September 30, 1999, are not necessarily indicative of results of operations to be expected for the twelve months ended December 31, 1999.

These financial statements should be read in conjunction with the financial statements and notes thereto contained in the Registrant's Annual Report on Form 10-K for the year ended December 31, 1998.

3 - EARNINGS PER SHARE

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

	NET INCOME -----	WEIGHTED AVERAGE SHARES OUTSTANDING -----	EARNINGS PER SHARE -----
THREE MONTHS ENDED SEPTEMBER 30:			
1999			
Basic	\$(2,442,880)	8,347,396	\$(.29)
Effect of stock options	--	--	--
	-----	-----	-----
Diluted	\$(2,442,880)	8,347,396	\$(.29)
	-----	-----	-----
1998			
Basic	\$ 44,414	8,145,510	\$ .01
Effect of stock options	--	107,982	--
	-----	-----	-----
Diluted	\$ 44,414	8,253,492	\$ .01
	-----	-----	-----

	NET INCOME -----	WEIGHTED AVERAGE SHARES OUTSTANDING -----	EARNINGS PER SHARE -----
NINE MONTHS ENDED SEPTEMBER 30:			
1999			
Basic	\$ 1,009,223	8,292,461	\$ .12
Effect of stock options	--	--	--
	-----	-----	-----
Diluted	\$ 1,009,223	8,292,461	\$ .12
	-----	-----	-----
1998			
Basic	\$ 5,253,959	8,105,566	\$ .64
Effect of stock options	--	148,613	(.01)
	-----	-----	-----
Diluted	\$ 5,253,959	8,254,179	\$ .63
	-----	-----	-----



4 - SEGMENT INFORMATION

The performance of the personal lines and commercial lines based upon underwriting results as determined under statutory accounting practices (SAP) which is used by management to measure performance for the total business of the Company.

Financial data by segment is as follows:

	THREE MONTHS ENDED SEPTEMBER 30,	
	1999	1998
(\$ in thousands)		
Revenues:		
Premiums earned:		
Commercial lines	\$12,069	\$10,479
Personal lines	23,886	17,586
Total net premiums earned	35,955	28,065
Net investment income	3,239	2,826
Realized investment gains (losses)	(82)	148
Other	690	616
Total revenues	\$39,802	\$31,655
Income before income taxes:		
Underwriting income (loss)		
Commercial lines	\$ (9)	\$ (25)
Personal lines	(7,326)	(3,192)
SAP underwriting gain (loss)	(7,335)	(3,217)
GAAP adjustments	(90)	(160)
GAAP underwriting gain (loss)	(7,425)	(3,377)
Net investment income	3,239	2,826
Realized investment gains (losses)	(82)	148
Other	58	(12)
Income before income taxes	\$ (4,210)	\$ (415)



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

OVERVIEW

Donegal Group Inc. (the "Company") was organized as a regional insurance holding company by Donegal Mutual Insurance Company (the "Mutual Company") on August 26, 1986 and operates in the Mid-Atlantic and Southern states through its wholly-owned stock insurance companies, Atlantic States Insurance Company ("Atlantic States"), Southern Heritage Insurance Company ("Southern Heritage"), Southern Insurance Company of Virginia ("Southern"), Delaware Atlantic Insurance Company ("Delaware") and Pioneer Insurance Company ("Pioneer"), (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 examinations by those departments. The Insurance Subsidiaries are also subject to competition from other insurance companies in their operating areas. Atlantic States participates in an inter-company pooling arrangement with the Mutual Company and assumes 65% of the pooled business. Southern cedes 50% of its business to the Mutual Company and Delaware cedes 70% of its Workers' Compensation business to the Mutual Company. At September 30, 1999, the Mutual Company held 60% of the outstanding common stock of the Company.

