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**RECEIVED**  
Corporate & Financial Regulation

October 4, 2013

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## VIA EMAIL AND FEDERAL EXPRESS

**Pennsylvania**  
**Insurance Department**

Stephen J. Johnson, Deputy Insurance Commissioner  
Kimberly A. Rankin, Director, Bureau of Company Licensing and Financial Analysis  
Office of Corporate & Financial Regulation  
Pennsylvania Insurance Department (the "Department")  
1345 Strawberry Square  
Harrisburg, PA 17120

Re: Advance Notice

Dear Mr. Johnson and Ms. Rankin,

Our client Gregory M. Shepard hereby notifies the Department that he is sending the enclosed letter (the "Letter") to the Boards of Directors of Donegal Group Inc. ("DGI") and its affiliate Donegal Mutual Insurance Company for delivery on Monday, October 7.

On behalf of Mr. Shepard, we are sending a copy of the Letter to the Department as an advance notification. Because the Letter contains highly sensitive and confidential information, we request that you not disclose the Letter or information about its contents before Monday, October 7. On that day, Mr. Shepard will also file the Letter in an Amendment to his Schedule 13D with the Securities and Exchange Commission, so the letter will be available at [www.sec.gov](http://www.sec.gov); search under "Donegal Group Inc."

If the Boards of Directors of DGI and Donegal Mutual Insurance Company accept Mr. Shepard's proposal in the Letter, then Mr. Shepard would submit an amended Form A to the Department.

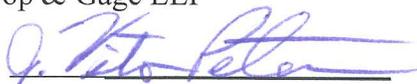
Thank you for your attention to this matter. If you have any questions or require any further information, please do not hesitate to contact the undersigned.

18

Stephen J. Johnson and Kimberly A. Rankin  
October 4, 2013  
Page 2

Very truly yours,

Lathrop & Gage LLP

By:   
J. Victor Peterson, Esq.

Enclosure

Cc (by email): Robert Brackbill  
Jodi Frantz, Esq.

Gregory M. Shepard  
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October 7, 2013

VIA FACSIMILE AND FEDERAL EXPRESS

Board of Directors  
Donegal Group Inc.  
1195 River Road  
Marietta, PA 17547-0302

Board of Directors  
Donegal Mutual Insurance Company  
1195 River Road  
Marietta, PA 17547-0302

Attention: Mr. Donald H. Nikolaus, Chairman, CEO and President

Gentlemen:

As you know, on August 2, 2013, following my tender offer to pay \$30 per share for 962,636 of the outstanding shares of Class B Common Stock ("Class B Shares") of Donegal Group Inc. ("DGI") which expired on July 31, 2013, I proposed an amicable transaction: Subject to due diligence for a period of three weeks for me and my banking institutions and to my obtaining financing on commercially reasonable terms, I would be willing to pay \$22 per share for 3,300,000 Class B Shares from Donegal Mutual.

On August 15, 2013, Donegal Mutual sent me a letter stating they had reviewed my August 2nd proposal and that the Board of Directors was unanimous in determining that it was not in the best interests of Donegal Mutual, its policyholders and other constituencies for Donegal Mutual to enter into the transaction described in my August 2<sup>nd</sup> proposal.

Since August 15, 2013, I have reviewed my options and evaluated the potential interest of strategic acquirers. As a result, today, as an alternative, I propose a revised amicable transaction: Subject to due diligence for a period of three weeks for me and a much larger highly rated mutual property and casualty insurance company, I would be willing to negotiate a price within a range of \$33 - \$37 per share for the 957,136 publicly traded Class B Shares (those not owned by Donegal Mutual or me), and the acquiring mutual would purchase the publicly traded Class A Shares (9,021,350 Class A Shares not owned by Donegal Mutual or me as of July 31, 2013 per your 2<sup>nd</sup> quarter 2013 10Q). I know of two much larger U.S. based mutual property and casualty insurers rated A or higher by A.M. Best who would be strongly interested.

As an incentive, if you elect to do a global transaction with the acquiring mutual, I agree in advance to accept whatever publicly traded Class A per share price you negotiate with the acquiring mutual as the price for both my Class A and Class B Shares. This offer would be subject to all applicable regulatory approvals, which you would not oppose, as this offer would be consensual. Again, I ask the DGI and Donegal Mutual Boards of Directors (the "Boards") to do their fiduciary duty, and establish a committee of independent directors to consider my proposal, and hire truly independent counsel and a financial advisor.

