



Donegal Group Inc. (DGICA)

Updated May 12th, 2024, by Patrick Neuwirth

Key Metrics

Current Price:	\$13.29	5 Year CAGR Estimate:	5.7%	Market Cap:	\$432 M
Fair Value Price:	\$10.80	5 Year Growth Estimate:	5.0%	Ex-Dividend Date¹:	07/29/24
% Fair Value:	123%	5 Year Valuation Multiple Estimate:	-4.1%	Dividend Payment Date¹:	08/15/24
Dividend Yield:	5.2%	5 Year Price Target	\$14	Years Of Dividend Growth:	22
Dividend Risk Score:	D	Retirement Suitability Score:	B	Rating:	Hold

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 (~59% of 2023 NPW²) consist primarily of homeowners and private passenger automobile policies. The Commercial Lines products (~41% of 2023 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 April 25th, 2024, Donegal Group released its first quarter results for the period ending March 31st, 2024. For the quarter, the company reported net income of \$6.0 million compared to a net income of \$5.2 million for the same quarter in the previous year. Reported earnings per diluted share were \$0.18, up from \$0.16. The improvement in commercial lines underwriting results was partly offset by an increase in severity of large fire losses and atypical workers' compensation reserve development related to prior-year losses. The company continued its strategic initiatives including enhancing underwriting performance and modernizing operations to increase effectiveness and efficiency. Net premiums earned for the quarter increased to \$227.7 million, up 5.8% from the previous year. The loss ratio for the quarter deteriorated slightly to 66.3%, compared to 64.2% for the same quarter last year, influenced by higher severity of large fire losses and ongoing inflationary impacts on loss costs, particularly in personal lines. Despite the challenging environment, personal lines saw robust growth, driven by ongoing renewal premium increases and strong policy retention. For 2024, management is focused on a multi-year expense management initiative designed to mitigate peak impacts of allocated expenses from technological improvements, and anticipates these efforts will result in improved underwriting results as the year progresses. They remain committed to strategic rate increases to ensure continued profitability in both commercial and personal lines.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	\$0.54	\$0.75	\$1.10	\$0.30	-\$1.00	\$1.01	\$1.76	\$0.66	\$0.20	\$0.06	\$0.60	\$0.77
DPS	\$0.52	\$0.54	\$0.55	\$0.56	\$0.57	\$0.58	\$0.60	\$0.63	\$0.66	\$0.68	\$0.69	\$0.80
Shares³	27	28	27	27	28	29	29	31	31	31	33	33

The company has not been able to grow earnings over the past decade (-21.7% per year) nor over the past five years (-9.9% per year). The \$0.06 earnings-per-share in 2023 is expected to be a trough, followed by a rebound to \$0.60 this year. 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 22 consecutive years. The annual dividend grew 2.7% per year over the last decade. In April 2024, the company increased its quarterly dividend by 1.5% from \$0.17 to \$0.1725 per share.

¹ Estimated date

² Net Premiums Written

³ 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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Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	21.3	16.4	17.0	30.0	-	24.8	7.7	12.3	16.0	29.1	22.2	18.0
Avg. Yld.	1.9%	3.8%	3.1%	3.2%	4.2%	3.9%	4.2%	4.4%	4.4%	4.7%	5.2%	5.8%

During the past decade, shares of Donegal Group have traded with an average price-to-earnings ratio of about 19.4 and today, it stands at around 22.2. 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 5.2%, which is well above the average yield over the past decade of 3.9%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	96%	72%	50%	187%	-57%	57%	34%	95%	328%	1133%	115%	104%

