PENN AMERICA GROUP INC
Form 10-Q
November 13, 2002

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

(x) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 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 0-22316

Penn-America Group, Inc.
(Exact name of registrant as specified in its charter)

Pennsylvania	23-2731409
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

420 South York Road, Hatboro, Pennsylvania 19040
(Address of principal executive offices, including zip code)

(215) 443-3600
(Registrant's telephone number, including area code)

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 other 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 ____ .

At November 11, 2002, 11,579,598 shares of the registrant's common stock, $.01 par value, were outstanding.

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Explanatory Note

Penn-America Group, Inc. ("PAGI" or the "Company") has recently resolved various accounting and disclosure comments from the Securities and Exchange Commission ("SEC") in conjunction with the Company's registration statement filing relating to the issuance of additional shares of common stock. One of the comments addressed the timing of recording other-than-temporary ("OTT") declines in the market value of certain equity securities. The Company agreed to amend its accounting policy and record OTT write-downs on these securities for the periods ending December 31, 2001, 2000 and 1999. This restatement affects net income for each of these periods but has no effect on total stockholders' equity since the unrealized loss on these securities was already recorded in Accumulated Other Income (Loss) in the Consolidated Balance Sheets and Statements of Stockholders' Equity. The Company has restated its financial statements for the affected periods and has filed such restatements on Form 10-K/A for the year ended December 31, 2001. For further information, see Note 1 to Notes to the Unaudited Consolidated Financial Statements.

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES
Consolidated Balance Sheets

(In thousands, except per share data)

	Sept

ASSETS	(Un
Investments:	
Fixed maturities:	
Available for sale, at fair value (amortized cost 2002, $166,938; 2001, $130,976)	$
Held to maturity, at amortized cost (fair value 2002, $2,034; 2001, $15,317)	
Equity securities, at fair value (cost 2002, $22,177; 2001, $24,720)	

Total investments	
Cash	
Accrued investment income	
Premiums receivable	
Reinsurance recoverable	
Prepaid reinsurance premiums	
Deferred policy acquisition costs	
Capital lease, affiliate	

Deferred income taxes	
Income tax recoverable	
Other assets	
Total assets	$
LIABILITIES AND STOCKHOLDERS' EQUITY	
Liabilities:	
Unpaid losses and loss adjustment expenses	$
Unearned premiums	
Accounts payable and accrued expenses	
Capitalized lease obligation, affiliate	
Income tax payable	
Other liabilities	
Total liabilities	
Stockholders' equity:	
Preferred stock, $.01 par value; authorized 2,000,000 shares; None issued	
Common stock, $.01 par value; authorized 20,000,000 shares; issued 2002 and 2001, 15,335,223 and 15,228,351 shares, respectively; outstanding 2002 and 2001, 11,585,223 and 11,478,351 shares, respectively	
Additional paid-in capital	
Accumulated other comprehensive income	
Retained earnings	
Treasury stock, 3,750,000 shares at cost	
Officers' stock loans	
Unearned compensation from restricted stock awards	
Total stockholders' equity	
Total liabilities and stockholders' equity	$

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES
Consolidated Statements of Operations
(Unaudited)

For the three and nine months ended September 30, 2002 and 2001
(In thousands, except per share data)

	Three months ended September 30,		
	2002	2001	
Revenues			
Premiums earned	$ 30,705	$ 20,946	$
Net investment income	3,038	2,851	

Net realized investment gain (loss)	1,172	40	
Total revenues	34,915	23,837	
Losses and expenses			
Losses and loss adjustment expenses	20,799	14,553	
Amortization of deferred policy acquisition costs	7,527	4,957	
Other underwriting expenses	2,209	2,028	
Corporate expenses	118	141	
Interest expense	35	40	
Total losses and expenses	30,688	21,719	
Income before income tax	4,227	2,118	
Income tax expense	1,330	567	
Net income	$ 2,897	$ 1,551	$
Net income per share			
Basic	$ 0.25	$ 0.14	$
Diluted	$ 0.25	$ 0.13	$
Weighted average shares outstanding			
Basic	11,585,043	11,437,697	
Diluted	11,775,916	11,532,284	
Cash dividends per share	$ 0.03875	$ 0.035	$

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES

Consolidated Statement of Stockholders' Equity
(Unaudited)

For the nine months ended September 30, 2002
(In thousands, except per share data)

	Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Income
Balance at December 31, 2001 (Restated)	$152	$ 70,735	$ 3,106

Net income	--	--	--
Other comprehensive income:			
net unrealized gain on investments, net of tax and reclassification adjustment	--	--	3,739
Comprehensive income			
Issuance of common stock	1	788	--
Unearned compensation from restricted stock awards issued	--	--	--
Amortization of compensation expense from restricted stock awards issued	--	--	--
Cash dividends paid ($0.11583 per share)	--	--	--
Balance at September 30, 2002	$153	$ 71,523	$ 6,845

	Officers' Stock Loans	Unearned Compensation From Restricted Stock Awards	Total Stockholders' Equity
Balance at December 31, 2001 (Restated)	$ (629)	$ (132)	$ 80,391
Net income	--	--	6,565
Other comprehensive income:			
net unrealized gain on investments, net of tax and reclassification adjustment	--	--	3,739
Comprehensive income			10,304
Issuance of common stock	--	--	789
Unearned compensation from restricted stock awards issued	--	(155)	(155)
Amortization of compensation expense from restricted stock awards issued	--	77	77
Cash dividends paid ($0.11583 per share)	--	--	(1,340)
Balance at September 30, 2002	$ (629)	$ (210)	$ 90,066