If the Boards accept this proposal, then I would suspend my plans to acquire up to 962,636 Class B Shares in the open market and privately negotiated transactions.

On Friday, October 4, 2013, the last full trading day prior to the initial public announcement of the proposal, the closing sale prices for the Class A Shares and Class B Shares on the NASDAQ Global Select Market were \$14.30 and \$18.56, respectively.

#### **Your September 20, 2013 Investor Presentation**

On September 20, 2013, DGI filed an 8-K with an attached Exhibit 99.1 titled "Pursuing Effective Business Strategy in Regional Insurance Markets—Investor Presentation September 2013" to "Achieve Book Value Growth By Implementing Plan." I have reviewed this presentation numerous times in the past two weeks, and while I appreciate the efforts of your management and employees in increasing net premiums written, completing the 10 acquisitions since 1988, the expansion into additional states/markets, an increased focus on commercial lines, improvements in your technology and agent support to achieve book value

growth. However, I am disappointed to find that your presentation fails to mention one word about the tremendous dilution to the shareholders as a result of the stock options that you have been granting over the last 5 years which is punishing the Class A and Class B stock prices, which after the last stock split in 2006, closed at \$20.22 per Class A Share and \$18.02 per Class B Share 7 years ago at September 30, 2006.

If you look below you will see that during the 5 years between 2007 and 2012 DGI's:

- book value grew by a total of 13.4% or a meager 2.7% per year;
- book value per outstanding shares grew by a total of only 12.2% or 2.4% per year;
- stock options grew by an astounding 181% or 36.2% per year; and
- fully diluted book value grew by a total of only 7.9% or 1.6% per year.

Donegal Group Inc. "DGI", a Delaware business corporation trading on the NASDAQ as "DGICA" and "DGICB" - all figures from DGI SEC documents																
Year	Stockholders		Class A & B		Book		Class A & B		Opt.		Class A & B			Fully Diluted	Book Value	
Ended	Equity	Incr.	Outstanding	Incr.	Value	Incr.	Options	Incr.	Avg.	Exer.	Option	Fully Diluted	Incr.	Stockholders	Per Fully Dil.	
			Shares		Per		Outstanding		Price		Proceeds	Shares		Equity	Shares	Incr.
2007	352,690,191	-	25,333,417	-	13.92	-	2,384,722	-	17.36		41,398,774	27,718,139	-	394,088,965	14.22	-
2008	363,583,865	3.1	25,445,840	0.4	14.29	2.6	3,422,432	43.5	17.98		61,535,327	28,868,272	4.1	425,119,192	14.73	3.6
2009	385,505,699	6.0	25,494,106	0.2	15.12	5.8	3,290,099	-3.9	17.98		59,155,980	28,784,205	-0.3	444,661,679	15.45	4.9
2010	380,102,810	-1.4	25,571,001	0.3	14.86	-1.7	3,998,667	21.5	16.80		67,177,606	29,569,668	2.7	447,280,416	15.13	-2.1
2011	383,451,592	0.9	25,548,216	-0.1	15.01	1.0	5,309,000	32.8	14.18		75,281,620	30,857,216	4.4	458,733,212	14.87	-1.7
2012	400,034,094	4.3	25,601,974	0.2	15.63	4.1	6,700,825	26.2	14.27		95,620,773	32,302,799	4.7	495,654,867	15.34	3.2
2012 v. 2007 Change		13.4		1.1		12.2		181.0					16.5			7.9
2012 v. 2007 Avg.		2.7		0.2		2.4		36.2					3.3			1.6

As a result, all of DGI's achievements over the past 7 years have been negated by the gigantic stock option dilution which isn't mentioned once in your Investor Presentation. DGI has failed to achieve the stated goal in your September 20, 2013 presentation, which is to "Achieve Book Value Growth By Implementing Plan." Because you have failed to deliver an increase in your stock prices over a 7 year period, I urge you to contact me to negotiate a transaction for the benefit of Donegal Mutual and DGI, and their policyholders, shareholders, employees and other constituencies.

I am available to meet with the Boards to explain why I believe such an amicable transaction would be in the best interests of Donegal Mutual and DGI, and their policyholders, shareholders, employees and other constituencies. On behalf of all DGI shareholders, I sincerely hope that you accept my invitation, rather than proceeding with your poorly performing plan to achieve book value growth especially on a fully diluted basis.

Very truly yours,

Gregory M. Shepard