PENN AMERICA GROUP INC
Form 10-Q
November 06, 2003

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, 2003

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes X No

At October 30, 2003, 14,731,853 shares of the registrant's common stock, $0.01 par value, were outstanding.

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES
Index

Page

Part I - Financial Information

Item 1. Financial Statements

Consolidated Balance Sheets - September 30, 2003 (unaudited) and December 31, 2002

Consolidated Unaudited Statements of Operations - For the three and nine months ended September 30, 2003 and 2002

Consolidated Unaudited Statement of Stockholders' Equity - For the nine months ended September 30, 2003

Consolidated Unaudited Statements of Cash Flows - For the nine months ended September 30, 2003 and 2002

Notes to Unaudited Consolidated Financial Statements

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Item 3. Quantitative and Qualitative Disclosure About Market Risk

Item 4. Controls and Procedures

Part II - Other Information

Page 2

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(In thousands, except share data)

	Septembe 200 (Unaudi
ASSETS	
Investments:	
Fixed maturities:	

Available for sale, at fair value (amortized cost, $301,989 and $237,450)	$ 311
Held to maturity, at amortized cost (fair value, $295 and $2,017)	
Equity securities, at fair value (cost, $11,405 and $17,859)	11
Total investments	322
Cash and cash equivalents	31
Accrued investment income	3
Premiums receivable	20
Reinsurance recoverable	31
Prepaid reinsurance premiums	12
Deferred policy acquisition costs	16
Capital lease, affiliate	1
Deferred income taxes	2
Income tax recoverable	
Other assets	1
Total assets	$ 444
LIABILITIES AND STOCKHOLDERS' EQUITY	
Liabilities:	
Unpaid losses and loss adjustment expenses	$ 159
Unearned premiums	87
Accounts payable and accrued expenses	8
Capitalized lease obligation, affiliate	1
Payable for investments purchased	26
Company obligated mandatorily redeemable preferred securities of subsidiary trusts holding solely junior subordinated debentures	30
Income tax payable	
Other liabilities	3
Total liabilities	317
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 and outstanding, 14,729,853 and 14,572,098 shares	
Additional paid-in capital	72
Accumulated other comprehensive income	5
Retained earnings	50
Officers' stock loans	
Unearned compensation from restricted stock awards	
Total stockholders' equity	127
Total liabilities and stockholders' equity	$ 444

See accompanying notes to Consolidated Financial Statements

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

(Unaudited)

For the three and nine months ended September 30, 2003 and 2002
(In thousands, except share data)

	Three months ended September 30,		N
	2003	2002	
Revenues			
Premiums earned	$ 40,337	$ 30,705	$
Net investment income	3,277	3,038	
Net realized investment gain (loss)	734	1,172	
Total revenues	44,348	34,915	
Losses and expenses			
Losses and loss adjustment expenses	24,594	20,799	
Amortization of deferred policy acquisition costs	9,901	7,527	
Other underwriting expenses	2,395	2,209	
Corporate expenses	214	118	
Interest expense	515	35	
Total losses and expenses	37,619	30,688	
Income before income tax	6,729	4,227	
Income tax expense	2,094	1,330	
Net income	$ 4,635	$ 2,897	$
Net income per share:			
Basic	$ 0.31	$ 0.25	$
Diluted	$ 0.31	$ 0.25	$
Weighted average shares outstanding:			
Basic	14,717,350	11,585,043	
Diluted	14,945,900	11,775,916	
Cash dividends per share	$ 0.04375	$ 0.03875	$

See accompanying notes to Consolidated Financial Statements

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES

Consolidated Statement of Stockholders' Equity

(Unaudited)

For the nine months ended September 30, 2003
(In thousands, except share data)

	Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Income	Retained Earnings	Off S L
Balance at December 31, 2002	$ 146	$ 70,875	$ 6,401	$ 39,995	$
Net income	--	--	--	12,208	
Other comprehensive loss:					
Unrealized loss on investments, net of tax and reclassification adjustment	--	--	(562)	--	
Unrealized loss on cash-flow hedging instrument, net of tax	--	--	(70)	--	
Comprehensive income					
Issuance of common stock	1	1,213	--	--	
Compensation expense on stock options	--	87	--	--	
Unearned compensation from restricted stock awards issued	--	--	--	--	
Amortization of compensation expense from restricted stock awards issued	--	--	--	--	
Repayment of officers' stock loans					
Cash dividends paid ($0.13125 per share)	--	--	--	(1,923)	
Balance at September 30, 2003	$ 147	$ 72,175	$ 5,769	$ 50,280	

See accompanying notes to Consolidated Financial Statements

Page 5

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

For the nine months ended September 30, 2003 and 2002

(In thousands)

	Nine mo
	2003
Cash flows from operating activities:	

Net income	$ 12,2
Adjustments to reconcile net income to net cash provided by operating activities:	
Amortization (accretion) and depreciation expense	1,4
Net realized investment loss (gain)	(1,8
Deferred income tax benefit	(6
Net change in premiums receivable, prepaid reinsurance premiums and unearned premiums	9,9
Net change in unpaid losses and loss adjustment expenses and reinsurance recoverable	18,1
Decrease (increase) in:	
Accrued investment income	(
Deferred policy acquisition costs	(3,5
Income tax recoverable/payable	8
Other assets	
Increase (decrease) in:	
Accounts payable and accrued expenses	4
Other liabilities	2
Net cash provided by operating activities	37,3
Cash flows from investing activities:	
Purchases of equity securities	(7,6
Purchases of fixed maturities available for sale	(168,1
Proceeds from sales of equity securities	14,4
Proceeds from sales and maturities of fixed maturities available for sale	104,0
Proceeds from maturities and calls of fixed maturities held to maturity	1,6
Increase in payable for investments purchased	26,2
Net cash used by investing activities	(29,3
Cash flows from financing activities:	
Issuance of common stock	1,2
Net proceeds from the issuance of trust preferred securities	14,5
Principal payments on capital lease obligations, affiliate	(1
Repayment of officers' loans	
Dividends paid	(1,9
Net cash provided (used) by financing activities	13,7
Increase in cash and cash equivalents	21,7
Cash and cash equivalents, beginning of period	9,7
Cash and cash equivalents, end of period	$ 31,5

See accompanying notes to Consolidated Financial Statements

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 31% of the outstanding common stock of PAGI was owned by Penn Independent Corporation ("Penn Independent") at September 30, 2003. The accompanying financial statements include the accounts of PAGI and its wholly-owned subsidiaries, Penn-America Insurance Company ("Penn-America") and its wholly-owned subsidiary, Penn-Star Insurance Company ("Penn-Star"); Penn-America Statutory Trust I (the "Trust I"); and Penn-America Statutory Trust II (the "Trust II") (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 is licensed to write business in all 50 states and the District of Columbia. The Company writes business on both an admitted and non-admitted basis in 37 states, on only an admitted basis in one state and on only a non-admitted basis in 12 states and the District of Columbia.

The accompanying 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 condensed unaudited consolidated financial statements and notes be read in conjunction with the financial statements and notes in the Company's 2002 Annual Report which was incorporated by reference into the Company's Form 10-K for the year ended December 31, 2002. The Company's results of operations for interim periods are not necessarily indicative of the results to be expected for the entire year.

Note 2 - Reinsurance

Premiums earned are presented net of amounts ceded to reinsurers of $7,503,000 and $5,057,000 for the three months ended September 30, 2003 and 2002, respectively. Losses and loss adjustment expenses are presented net of amounts ceded to reinsurers of $2,576,000 and $3,188,000 for the three months ended September 30, 2003 and 2002, respectively.

Premiums earned are presented net of amounts ceded to reinsurers of $20,409,000 and $12,257,000 for the nine months ended September 30, 2003 and 2002, respectively. Losses and loss adjustment expenses are presented net of amounts ceded to reinsurers of $10,890,000 and $5,988,000 for the nine months ended September 30, 2003 and 2002, respectively.