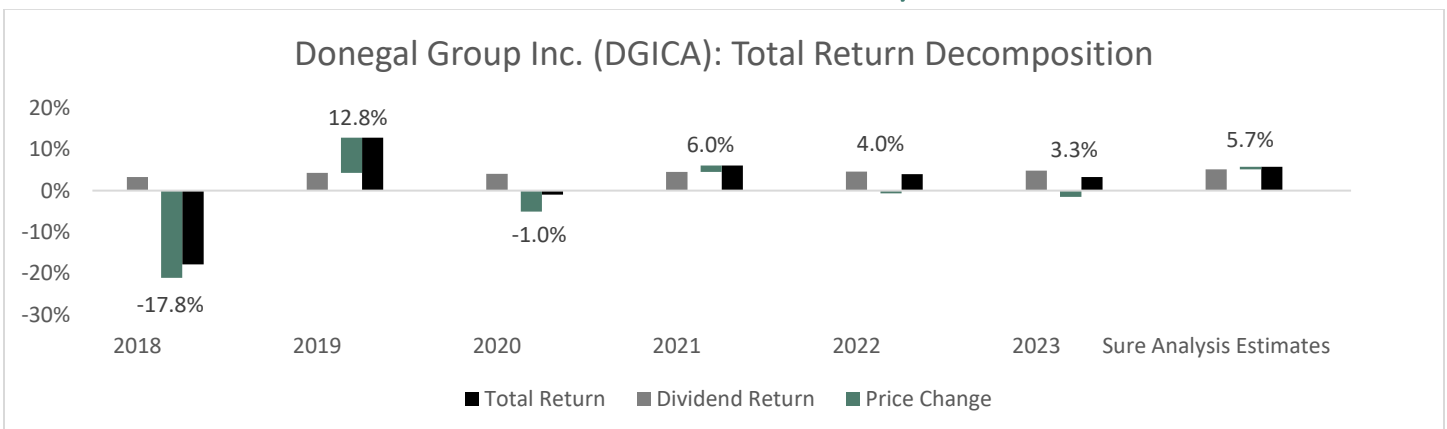
During the past five years, the company's dividend payout ratio has averaged around 330%. Donegal's dividend was not covered by earnings in 2022 or 2023. It's important to note that Donegal Group's earnings per share has not grown from where it was five years ago, which could mean that the payout ratio 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 earnings per share and payout ratio will return to normal levels from 2025 onwards.

Donegal Group is primarily a conservative multi-line insurance company with a price-to-book multiple of 0.97 compared to a peer average of 2.07 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 102.4%, 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 hovered in the range of \$13 to \$15.

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 4.9%. 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 5.7% per year for the next five years based on the earnings-per-share rebounding from the 2023 dip and the dividend yield, offset by a valuation headwind. Shares earn a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	585	635	687	737	769	812	778	816	848	927
D&A Exp.	4	7	7	6	7	6	7	6	5	4.3
Net Profit	15	21	31	7	(33)	47	53	25	(2)	4.4
Net Margin	2.5%	3.3%	4.5%	1.0%	-4.3%	5.8%	6.8%	3.1%	-0.2%	0.5%
Free Cash Flow	42	68	60	80	64	76	101	77	67	29
Income Tax	2	7	11	5	(15)	10	10	5	(1.7)	0.6

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	1,459	1,538	1,623	1,738	1,832	1,923	2,161	2,255	2,243	2,266
Cash & Equivalents	36	28	25	38	53	49	103	58	25	24
Goodwill & Int.	7	7	7	7	7	7	7	7	7	6.6
Total Liabilities	1,043	1,129	1,185	1,289	1,433	1,472	1,643	1,724	1,760	1,787
Long-Term Debt	59	86	74	64	65	40	90	35	35	35
Total Equity	416	408	439	449	399	451	518	531	484	480
LTD/E Ratio	0.14	0.21	0.17	0.14	0.16	0.09	0.17	0.07	0.07	0.07

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	1.0%	1.4%	1.9%	0.4%	-1.8%	2.5%	2.6%	1.1%	(0.1%)	0.2%
Return on Equity	3.6%	5.1%	7.3%	1.6%	-7.7%	11.1%	10.9%	4.8%	(0.4%)	0.9%
ROIC	3.1%	4.3%	6.1%	1.4%	-6.7%	9.9%	9.6%	4.3%	(0.4%)	0.9%
Shares Out.	27	28	27	27	28	29	29	31	32	33.1
Revenue/Share	21.56	22.71	25.36	26.13	27.20	28.23	26.40	26.24	26.50	27.98
FCF/Share	1.56	2.43	2.20	2.83	2.25	2.65	3.43	2.47	2.10	0.86

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

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