RESULTS OF OPERATIONS - THREE MONTHS ENDED SEPTEMBER 30, 1999  
TO THREE MONTHS ENDED SEPTEMBER 30, 1998

Revenues for the three months ended September 30, 1999 were \$39,802,234 an increase of \$8,147,498 or 25.7%, over the same period of 1998. An increase in net premiums earned of \$7,890,792 or 28.1%, represented most of this change. Premium growth escalated as a result of the Company's acquisition of Southern Heritage in November, 1998. Southern Heritage accounted for \$5,760,633, or 20.5%, of the increase in net premiums earned. Investment income for the third quarter increased \$413,144 or 14.6% with Southern Heritage accounting for an increase of \$563,696. The annualized average return on investments was unchanged from 1998 at 5.4% with the average invested assets increasing from \$208.0 million in the third quarter 1998 to \$239.0 million in the third quarter 1999, accounted for the change. Realized investment gains, which resulted from normal turnover of the Company's investment portfolio, were a loss of \$82,852 in the third quarter 1999 compared to a gain of \$147,659 for the same period of 1998.

The GAAP combined ratio of insurance operations in the third quarter of 1999 was 120.6% compared to 112.0% for the same period in 1998. The GAAP combined ratio is the sum of the ratios of incurred losses and loss adjusting expenses to premiums earned (loss ratio), policyholders dividends to premiums earned (dividend ratio), and underwriting expenses to premiums earned (expense ratio). The Company's loss ratio in the third quarter of 1999 was 73.5% compared to 72.8% in the third quarter of 1998. Results for the third quarter of 1999 reflect the integration of Southern Heritage and an increase in losses of approximately \$1 million associated with claims resulting from Hurricane Floyd. The expense ratio for the third quarter 1999 was 46.2% compared to 37.5% for the third quarter 1998. Expenses for the third quarter 1999 included a restructuring charge of \$2.2 million which resulted from an approved plan that included streamlining of operations, reengineering of work flows, and team approached to marketing and underwriting functions to increase sales and reduce expenses. The restructuring charge included costs associated with the termination of approximately 10% of the Company's employees, the removal from service of certain equipment, the closing of the Company's Delaware office and other costs associated with the consolidation of certain subsidiary support functions into the Marietta, Pennsylvania home office. Other changes were made to increase productivity, eliminate duplicate services, reduce employee benefit costs and improve efficiency and profitability. The Company anticipates annualized expense savings of \$6.1 million in 2000 from these changes. The dividend ratio decreased to 0.9% for the third quarter of 1999 compared to 1.7% for the same period of 1998 due to higher loss ratios in the workers' compensation line of business and the addition of Southern Heritage which decrease the percentage that Workers' Compensation represents of the total premiums earned.

RESULTS OF OPERATIONS - NINE MONTHS ENDED SEPTEMBER 30, 1999  
TO NINE MONTHS ENDED SEPTEMBER 30, 1998

Revenues for the nine months ended September 30, 1999 were \$119,700,211 an increase of \$26,126,305 or 27.9%, over the same period of 1998. An increase in net premiums earned of \$25,031,777 or 30.2%, represented most of this change. Premium growth escalated as a result of the Company's acquisition of Southern Heritage in November, 1998. Southern Heritage accounted for \$19,158,715, or 23.1%, of the increase in net premiums earned. Investment income for the first nine months increased \$1,324,816 or 15.7% with Southern Heritage accounting for an increase of \$1,741,597. The annualized average return on investments decreased from 1998 at 5.4% to 5.2% for the first nine months of 1999 with the average invested assets increasing from \$208.0 million in 1998 to \$247.4 million in 1999, accounted for the change. Realized investment gains, which resulted from normal turnover of the Company's investment portfolio, were a loss of \$67,437 for the first nine months of 1999 compared to a gain of \$494,894 for the same period of 1998.