Notes to Unaudited Consolidated Financial Statements
(continued)

Note 3 - Comprehensive Income

For the three months ended September 30, 2003, comprehensive income was $2,153,000, which consisted of net income of $4,635,000 and other comprehensive loss of $2,482,000 related to net unrealized loss on investments and an unrealized gain on a cash flow hedging instrument. For the three months ended September 30, 2002, comprehensive income was $5,197,000, which consisted of net income of $2,897,000 and other comprehensive gain of $2,300,000 related to net unrealized gains on investments.

For the nine months ended September 30, 2003, comprehensive income was $11,576,000, which consisted of net income of $12,208,000 and other comprehensive loss of $632,000 related to net unrealized loss on investments and an unrealized loss on a cash flow hedging instrument. For the nine months ended September 30, 2002, comprehensive income was $10,304,000, which consisted of net income of $6,565,000 and other comprehensive gain of $3,739,000 related to net unrealized gains on investments.

Note 4 - Net Income Per Share

Basic net income per share is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding for each period. Diluted net income per share includes the potential dilution that could occur if outstanding contracts to issue common stock were exercised and converted to common stock. The following is a reconciliation of the basic and diluted net income per share computations:

(in thousands, except share data)	Three months ended September 30,		Nin
	2003	2002	
Basic per share computation:			
Net income	$ 4,635	$ 2,897	
Weighted average common shares (outstanding	14,717,350	11,585,043	
Basic net income per share	$ 0.31	$ 0.25	
Diluted per share computation:			
Net income	$ 4,635	$ 2,897	
Weighted average common shares (1)outstanding	14,717,350	11,585,043	
Additional shares outstanding after the assumed assumed exercise of stock options by applying the treasury stock method	228,550	190,873	
Total shares	14,945,900	11,775,916	
Diluted net income per share	$ 0.31	$ 0.25	

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PENN-AMERICA GROUP, INC. AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements
(continued)

Note 5 - Segment Information

The Company has one reportable segment that consists of its commercial property and casualty lines of business. In 1999, the Company exited the non-standard personal automobile line of business and announced that it would run-off its remaining portfolio of such business. For the three and nine months ended September 30, 2003 and 2002, amounts relating to the non-standard personal automobile business were not material to the financial statements presented, and therefore, are not presented separately.

Note 6 - Stock Options

On January 1, 2003, the Company adopted the fair value recognition provisions of SFAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure ("SFAS 148"), and SFAS No. 123, Accounting for Stock-Based Compensation ("SFAS 123") by implementing the modified prospective transition method permitted under SFAS 148. This method requires the Company to record compensation expense in 2003, and annually thereafter, as if the fair value recognition method had been used since January 1, 1995. Compensation expense of $41,000 and $87,000 was recorded for the three and nine months ended September 30, 2003.

Prior to January 1, 2003, the Company applied the recognition principles of APB No. 25, Accounting for Stock Issued to Employees, and, accordingly, no compensation expense was recognized. If the Company had applied the fair value recognition provisions of SFAS 123 in 2002, compensation expense of $62,000 and $186,000 would have been recorded for the three and nine months ended September 30, 2002. The following table illustrates the effect on net income and net income per share for the three and nine months ended September 30, 2003 and 2002 as if the Company had applied the fair value recognition provisions of SFAS 123.

(in thousands, except share data)	Three months ended September 30,		Nine months
	2003	2002	2003
Net income, as reported	$ 4	$ 2,897	$ 12,2
Add: Stock-based employee compensation included in net income, net of tax			

	27	--	
Deduct: Stock-based employee compensation determined under the fair value based method, net of tax	(27)	(41)	(
Pro forma net income	$ 4	$ 2,856	$ 12,2
Basic net income per share:			
As reported	$ 0.31	$ 0.25	$ 0.
Pro forma	$ 0.31	$ 0.25	$ 0.
Diluted net income per share:			
As reported	$ 0.31	$ 0.25	$ 0.
Pro forma	$ 0.31	$ 0.24	$ 0.