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(Unaudited)

For the nine months ended September 30, 2002 and 2001
(In thousands)

	Nine mon
	2002
Cash flows from operating activities:	
Net income	$ 6,565
Adjustments to reconcile net income to net cash provided by operating activities:	
Net (accretion)/amortization and depreciation expense	(100
Net realized investment loss	173
Deferred income tax	(575
Net increase (decrease) in premiums receivable, prepaid reinsurance premiums and unearned premiums	18,698
Net increase in unpaid losses and loss adjustment expenses and reinsurance recoverable	10,934
Accrued investment income	82
Deferred policy acquisition costs	(4,157
Income tax recoverable/payable	461
Other assets	(29
Accounts payable and accrued expenses	3,348
Other liabilities	590
Net cash provided by operating activities	35,990
Cash flows from investing activities:	
Purchases of equity securities	(1,500
Purchases of fixed maturities available for sale	(69,372
Proceeds from sales of equity securities	1,494
Proceeds from sales and maturities of fixed maturities available for sale	35,924
Proceeds from maturities and calls of fixed maturities held to maturity	13,130
Net cash used by investing activities	(20,324
Cash flows from financing activities:	
Issuance of common stock	300
Officers' stock loans	--
Principal payments on capital lease obligations, affiliate	(106
Dividends paid	(1,340
Net cash used by financing activities	(1,146
Decrease in cash	14,520
Cash, beginning of period	13,129
Cash, end of period	$27,649

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PENN-AMERICA GROUP, INC. AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements

Note 1 - Organization and Basis of Presentation

Penn-America Group, Inc. ("PAGI") is an insurance holding company. Approximately 40% of the outstanding common stock of PAGI was owned by Penn Independent Corporation ("Penn Independent") at September 30, 2002. The accompanying financial statements include the accounts of PAGI and its wholly owned subsidiary, Penn-America Insurance Company ("Penn-America") and its wholly owned subsidiary, Penn-Star Insurance Company ("Penn-Star"), (collectively the "Company").

The Company markets and underwrites general liability, commercial property and multi-peril insurance for small businesses located primarily in small towns and suburban and rural areas. The Company can write business in all fifty states and the District of Columbia on both an admitted and non-admitted basis.

The accompanying interim condensed unaudited consolidated financial statements and notes have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal and recurring adjustments) considered necessary for a fair presentation of results for the interim periods have been included. All significant intercompany accounts and transactions have been eliminated in consolidation. It is suggested that these interim condensed unaudited consolidated financial statements and related notes be read in conjunction with the financial statements and related notes in the Company's Form 10-K/A for the year ended December 31, 2001. The Company's results of operations for interim periods are not necessarily indicative of the results to be expected for the entire year.

In conjunction with the Company's registration statement filing relating to the issuance of additional shares of common stock, the Company has resolved various accounting and disclosure comments from the Securities and Exchange Commission ("SEC"). One of the comments addressed related to the timing of the recording of other than temporary ("OTT") declines in the market value of certain equity securities. The Company agreed to amend its accounting policy and record OTT write-downs on these securities for the periods ending December 31, 2001, 2000 and 1999. This restatement affects net income for each of these periods but has no effect on aggregate stockholders' equity since the unrealized loss on these securities was already recorded in Accumulated Other Income (Loss) in the Consolidated Balance Sheets and Statements of Stockholders' Equity. This restatement resulted in an increase to accumulated other comprehensive income of $2,014,000 and decrease to retained earnings of the same amount as of December 31, 2001.

The table below shows a comparison of previously reported and restated total revenues, net income and net income per share (basic and diluted) for the periods affected.

(in thousands except per share data)	For the years ended, December 31, 2001 As Reported	December 31, 2001 As Restated	December 31, 2000 As Reported	December 31, 2000 As Restated
Total revenues	$99,718	$99,095	$100,572	$99,095
Net income (loss)	5,351	4,940	(3,856)	(4,831)
Net income (loss) per share				
Basic	0.47	0.43	(0.33)	(0.42)
Diluted	0.47	0.43	(0.33)	(0.42)

The restatement had no effect on net income for the three and nine months ended September 30, 2001. The effect of this restatement is reflected in the Consolidated Balance Sheets and Consolidated Statement of Stockholders' Equity for balances at December 31, 2001.

Note 2 - Reinsurance

Premiums earned are presented net of amounts ceded to reinsurers of $5.1 million and $2.8 million for the three months ended September 30, 2002 and 2001, respectively. Losses and loss adjustment expenses are presented net of amounts ceded to reinsurers of $3.2 million and $1.1 million for the three months ended September 30, 2002 and 2001, respectively.

Premiums earned are net of amounts ceded to reinsurers of $12.3 million and $8.8 million for the nine months ended September 30, 2002 and 2001, respectively. Losses and loss adjustment expenses are net of amounts ceded to reinsurers of $6.0 million and $4.5 million for the nine months ended September 30, 2002 and 2001, respectively.

