



Donegal Group Inc. (DGICA)

Updated November 6th, 2023, by Patrick Neuwirth

Key Metrics

Current Price:	\$15	5 Year CAGR Estimate:	0.9%	Market Cap:	\$474m
Fair Value Price:	\$9	5 Year Growth Estimate:	5.0%	Ex-Dividend Date:	10/31/23
% Fair Value:	167%	5 Year Valuation Multiple Estimate:	-9.2%	Dividend Payment Date:	11/15/23
Dividend Yield:	4.7%	5 Year Price Target	\$11	Years Of Dividend Growth:	21
Dividend Risk Score:	F	Retirement Suitability Score:	D	Rating:	Sell

Overview & Current Events

Donegal Group Inc. (DGICA) is an insurance holding company that offers commercial and personal lines of property and casualty insurance to businesses and individuals in 24 Mid-Atlantic, Midwestern, New England, Southern, and Southwestern states through approximately 2,300 independent insurance agencies. It operates through three segments: Investment Function, Personal Lines of Insurance, and Commercial Lines of Insurance. Personal Lines products (~62% of 2022 NPW¹) consist primarily of homeowners and private passenger automobile policies. The Commercial Lines products (~38% of 2022 NPW) of its insurance subsidiaries consist primarily of commercial automobile, commercial multi-peril, and workers' compensation policies. The company was founded in 1986 and has 410 employees.

On October 26th, 2023, Donegal Group released its third quarter 2023 results for the period ending September 30th, 2023. For the quarter, the company reported a net loss of \$0.8 million compared to a net loss of \$10.4 million for the same year-ago quarter. Reported earnings per diluted share for the same periods were -\$0.02 and -\$0.33, respectively. Commercial lines underwriting results for the quarter improved due to fewer large commercial property fire losses, but personal lines faced higher weather-related losses. The company enhanced its product offerings and agency portal across 22 states and began non-renewing policies in Georgia and Alabama. It also increased renewal premiums and made other underwriting adjustments to improve profitability. Despite these changes, retention rates remained high. Premium rate increases are expected to continue into 2024 to achieve rate adequacy in the personal lines segment. Net premiums earnings for the quarter were \$219.2 million compared to \$206 million, an increase of 6.3% from the same quarter last year. The loss ratio increased to 69.8%, compared to 75.6% for the same quarter last year. Weather-related losses of \$25.7 million, or 11.5 percentage points of the loss ratio, for the third quarter of 2023, increased from \$19.4 million, or 9.4 percentage points of the loss ratio, compared to year-ago quarter. The insurance industry is facing challenges due to increased loss cost inflation. To address this, the company has intentionally slowed new business growth in personal lines due to rising costs of automobile and property repairs. Despite this, personal lines premium growth was 17.7%, driven by rating actions and average renewal rate increases of 13.6%. The company remains cautious of the current economic environment and inflation's ongoing impact and expect to generate additional premium growth in their commercial lines segment with the deployment of new products via their modernized operating platform.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	\$1.00	\$0.54	\$0.75	\$1.10	\$0.30	-\$1.00	\$1.01	\$1.76	\$0.66	\$0.20	\$0.50	\$0.64
DPS	\$0.51	\$0.52	\$0.54	\$0.55	\$0.56	\$0.57	\$0.58	\$0.60	\$0.63	\$0.66	\$0.68	\$0.79
Shares²	26	27	28	27	27	28	29	29	31	31	33	33

The company has not been able to grow earnings over the past decade (-16.4%) nor over the past five years. The \$0.20 earnings per share for last year is expected to be a trough, followed by a rebound to \$0.50. We expect earnings to be volatile and grow on average by 5% per year for the next five years. The company has been able to increase its dividend for an impressive 21 consecutive years. The annual dividend grew from \$0.49 in 2012 to the most recent full-year

¹ Net Premiums Written

² In millions.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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payment of \$0.68. This means an average annual dividend growth rate of 3.0%. In April 2023, the company increased its quarterly dividend by 3.0% from \$0.165 to \$0.17 per share.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Avg. P/E	17.7	21.3	16.4	17.0	30.0	-	24.8	7.7	12.3	16.0	29.1	18.0
Avg. Yld.	1.9%	3.3%	3.8%	3.1%	3.2%	4.2%	3.9%	4.2%	4.4%	4.4%	4.7%	6.9%

During the past decade, shares of Donegal Group have traded with an average price-to-earnings ratio of about 18.1 and today, it stands at around 29.1. We are using 18 times earnings as a fair value baseline, implying the potential for a valuation headwind. The company's dividend yield is currently 4.7%, which is well above the average yield over the past decade of 3.8%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	51%	96%	72%	50%	187%	-57%	57%	34%	95%	328%	136%	124%