The GAAP combined ratio of insurance operations for the first nine months of 1999 was 108.9% compared to 102.3% for the same period in 1998. The GAAP combined ratio is the sum of the ratios of incurred losses and loss adjusting expenses to premiums earned (loss ratio), policyholders dividends to premiums earned (dividend ratio), and underwriting expenses to premiums earned (expense ratio). The Company's loss ratio in the first nine months of 1999 was 69.6% compared to 66.9% in the same period in 1998. Results for 1999 reflect the integration of Southern Heritage and an increase in losses of approximately \$1 million associated with third quarter claims resulting from Hurricane Floyd. The expense ratio for the first nine months of 1999 was 38.4% compared to 34.3% for the same period in 1998. Expenses for 1999 included a restructuring charge of \$2.2 million which resulted from an approved plan that included streamlining of operations, reengineering of work flows, and team approach to marketing and underwriting functions to increase sales and reduce expenses. The restructuring charge included costs associated with the termination of approximately 10% of the Company's employees, the removal from service of certain equipment, the closing of the Company's Delaware office and other costs associated with the consolidation of certain subsidiary support functions into the Marietta, Pennsylvania home office. Other changes were made to increase productivity, eliminate duplicate services, reduce employee benefit costs and improve efficiency and profitability. The Company anticipates annualized expense savings of \$6.1 million in 2000 from these changes. The dividend ratio decreased to 0.9% for the 1999 compared to 1.6% for the same period of 1998 due to higher loss ratios in the workers' compensation line of business and the addition of Southern Heritage which decrease the percentage that Workers' Compensation represents of the total premiums earned.

For the first nine months of 1999, the Company recorded a Federal Income Tax benefit of \$997,372 which resulted from a carryback of a taxable loss resulting primarily from the deduction of tax free interest from its operating income. The effective Federal income tax rate for the first nine months of 1998 was 20.1% which is lower than the expected rate of 34% due primarily to the deduction of tax free interest.

## 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 September 30, 1999 the Company had no material commitment for capital expenditures.

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

As of September 30, 1999, pursuant to a credit agreement dated December 29, 1995 with Fleet National Bank of Connecticut, (the "Bank") the Company had unsecured borrowings of \$15.0 million. Per the terms of the credit agreement, the Company may borrow up to \$40 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 September 30, 1999, the interest rate on the outstanding balance was 7.2125%. In addition, the Company will pay a non-use fee at a rate of 3/10 of 1% per annum on the average daily unused portion of the Bank's commitment. On each July 27, commencing July 27, 2001, the credit line will be reduced by \$8 million. Any outstanding loan in excess of the remaining credit line, after such reduction, will then be payable.

The Company's principal source of cash with which to pay stockholder dividends is dividends from Atlantic States, Southern, Pioneer, Southern Heritage and Delaware, 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. Atlantic States, Southern, Pioneer, Southern Heritage and Delaware are subject to Risk Based Capital (RBC) requirements effective for 1994. At December 31, 1998, all five Companies' capital was substantially above the RBC requirements. At December 31, 1998, amounts available for distribution as dividends to Donegal Group without prior approval of the insurance regulatory authorities are \$6,480,524 from Atlantic States, \$638,832 from Southern, \$530,035 from Pioneer, \$1,085,807 from Delaware and \$1,580,564 from Southern Heritage.

## 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 Donegal Group's commercial business is billed through its agents who are extended credit in the normal course of business.

The Company's subsidiaries have reinsurance agreements in place with the Mutual Company and with a number of other major authorized reinsurers.

## IMPACT OF INFLATION

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

## YEAR 2000 ISSUES

The Year 2000 issue (i. e. the ability of computer systems to properly process information which contains dates beginning with January 1, 2000 and thereafter) affects virtually all companies. All Computer systems used for processing of business for the Company are owned and operated by Donegal Mutual Insurance Company (the "Mutual Company").

The ability to process information in a timely and accurate manner is vital to the Company's property and casualty insurance business. The Company recognizes that the systems used to process its business must be able to accurately identify and process information containing year 2000 dates. The Mutual Company has had a vigorous and comprehensive project underway since 1995 to ensure substantial compliance by the end of 1998. This project was initiated as part of a review of the main application systems utilized by the Mutual Company and was geared towards the implementation of new or current versions of its application software to bring greater efficiencies and operational improvements to its users. The project was expanded to include a review of all hardware, peripheral software and inquires of agents and vendors to determine the readiness of each related to the Year 2000 problem. During 1998 the Mutual Company put into production its updated, Year 2000 compliant versions of its main application softwares and late in the year began issuing policies with expiration dates in the year 2000. The implementation of these updated systems were without major problems and the Mutual Company's mission critical systems were substantially Year 2000 compliant by the end of 1998. Testing of less critical systems, documentation of vendors' readiness, replacement of some hardware and final testing of certain other potential problem dates continues in 1999 and is anticipated to be complete by year end. Costs directly related to the Year 2000 changes were not material.