Note 3 - Comprehensive Income

Accumulated other comprehensive income consists solely of unrealized gains or losses on investment securities net of applicable income tax expense or benefit and reclassification adjustments. Comprehensive income was $5.2 million for the three months ended September 30, 2002 compared with $3.6 million for the three months ended September 30, 2001. Comprehensive income was $10.3 million and $6.0 million for the nine months ended September 30, 2002 and 2001, respectively.

Note 4 - Income Per Share

Income per share for the three and nine months ended September 30, 2002 and 2001 is computed by dividing net income by the basic and diluted weighted average number of common shares outstanding during the respective periods. The following table is a reconciliation of the numerators and denominators of the basic and diluted income per share computations:

(in thousands, except per share data)	Three months ended September 30,	
	2002	2001
Basic per share computation:		
Net income	$ 2,897	$ 1,551
Weighted average common shares (1)	11,585,043	11,437,697
Basic net income per share (1)	$ 0.25	$ 0.14
Diluted per share computation:		
Net income	$ 2,897	$ 1,551
Weighted average common shares (1)	11,585,043	11,437,697
Additional shares outstanding after the assumed assumed exercise of stock options by applying the treasury stock method (1)	190,873	94,587
Total shares (1)	11,775,916	11,532,284
Diluted net income per share (1)	$ 0.25	$ 0.13

Note 5 - Retroactive Adjustment for Stock Split

The common stock issued and outstanding and treasury stock at December 31, 2001 have been restated to reflect the three-for-two stock split announced on April 11, 2002 and distributed on May 9, 2002. Accordingly, the balance sheet values for common stock and additional paid-in capital have been adjusted for the effect of the stock split. This adjustment resulted in a $51,000 increase in common stock and a $51,000 decrease in additional paid-in capital. The following table illustrates share information on a pre stock split and a post stock split basis as of December 31, 2001:

	Pre Stock Split Basis	Post Stock Split Basis
Common stock issued	10,152,234	15,228,351
Common stock outstanding	7,652,234	11,478,351
Treasury stock	2,500,000	3,750,000

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements (continued)

Note 6- Segment Information

The Company had two reportable segments: non-standard personal automobile and commercial lines. These segments were managed separately because they had different customers, pricing and expense structures. The Company exited the non-standard personal automobile business in 1999 and announced that it would run-off its remaining portfolio of such business. The Company will continue to report on this segment separately until the amounts relating to the non-standard personal automobile business become immaterial to the financial statements presented. The Company does not allocate assets between segments because assets are reviewed in total by management for decision-making purposes.

The accounting policies of the segments are the same as those more fully described in the summary of significant accounting policies in Note 1 of the Company's 2001 Form 10-K/A. The Company evaluates segment results based on profit or loss from operating activities. Segment profits or losses from operations are pre-tax and do not include unallocated expenses but do include investment income attributable to insurance transactions. Segment profit or loss therefore excludes federal income taxes, unallocated expenses and investment income attributable to equity.

The following is a summary of the Company's segment revenues, expenses and profit:

(in thousands)	Three months en	
	Commercial	Pe

	Aut
Premiums earned	$ 30,705
Net investment income and net realized investment loss	
loss from insurance operations	2,227
Total segment revenues	32,932
Segment losses and loss adjustment expenses	20,799
Segment expenses	8,225
Total segment expenses	29,024
Segment income	$ 3,908
Plus unallocated items:	
Net investment income from equity	
Unallocated expenses	
Income tax expense	
Net income	

$

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements
(continued)

(in thousands)	Three months ended September 30,	
	Commercial	Personal Automobile
Premiums earned	$ 20,946	$ --
Net investment income and net realized investment		

loss from insurance operations	1,926	85
Total segment revenues	22,872	85
Segment losses and loss adjustment expenses	14,553	--
Segment expenses	5,731	5
Total segment expenses	20,284	5
Segment income	$ 2,588	$ 80
Plus unallocated items:		
Net investment income from equity		
Unallocated expenses		
Income tax expense		
Net income		

Total segment revenue of $32,932,000 and $22,957,000 plus unallocated net investment income from equity of $1,983,000 and $880,000 equals total Company revenues of $34,915,000 and $23,837,000 for the three months ended September 30, 2002 and 2001, respectively.

The following is a summary of the Company's segment revenues, expenses and profit:

(in thousands)	Nine months ended Septembe	
	Commercial	Personal Automobi
Premiums earned	$80,922	$ --
Net investment income and net realized investment loss from insurance operations	4,666	--
Total segment revenues	85,588	--
Segment losses and loss adjustment expenses	53,449	--
Segment expenses	22,459	--
Total segment expenses	75,908	--
Segment income	$ 9,680	$ --
Plus unallocated items:		
Net investment income from equity		
Unallocated expenses		
Income tax expense		
Net income		

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements
(continued)

(in thousands)	Nine months ended September	
	Commercial	Personal Automobile
Premiums earned	$66,172	$ 22
Net investment income and net realized investment loss from insurance operations	5,360	240
Total segment revenues	71,532	262
Segment losses and loss adjustment expenses	48,233	(1,493)
Segment expenses	18,880	15
Total segment expenses	67,113	(1,478)
Segment income	$ 4,419	$ 1,740
Plus unallocated items:		
Net investment income from equity		
Unallocated expenses		
Income tax expense		
Net income		

Total segment revenue of $85,588,000 and $71,794,000 plus unallocated net investment income from equity of $3,957,000 and $2,724,000 equals total Company revenues of $89,545,000 and $74,518,000 for the nine months ended September 30, 2002 and 2001, respectively.