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements
(continued)

Note 7 - Company Obligated Mandatorily Redeemable Preferred Securities of Subsidiary Trusts Holding Solely Junior Subordinated Debentures ("Trust Preferred Securities")

On May 15, 2003, Penn-America Statutory Trust II ("the Trust II"), a business trust subsidiary formed by PAGI, issued $15 million of floating rate trust preferred securities. These securities have a thirty-year maturity, with a provision that allows the Company to call these securities at par after five years from the date of issuance. Cash distributions will be paid quarterly in arrears at a rate of 410 basis points over three-month London Interbank Offered Rates. Distributions on these securities can be deferred for up to five years, but in the event of such deferral, the Company may not declare or pay cash dividends on its common stock. The Company guarantees all obligations of the Trust II with respect to distributions and payments of these securities.

Proceeds from the sale of these securities by the Trust II were used to acquire $15 million of Floating Rate Junior Subordinated Deferrable Interest Rate Debentures issued by the Company. These debentures have the same terms with respect to maturity, payments, and distributions as the floating rate trust preferred securities issued by the Trust II. The proceeds from these debentures will be used to support growth in the Company's insurance operations and for general corporate purposes.

On July 1, 2003, the Company adopted Statement of Financial Accounting Standards No. 150 ("SFAS 150"), Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. SFAS 150 establishes standards for classifying and measuring certain financial instruments with characteristics of both liabilities and equity. The Company's Trust Preferred Securities are classified as a liability on the Consolidated Balance Sheets and the related distributions are recorded as interest expense on the Consolidated Statements of Operations, which is in accordance with SFAS 150. Therefore, the

adoption of SFAS 150 had no effect on the Company's financial statements.

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements
(continued)

Note 8 - Unpaid Losses and Loss Adjustment Expenses

During the first nine months of 2003, the Company increased incurred losses and loss adjustment expenses attributable to insured events of prior years by $1,974,000. This increase was primarily due to an increase of $1,928,000 in estimates for loss and loss adjustment expense reserves for the exited automobile lines of business. In 2003, the Company experienced an unanticipated increase in paid allocated loss adjustment expenses on its remaining open commercial automobile liability claims. Consequently, combined with the unanticipated 2003 activity and review of open claims, the Company increased its estimates for loss and loss adjustment expense reserves. The remaining increase of $46,000 in incurred losses and loss adjustment expenses attributable to insured events of prior years related to the Company's core commercial property and casualty lines of business. This increase consisted of a reduction in the Company's estimate for the commercial property lines of business by $2,143,000 relating primarily to the 2002 accident year, offset by an increase in the Company's estimate for the commercial liability lines of business of $2,189,000 due to the development of outstanding claim reserves on claims occurring in various accident years.

In October 2003, the Eighteenth Circuit Court in the State of Michigan entered a judgment of $4.9 million against one of the Company's insureds, which judgment the Company has appealed. While the Company issued only a $1.0 million policy limit, the insured could allege the Company is responsible for this entire judgment. This policy is applicable to the Company's reinsurance program that provides coverage for losses and loss adjustment expenses, including judgments in excess of policy limits, of $2.75 million in excess of $0.25 million. The Company believes that the judgment has no merit and the likelihood of a loss in excess of the Company's reinsurers limit of liability of $3.0 million is remote. Therefore, the Company has not included any amounts over its reinsurers limit of liability of $3.0 million in its unpaid losses and loss adjustment expenses at September 30, 2003.

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, 2003 and 2002

Premiums earned increased 31.4% to $40.3 million for the three months ended September 30, 2003, compared with $30.7 million for the same period in 2002, due to the growth in net written premiums over the last 12 months.

Gross written premiums, which represent the amount received or to be received for insurance policies written without reduction for acquisition costs, reinsurance costs or other deductions, increased 35.6% for the three months ended September 30, 2003 to $58.5 million, compared with $43.1 million for the three months ended September 30, 2002. The increase was attributable to rate increases, growth in new business and higher average exposures per policy.

Ceded written premiums, the portion of gross written premiums reinsured by unaffiliated insurers, increased 36.3% to $9.0 million for the three months ended September 30, 2003, compared with $6.6 million for the three months ended September 30, 2002. The increase in ceded written premiums was due primarily to growth in gross written premiums and an approximately 4.0% increase in reinsurance rates on the Company's multiple-line excess of loss treaty.