With respect to insurance policies issued by the Company providing coverage to insureds who may incur losses as a result of year 2000 problems, the Company is evaluating its possible exposure under such coverages. Endorsements excluding losses related to or resulting from year 2000 issues are being attached to commercial policies.

Given the nature of its business, the Company believes that its exposure to embedded chip Year 2000 issues is minimal. The Company believes that its most significant Year 2000 exposure is the potential business disruption that would be caused by widespread failure of public utility systems. Prolonged failure of power and telecommunications systems could have a material adverse effect on the Company's results of operation, cash flow and consolidated financial position.

This Year 2000 disclosure contains statements which are forward looking statements that involve risks and uncertainties and qualify for the statutory safe harbor under the Private Securities Litigation Reform Act of 1995. Future Year 2000 readiness activities may not adhere to the anticipated schedule because more problems may be encountered than anticipated in the various stages of testing and trained personnel may not be available to work on internal systems in the time required; or there may be unexpected problems with the readiness of third party business partners and vendors who cannot produce services, or utility companies may not be able to provide the vital services required to maintain operations.

## IMPACT OF NEW ACCOUNTING STANDARDS

### ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

In June, 1998, the Financial Accounting Standards Board issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities". SFAS No. 133 establishes accounting and reporting standards for derivative instruments and for hedging activities. SFAS No. 133 is effective for fiscal years beginning after June 15, 1999, with earlier adoption permitted.

### INSURANCE RELATED ASSESSMENTS

In December 1997, the AICPA Accounting Standards Executive Committee issued Statement of Position (SOP) 97-3, Accounting by Insurance and Other Enterprises for Insurance-Related Assessments. The accounting guidance of this SOP focuses on the timing of recognition and measurement of liabilities for insurance-related assessments. The SOP is effective for fiscal years beginning after December 15, 1998. The Company believes that they are in compliance with the provisions of this SOP and no impact on the Company's financial reporting is expected.

### COMPUTER SOFTWARE DEVELOPMENT COSTS

On March 4, 1998, the AICPA Accounting Standards Executive Committee issued Statement of Position (SOP) 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use. This SOP requires that certain costs related to the development or purchase of internal-use software be capitalized and amortized over the estimated useful life of the software. This SOP also requires that costs related to the preliminary project stage and the post-implementation/operations stage in an internal-use computer software development project be expensed as incurred. SOP 98-1 is effective for financial statements issued for fiscal years beginning after December 15, 1998. The Company believes that they are in compliance with the provisions of this SOP and no material impact of the Company's financial reporting is expected.



PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

None.

ITEM 2. CHANGES IN SECURITIES.

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

None.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) EX -27 Financial Data Schedule

(b) Reports on 8-K:

No reports on Form 8-K were filed by the Company during the quarter ended Sept. 30, 1999

SIGNATURES

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

DONEGAL GROUP INC.

SEPTEMBER 12, 1999

BY:

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Donald H. Nikolaus, President  
and Chief Executive Officer

SEPTEMBER 12, 1999

BY:

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

9-MOS  
 DEC-31-1999  
 JAN-30-1999  
 SEP-30-1999  
 94,785,484  
 125,111,853  
 124,796,635  
     8,333,115  
         0  
     2,456,224  
     239,789,866  
         2,324,706  
             0  
 11,586,691  
     376,644,453  
     147,748,276  
     101,397,903  
         0  
     15,000,000  
         0  
             0  
         8,484,854  
         90,574,126  
 376,644,453  
     107,879,342  
     9,763,940  
     (67,437)  
     2,124,366  
     75,063,913  
 18,376,000  
     23,105,011  
         11,851  
         (997,372)  
     1,009,223  
         0  
         0  
             0  
         1,009,223  
             .12  
             .12  
         93,863  
     79,261  
     (4,197)  
     23,739  
     49,976  
     95,212  
 (4,197)