Note 7- Capital Offerings

On June 27, 2002, PAGI filed a registration statement with the Securities and Exchange Commission relating to a proposed offering of 4,000,000 shares of its common stock. Until the registration statement is effective, these securities may not be sold nor may offers to buy be accepted.

On October 27, 2002, the Company signed a non-binding letter of intent to issue approximately $15 million of trust preferred securities by a business trust subsidiary to be established by the Company.

The intended use of the net proceeds of these offerings are to support the Company's operations, including contributing capital to the insurance subsidiaries and capitalizing new insurance subsidiaries to support the growth in business, and for working capital and other general corporate expenses.

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES

Management's Discussion and Analysis of Financial
Condition and Results of Operations

Results of Operations

Three Months Ended September 30, 2002 and 2001

Premiums earned were $30.7 million for the three months ended September 30, 2002 compared to $20.9 million for the three months ended September 30, 2001. The Company previously announced that it was exiting both commercial automobile and non-standard personal automobile lines of business. Premiums earned for these exited lines of business decreased to $13,000 for the three months ended September 30, 2002 compared to $812,000 for the three months ended September 30, 2001. The Company's core commercial lines premiums earned (excluding exited lines of business) increased $10.6 million, or 52.4%, attributable to the increase in net written premiums for the three months ended September 30, 2002 as compared to the same period of 2001.

Gross written premiums increased 82.9% for the three months ended September 30, 2002 to $43.1 million compared to $23.6 million for the three months ended September 30, 2001. This increase was attributable to rate increases, strong growth in new business and higher average exposures per policy.

Ceded written premiums, the portion of gross written premiums reinsured by other unaffiliated insurers, increased to $6.6 million for the three months ended September 30, 2002 compared to $2.5 million for the three months ended September 30, 2001. The increase in ceded written premiums was primarily due to growth in gross written premiums, and approximately a 50% increase in reinsurance rates on the Company's multiple-line excess of loss reinsurance treaty.

Net written premiums which are gross written premiums less ceded written premiums, increased 73.3% for the three months ended September 30, 2002 to $36.5 million compared to $21.1 million for the three months ended September 30, 2001. The increase in net written premiums was consistent with the increase in gross written premiums, but was partially offset by higher reinsurance costs.

Net investment income increased to $3.0 million for the three months ended September 30, 2002 compared to $2.9 million for the same period last year, primarily due to growth in average invested assets, which was partially offset by a lower average investment yield on the Company's fixed-income investments and lower interest rates on the Company's overnight cash balances.

Net realized investment gain was $1.2 million for the three months ended September 30, 2002 compared to $40,000 from the three months ended September 30, 2001. The net realized gain for the three months ended September 30, 2002 consists of $2.3 million in net realized gain recognized on the sale of certain of the Company's fixed-income investments, partially offset by a $1.1 million other-than-temporary impairment write-down on certain of the Company's common stocks.

Losses and loss adjustment expenses increased 42.9% to $20.8 million for the three months ended September 30, 2002 from $14.6 million for the three months ended September 30, 2001. The loss ratio for the three months ended September 30, 2002 was 67.7 compared to 69.5 for the three months ended September 30, 2001. The loss ratio is calculated by dividing losses and loss adjustment expenses by premiums earned. The improvement in the loss ratio was primarily attributable to rate increases implemented in 2001 and 2002 and exiting of the commercial automobile line of business, partially offset by an increase in the severity of property claims.

Amortization of deferred policy acquisition costs ("ADAC") increased 51.8% to $7.5 million for the three months ended September 30, 2002 from $5.0 million for the three months ended September 30, 2001 primarily due to the growth in premiums earned.

Other underwriting expenses increased 8.9% to $2.2 million for the three months ended September 30, 2002 from $2.0 million for the three months ended September 30, 2001. This increase is mainly attributable to increases in salary and benefit expenses associated with the hiring of additional underwriting and marketing personnel.

The overall GAAP combined ratio, which is the sum of the loss and expense ratios, decreased to 99.4 for the three months ended September 30, 2002 from 102.8 for the three months ended September 30, 2001. This improvement was primarily due to the decrease in the loss ratio to 67.7 in 2002 compared to 69.5 in 2001. The expense ratio decreased to 31.7 for the three months ended September 30, 2002 from 33.3 for the three months ended September 30, 2001. The expense ratio is calculated by dividing the sum of ADAC and other underwriting expenses by premiums earned. The GAAP combined ratio is a standard measure of underwriting profitability used throughout the property and casualty insurance industry. A ratio below 100.0 generally indicates profitable underwriting results.

The factors described above resulted in net income for the three months ended September 30, 2002 of $2.9 million or $0.25 per share (basic and diluted) compared to net income of $1.6 million or $0.14 per basic and $0.13 per diluted share for the three months ended September 30, 2001.

Nine Months Ended September 30, 2002 and 2001

Premiums earned were $80.9 million for the nine months ended September 30, 2002 compared to $66.2 million for the nine months ended September 30, 2001. The Company previously announced that it was exiting both commercial automobile and non-standard personal automobile lines of business. Premiums earned for these exited lines of business decreased to $26,000 for the nine months ended September 30, 2002 compared to $4.4 million for the nine months ended September 30, 2001. The Company's core commercial lines premiums earned (excluding exited lines of business) increased $19.1 million, or 31.0%, attributable to the increase in net written premiums for the nine months ended September 30, 2002 as compared to the same period of 2001.