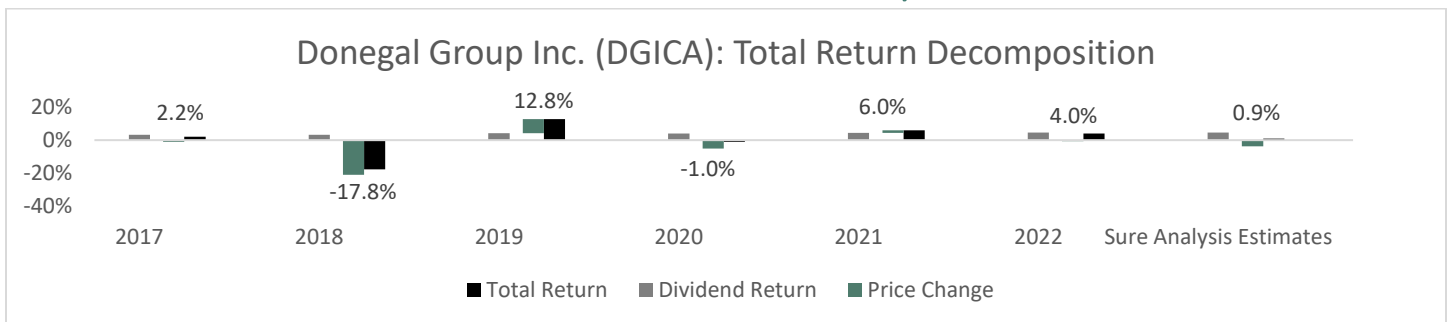
During the past five years, the company's dividend payout ratio has averaged around 91%. Donegal's was not covered by earnings in 2022. It's important to note that Donegal Group's earnings per share has basically not grown from where it was five years ago, which could mean that the payout ratio will increase further if the company maintains its dividend growth policy. The current payout ratio levels are not considered to be safe and sustainable. However, the expectation is that the earnings per share and payout ratio will return to normal levels in the coming years.

Donegal Group is primarily a conservative multi-line insurance company with a price-to-book multiple of 0.96 compared to a peer average of 2.08 which is a positive. The company's strategy is to shift the product mix towards a higher proportion of commercial business, which is expected to provide higher returns along with the opportunity for growth. The insurance underwriting business is only profitable with a combined ratio below 100. Donegal's combined ratio is a concern since it is at a significantly higher level, which has been bringing underwriting losses to the company. The latest reported combined ratio is 104.5%, largely due to weather-related and fire-loss activity. Furthermore, it should be noted that despite significant volatility in earnings-per-share, the stock price has been hovering around an average of \$14.50.

Final Thoughts & Recommendation

Donegal Group is an established regional insurance group with a diverse book of business including both commercial and personal lines. Investors could be attracted to the stock based on its dividend growth track record and above-average dividend yield of 4.7%. We expect earnings to be volatile, however. The dividend growth rate has outpaced the earning growth rate, which has resulted in an unsafe payout ratio in our opinion. We estimate total return potential of 0.9% per year for the next five years based on the earnings-per-share rebounding from the 2022 dip and the dividend yield, offset by a valuation headwind. Shares earn a sell rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	544	585	635	687	737	769	812	778	816	848
D&A Exp.	3	4	7	7	6	7	6	7	6	5
Net Profit	26	15	21	31	7	(33)	47	53	25	(2)
Net Margin	4.8%	2.5%	3.3%	4.5%	1.0%	-4.3%	5.8%	6.8%	3.1%	-0.2%
Free Cash Flow	45	42	68	60	80	64	76	101	77	67
Income Tax	6	2	7	11	5	(15)	10	10	5	(1.7)

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	1,385	1,459	1,538	1,623	1,738	1,832	1,923	2,161	2,255	2,243
Cash & Equivalents	28	36	28	25	38	53	49	103	58	25
Goodwill & Int.	7	7	7	7	7	7	7	7	7	7
Total Liabilities	989	1,043	1,129	1,185	1,289	1,433	1,472	1,643	1,724	1,760
Long-Term Debt	63	59	86	74	64	65	40	90	35	35
Total Equity	397	416	408	439	449	399	451	518	531	484
LTD/E Ratio	0.16	0.14	0.21	0.17	0.14	0.16	0.09	0.17	0.07	0.07

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	1.9%	1.0%	1.4%	1.9%	0.4%	-1.8%	2.5%	2.6%	1.1%	(0.1%)
Return on Equity	6.6%	3.6%	5.1%	7.3%	1.6%	-7.7%	11.1%	10.9%	4.8%	(0.4%)
ROIC	5.6%	3.1%	4.3%	6.1%	1.4%	-6.7%	9.9%	9.6%	4.3%	(0.4%)
Shares Out.	26	27	28	27	27	28	29	29	31	32
Revenue/Share	20.66	21.56	22.71	25.36	26.13	27.20	28.23	26.40	26.24	26.50
FCF/Share	1.70	1.56	2.43	2.20	2.83	2.25	2.65	3.43	2.47	2.10

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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