Gross written premiums increased 66.8% for the nine months ended September 30, 2002 to $118.4 million compared to $71.0 million for the nine months ended September 30, 2001. This increase was attributable to rate increases, strong growth in new business and higher average exposures per policy.

Ceded written premiums, the portion of gross written premiums reinsured by other unaffiliated insurers, increased to $16.8 million for the nine months ended September 30, 2002 compared to $8.0 million for the nine months ended September 30, 2001. The increase in ceded written premiums was primarily due to growth in gross written premiums, and approximately a 42% increase in reinsurance rates on the Company's multiple-line excess of loss reinsurance treaty.

Net written premiums, which are gross written premiums less ceded premiums, increased 61.3% for the nine months ended September 30, 2002 to $101.6 million compared to $63.0 million for the nine months ended September 30, 2001. The increase in net written premiums was consistent with the increase in gross written premiums, but was partially offset by higher reinsurance costs.

Net investment income increased to $8.8 million for the nine months ended September 30, 2002 compared to $8.5 million for the same period last year, primarily due to growth in the average invested assets, which was partially offset by a lower average investment yield on the Company's fixed-income securities and lower interest rates on the Company's overnight cash balances.

Net realized investment loss was $0.2 for the nine months ended September 30, 2002 and 2001. The net realized loss for the current period consists of a $2.1 million other-than-temporary write-down on certain of the Company's preferred and common stocks, along with a loss on the sale of certain of the Company's common stocks of $0.3 million. This loss was partially offset by $2.3 million in net realized gains on the sale of certain of the Company's fixed-income investments.

Losses and loss adjustment expenses increased 14.4% to $53.4 million for the nine months ended September 30, 2002 from $46.7 million for the nine months ended September 30, 2001. The loss ratio for the nine months ended September 30, 2002 was 66.1 compared to 70.6 for the nine months ended September 30, 2001. This improvement is attributable to rate increases implemented in 2001 and 2002 and exiting of the commercial automobile line of business, primarily offset by an increase in the severity of property claims.

Amortization of deferred policy acquisition costs ("ADAC") increased 18.0% to $20.3 million for the nine months ended September 30, 2002 from $17.2 million for the nine months ended September 30, 2001 primarily due to the growth in premiums earned. This increase was partially offset by a decline in the ratio of ADAC to premiums earned of 25.1 for the nine months ended September 30, 2002 compared to 26.0 for the nine months ended September 30, 2001. The improvement in this ratio was attributable to the Company writing a larger portion of its business on a non-admitted basis, which is not subject to premium tax expense and has a lower overall commission rate.

Other underwriting expenses increased 15.0% to $6.0 million for the nine months ended September 30, 2002 from $5.2 million for the nine months ended September 30, 2001. This increase is mainly attributable to increases in salary and benefit expenses associated with the hiring of additional underwriting and marketing personnel.

The overall GAAP combined ratio for the Company decreased to 98.6 for the nine months ended September 30, 2002, from 104.5 for the nine months ended September 30, 2001, primarily due to the decrease in the loss ratio to 66.1 in 2002 compared to 70.6 in 2001. The expense ratio was 32.5 for the nine months ended September 30, 2002 and 33.9 for the nine months ended September 30, 2001.

The factors described above resulted in net income for the nine months ended September 30, 2002 of $6.6 million or $0.57 per basic share and $0.56 per diluted share compared to net income of $3.5 million or $0.31 per share (basic and diluted) for the nine months ended September 30, 2001.

Critical Accounting Estimates

The Company is directly liable for losses and loss adjustment expenses under the terms of the insurance policies it writes. In many cases, several years may lapse between the occurrence of an insured loss, the reporting of the loss and the payment of that loss. The Company reflects its liability for the ultimate payment of all incurred losses and loss adjustment expenses by establishing its best estimate of loss and loss adjustment expense reserves as balance sheet liabilities for both reported and unreported claims.

When a claim involving a probable loss is reported, the Company establishes a case reserve for the estimated amount of its ultimate loss. The estimate of the amount of the ultimate loss is based upon factors such as:

|X| the type of loss,
|X| the jurisdiction of the occurrence,
|X| the Company's knowledge of the circumstances surrounding the claim,
|X| the severity of injury or damage,
|X| the potential for ultimate exposure, and
|X| policy provisions relating to the claim.

The Company determines loss adjustment expenses via a formula method that estimates loss adjustment expenses as a percentage of expected indemnity losses based on historical patterns adjusted to current experience.

In addition to case reserves, the Company establishes reserves on an aggregate basis to provide for incurred but not reported losses and loss adjustment expenses, commonly referred to as "IBNR". To establish reserves for IBNR, the Company must estimate the ultimate liability based primarily on past experience. The Company applies a variety of traditional actuarial techniques to estimate its ultimate liability. The techniques recognize, among other factors:

- |X| the Company's and the industry's experience,
- |X| historical trends in reserving patterns and loss payments,
- |X| the impact of claim inflation,
- |X| the pending level of unpaid claims,
- |X| the cost of claim settlements,
- |X| the line of business mix, and
- |X| the economic environment in which property and casualty insurance companies operate.

The Company continually reviews these estimates and, based on new developments and information, the Company includes adjustments of the probable ultimate liability in the operating results for the periods in which the adjustments are made. In general, initial reserves are based upon the actuarial and underwriting data utilized to set pricing levels and are reviewed as additional information, including claims experience, becomes available.

The establishment of loss and loss adjustment expense reserves makes no provision for the broadening of coverage by legislative action or judicial interpretation or for the extraordinary future emergence of new types of losses not sufficiently represented in our historical experience, or which cannot yet be quantified. The Company regularly analyzes its reserves and reviews pricing and reserving methodologies so that future adjustments to prior year reserves can be minimized. However, given the complexity of this process, reserves will require continual updates and the ultimate liability may be higher or lower than previously indicated. The Company does not discount its loss reserves.

During the first nine months of 2002, there were no material adjustments in the aggregate to prior year reserves. During the first nine months of 2002, the Company decreased its estimate for the commercial multi-peril property line of business by $2.5 million, primarily relating to claims occurring in 2001. This reduction was offset by an increase in the Company's estimate for the commercial multi-peril liability line of business due to the development of outstanding claim reserves on claims occurring primarily in 1998 and 1999.

Liquidity and Capital Resources

PAGI is a holding company, the principal asset of which is the common stock of Penn-America Insurance Company. The principal source of cash to meet PAGI's short-term liquidity needs, including the payment of dividends to PAGI's stockholders and PAGI operating expenses is dividends from Penn-America Insurance Company. PAGI has no long-term debt obligations or planned capital expenditures that could impact its long term liquidity needs. Penn-America Insurance Company's principal sources of funds are underwriting operations, investment income and proceeds from sales and redemptions of investments. Funds are used by Penn-America Insurance Company and Penn-Star Insurance Company principally to pay claims and operating expenses, to purchase investments and to make dividend payments to PAGI. PAGI's future liquidity is dependant on the ability of Penn-America Insurance Company to pay dividends to PAGI.

PAGI's insurance subsidiaries are restricted by statute as to the amount of dividends that they may pay without the prior approval of regulatory authorities. Penn-America Insurance Company may pay dividends to PAGI without advance regulatory approval only from unassigned surplus and only to the extent that all dividends in the past twelve months do not exceed the greater of 10% of total statutory policyholders' surplus, or statutory net income for the prior year. Using these criteria, the available ordinary dividend payable by Penn-America Insurance Company to PAGI for 2002 is $6,473,325. Ordinary dividends paid by Penn-America Insurance Company to PAGI were $0.5 milion during the nine months ended September 30, 2002 and $1.6 million in 2001. Penn-America Insurance Company's ability to pay future dividends to PAGI without advance regulatory approval is dependent upon maintaining a positive level of unassigned and policyholders' surplus, which in turn, is dependent upon Penn-America Insurance Company and Penn-Star Insurance Company generating net income in excess of dividends to PAGI. As of September 30, 2002, Penn-America Insurance Company's unassigned surplus was $21.2 million and policyholders' surplus was $69.2 million, both up $4.5 million from December 31, 2001.

Penn-America Insurance Company provides strong incentives to its general agents to produce profitable business through a contingent profit commission structure that is tied directly to underwriting profitability. Payment of these contingent profit commissions has been through the issuance of PAGI common stock and cash. In 2002, PAGI issued 62,836 shares of its common stock at an average value of $7.79 per share as part of the payment of the 2001 contingent profit commission due to the general agents of Penn-America Insurance Company.

Penn-America Insurance Company and Penn-Star Insurance Company are required by law to maintain a certain minimum level of policyholders' surplus on a statutory accounting basis. Policyholders' surplus is calculated by subtracting total liabilities from total assets. The National Association of Insurance Commissioners adopted risk-based capital standards designed to identify property and casualty insurers that may be inadequately capitalized based on inherent risks of each insurer's assets and liabilities and its mix of net written premiums. Insurers falling below a calculated threshold may be subject to varying degrees of regulatory action. As of December 31, 2001, the policyholders' surplus of Penn-America Insurance Company and Penn-Star Insurance Company was in excess of the prescribed risk-based capital requirements. Penn-America Insurance Company's policyholders' surplus at December 31, 2001 was $64,733,251 and its regulatory action level was $17,124,648. Penn-Star Insurance Company's policyholders' surplus at December 31, 2001 was $33,389,965 and its regulatory action level was $5,675,459.

Net cash provided by operating activities was $36.0 million for the nine months ended September 30, 2002 compared to $2.8 million for the nine months ended September 30, 2001. This improvement is mostly attributable to the increase in net written premiums combined with a decrease in paid losses.

Net cash used by investing activities was $20.3 million for the nine months ended September 30, 2002, compared to $5.4 million for the nine months ended September 30, 2001. This increase is mostly attributable to the improved operating cash flows that were primarily used to purchase fixed maturities available for sale.

Net cash used by financing activities was $1.1 million for the nine months ended September 30, 2002, compared to $1.0 million for the nine months ended September 30, 2001.

On June 27, 2002, PAGI filed a registration statement with the Securities and Exchange Commission relating to a proposed offering of 4,000,000 shares of its common stock. Until the registration statement is effective, these securities may not be sold nor may offers to buy be accepted. On October 27, 2002, the Company signed a non-binding letter of intent to issue approximately $15 million of trust preferred securities by a business trust subsidiary to be established by the Company. The intended use of the net proceeds of these offerings are to support the Company's operations, including contributing capital to the insurance subsidiaries and capitalizing new insurance subsidiaries to support the growth in business, and for working capital and other general corporate purposes.

Investment Portfolio

The Company seeks to maintain sufficient liquidity from operations, investing and financing activities to meet its anticipated insurance obligations and operating and capital expenditure needs. The Company's investment strategy emphasizes quality, liquidity and diversification, as well as total return. With respect to liquidity, the Company considers liability durations, specifically related to loss reserves, when determining desired investment maturities. In addition, maturities have been staggered to produce cash flows for loss payments and reinvestment opportunities. At September 30, 2002, the Company held a total of $229.1 million in cash and investments. Of this amount, cash represented $27.6 million, equity securities represented $23.4 million, and fixed-income securities represented $178.1 million.

The Company's cash and investments portfolio mix as of September 30, 2002 was as follows:

Fixed-income:

U.S. Treasury securities and obligations of U.S. government agencies
Corporate securities

Mortgage-backed securities
Other structured securities
Municipal securities

Total fixed income
Cash
Preferred stock
Common stock

The Company's fixed-income portfolio of $178.1 million was 78% of the total cash and investments as of September 30, 2002. Approximately 90% of these securities were rated "A" or better by Standard & Poor's. Standard & Poor's rates publicly traded securities in twenty categories ranging from AAA to CC. Securities with ratings from AAA to BBB- (the top ten categories) are commonly referred to as having an investment grade rating. Equity securities, which consist of preferred stocks and common stocks (comprised exclusively of exchange traded funds), were $23.4 million or 10% of total cash and investments as of September 30, 2002.

As of September 30, 2002, our investment portfolio contained corporate fixed-income and preferred stock securities with a market value of $79.6 million. A summary of these securities by industry segment is as follows:

Financial institutions
Communications
Utilities
Consumer, non-cyclical
Industrial
Basic materials
Consumer, cyclical
Technology
Energy

As of September 30, 2002, the investment portfolio contained $61.2 million of mortgage-backed, asset-backed and collateralized mortgage obligations. All of these securities were rated "A" or better and 78% were rated "AAA" by Standard & Poor's. These securities are publicly traded, and have market values obtained from an independent pricing service. Changes in estimated cash flows due to changes in prepayment assumptions from the original purchase assumptions are revised based on current interest rates and the economic environment. The Company had no derivative financial instruments, real estate or mortgages in the investment portfolio as of September 30, 2002.

Management's Discussion and Analysis of Financial
Condition and Results of Operations (continued)

The quality of the fixed-income portfolio as of September 30, 2002 was as follows:

"AAA"	49%
"AA"	22%
"A"	19%
"BBB"	8%
Below "BBB"	2%
	100%

The Company regularly evaluates its investment portfolio to identify other-than-temporary impairments of individual securities. The Company considers many factors in determining if an other-than-temporary impairment exists, including the length of time and extent to which the market value of the security has been less than cost, the financial condition and near-term prospects of the issuer of the security and the Company's ability and willingness to hold the security until the market value is expected to recover.

The following table contains an analysis of the Company's securities with gross unrealized losses, categorized by the period that the securities were in a continuous unrealized loss position as of September 30, 2002:

	Investment Securities with Gross Unrealized Losses, Categoriz Unrealized Loss Position				
(in thousands)	Number of Securities	Fair Value	Book Value	Gross Unrealized Losses	Six Months or Less
Fixed income securities	6	$6,078	$6,462	$384	$
Preferred stock	2	1,276	1,289	13	1
Common stock	1	550	602	52	5
				$449	$73

As of September 30, 2002, the Company's fixed-income investment portfolio had six securities with $384,000 of gross unrealized losses. No single issuer had an unrealized loss position of greater than $150,000. The over one year gross unrealized losses of $325,000 represents two public utility securities and one other structured security. The two public utility securities had a combined unrealized loss of $225,000. These securities have maturity dates in 2004, were upgraded to B- and BB by Standard and Poor's in February 2002 and the unrealized loss position was 8.9% of original cost. The other structured security has a maturity date in 2003, a Standard & Poor's rating of AA and the unrealized loss position was 10% of book value. The over six months to one year gross unrealized loss for fixed-income securities of $51,000 consists primarily of one corporate security with a Standard & Poor's rating of BBB and an unrealized loss position of 3.2% of original cost.

As of September 30, 2002, the Company's preferred stock portfolio has two securities with a gross unrealized loss of $13,000. Both securities are investment grade with Standard and Poor's ratings of BBB- and A+.

As of September 30, 2002, the Company's common stock portfolio contains one security, an exchange-traded fund, with a gross unrealized loss of $52,000. The unrealized loss position on this security is 8.7 % of its book value and has been in a continuous unrealized loss position for less than three months at September 30, 2002.

Three-for-Two Stock Split

On April 11, 2002, the Company announced a three-for-two stock split to be effected in the form of a 50% stock dividend payable to stockholders of record as of April 25, 2002. The distribution date was May 9, 2002.

Quantitative and Qualitative Disclosures About Market Risk

Market Risk

Market risk is the potential economic loss principally arising from adverse changes in the market value of financial instruments. The major components of market risk affecting the Company are interest rate risk and equity price risk.

Interest Rate Risk

The Company had fixed-income and preferred stock investments with a market value of $195.0 million at September 30, 2002 that are subject to interest rate risk. The Company manages its exposure to interest rate risk through a disciplined asset/liability matching and capital management process. In the management of this risk, the characteristics of duration, credit and variability of cash flows are critical elements. These risks constantly are assessed and balanced within the context of the Company's liability and capital position.

Equity Price Risk

Equity rice risk is the Company's underlying exposure to an economic loss from the decline of common stock prices. The Company's common equity portfolio was $6.6 million at September 30, 2002.

The Company attempts to mitigate equity price risk to its common stock portfolio by investing exclusively in exchange-traded funds or ETFs. ETFs are securities that represent an interest in a trust that owns and holds a basket of common stocks that replicate a major market index (such as the S&P 500 or the Dow Jones Industrial Average) or a portion of a major market index (such as the Value Component of the S&P). Since these securities represent an interest in the equity capital markets as a whole, or a sub-sector thereof, they are a diversified, index-based exposure to common stocks. As such, the value of these ETFs will be determined by the performance of the equity capital markets in general or of a particular sub-sector and reduces equity price risk to a single issuer of stock.

The Company's market risk at September 30, 2002 has not materially changed from that identified at December 31, 2001.

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES

Controls and Procedures

As of September 30, 2002, an evaluation was performed under the supervision and with the participation of the Company's management, including the President and CEO and Senior Vice President, CFO and Treasurer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Company's management, including the President and CEO and Senior Vice President, CFO and Treasurer, concluded that the Company's disclosure controls and procedures were effective as of September 30, 2002. There have been no significant changes in the Company's internal controls or in other factors that could significantly affect internal controls subsequent to September 30, 2002.

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES

PART II. OTHER INFORMATION

Item 1. Legal Proceedings - None

Item 2. Changes in Securities and Use of Proceeds - None

Item 3. Default Upon Senior Securities - None

Item 4. Submission of Matters to a Vote by Security Holders - None

Item 5. Other Information

On June 27, 2002, PAGI filed a registration statement with the Securities and Exchange Commission relating to a proposed offering of 4,000,000 shares of its common stock. Until the registration statement is effective, these securities may not be sold nor may offers to buy be accepted. On October 27, 2002, the Company signed a non-binding letter of intent to issue approximately $15 million of trust preferred securities by a business trust subsidiary to be established by the Company.
The intended use of the net proceeds of these offerings are to support the Company's operations, including contributing capital to the insurance subsidiaries and capitalizing new insurance subsidiaries to support the growth in business, and for working capital and other general corporate purposes.

Item 6. Exhibits and Reports on Form 8-K

On August 13, 2002, the Company filed a current report on Form 8-K announcing the availability of the second quarter statements of its insurance subsidiaries, Penn-America Insurance Company and Penn-Star Insurance Company, on the Company's website, in hard copy from the Company, or from the Pennsylvania Insurance Department.

SIGNATURE

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.

Penn-America Group, Inc.

Date: November 13, 2002

By: /s/ Jon S. Saltzman
Jon S. Saltzman
President and
Chief Executive Officer

By: /s/ Joseph F. Morris
Joseph F. Morris
Senior Vice President,
Chief Financial Officer
Chief Financial Officer
and Treasurer

CERTIFICATION OF CHIEF EXECUTIVE OFFICER AS ADOPTED PURSUANT TO
SECTION 302(a) OF THE SARBANES-OXLEY ACT OF 2002

I, Jon S. Saltzman, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Penn-America Group, Inc.

2. Based on my knowledge, this quarterly 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 quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly report;

4. The registrant's other certifying officer 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 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 quarterly 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 quarterly report (the "Evaluation Date"); and

c) presented in this quarterly 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 officer 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 functions):

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 officer and I have indicated in this quarterly report whether 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: November 13, 2002

/s/ Jon S. Saltzman
Jon S. Saltzman
President and Chief Executive Officer

CERTIFICATION OF CHIEF FINANCIAL OFFICER AS ADOPTED PURSUANT TO SECTION 302(a) OF THE SARBANES-OXLEY ACT OF 2002

I, Joseph F. Morris, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Penn-America Group, Inc.

2. Based on my knowledge, this quarterly 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 quarterly report;

3. Based on my knowledge, the financial statements, and other financial

information included in this quarterly 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 quarterly report;

4. The registrant's other certifying officer 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 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 quarterly 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 quarterly report (the "Evaluation Date"); and

   c) presented in this quarterly 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 officer 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 functions):

   d) 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

   e) 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 officer and I have indicated in this quarterly report whether 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: November 13, 2002

/s/ Joseph F. Morris
Joseph F. Morris
Senior Vice President, Chief Financial Officer
and Treasurer

CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Penn-America Group, Inc. (the "Company") on Form 10-Q for the period ending September 30, 2002, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Jon S. Saltzman , Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) and 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 result of operations of the Company.

/s/ Jon S. Saltzman
Jon S. Saltzman
President and Chief Executive Officer

November 13, 2002

CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Penn-America Group, Inc. (the "Company") on Form 10-Q for the period ending September 30, 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Joseph F. Morris, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) and 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 result of operations of the Company.

/s/ Joseph F. Morris
Joseph F. Morris
Senior Vice President, Chief Financial Officer
and Treasurer

November 13, 2002