Net written premiums, which are gross written premiums less ceded written premiums, increased 35.5% for the three months ended September 30, 2003 to $49.5 million, compared with $36.5 million for the three months ended September 30, 2002. The increase in net written premiums was consistent with the increase in gross written premiums, but was offset partially by higher reinsurance costs.

Net investment income increased to $3.3 million for the three months ended September 30, 2003, compared with $3.0 million for the three months ended September 30, 2002, primarily due to the growth in average invested assets, partially offset by a decrease in average yield on fixed-maturity investments.

Net realized investment gain was $0.7 million for the three months ended September 30, 2003, compared to a net realized investment gain of $1.2 million for the three months ended September 30, 2002. The net realized investment gain for the three months ended September 30, 2003 was primarily attributable to the sale of certain of the Company's preferred stock securities. The net realized investment gain for the three months ended September 30, 2002 consists primarily of $2.3 million in net realized gains recognized on the sale of certain of the Company's fixed-maturity securities, partially offset by $1.1 million other-than-temporary impairment write-downs on certain of the Company's common stocks.

Losses and loss adjustment expenses increased 18.2% to $24.6 million for the three months ended September 30, 2003, compared with $20.8 million for the three months ended September 30, 2002. The loss ratio for the three months ended September 30, 2003 was 61.0, compared with 67.7 for the three months ended September 30, 2002. 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 2002 and 2003 partially offset by an increase in catastrophe-related losses, which were $1.3 million for the three months ended September 30, 2003 versus $0.4 million for the three months ended September 30, 2002. This increase in

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES

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

catastrophe-related losses was primarily due to claims the Company received related to Hurricane Isabel which occurred in the third quarter of 2003.

Amortization of deferred policy acquisition costs ("ADAC") increased 31.5% to $9.9 million for the three months ended September 30, 2003 from $7.5 million for the three months ended September 30, 2002, primarily due to the growth in premiums earned.

Other underwriting expenses increased 8.4% to $2.4 million for the three months ended September 30, 2003 from $2.2 million for the three months ended September 30, 2002, primarily due 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, improved to 91.5 for the three months ended September 30, 2003 from 99.4 for the three months ended September 30, 2002. The loss ratio improved to 61.0 for the three months ended September 30, 2003 from 67.7 for the three months ended September 30, 2002. The expense ratio, which is calculated by dividing the sum of ADAC and other underwriting expenses by premiums earned, improved to 30.5 for the three months ended September 30, 2003 from 31.7 for the three months ended September 30, 2002. 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 underwriting profitability.

Interest expense increased to $515,000 for the three months ended September 30, 2003 from $35,000 for the three months ended September 30, 2002, primarily due to interest expense on the Company's Trust Preferred Securities.

Income tax expense increased to $2.1 million for the three months ended September 30, 2003 from $1.3 million for the three months ended September 30, 2002, primarily due to improved underwriting profitability.

The factors described above resulted in net income for the three months ended September 30, 2003 of $4.6 million or $0.31 per share (basic and diluted), compared with $2.9 million or $0.25 per share (basic and diluted) for the three months ended September 30, 2002.

Nine Months Ended September 30, 2003 and 2002

Premiums earned increased 37.2% to $111.0 million for the nine months ended September 30, 2003, compared with $80.9 million for the same period in 2002, due to the growth in net written premiums over the last 12 months.

Gross written premiums, which represent the amount received or to be received for insurance policies written without reduction for acquisition costs, reinsurance costs or other deductions, increased 29.5% for the nine months ended September 30, 2003 to $153.3 million, compared with $118.4 million for the nine months ended September 30, 2002. The increase was attributable to rate increases, growth in new business and higher average exposures per policy.

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES

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

Ceded written premiums, the portion of gross written premiums reinsured by unaffiliated insurers, increased 42.6% to $23.9 million for the nine months ended September 30, 2003, compared with $16.8 million for the nine months ended September 30, 2002. The increase in ceded written premiums was due primarily to growth in gross written premiums and an approximately 11.0% percent increase in reinsurance rates on the Company's multiple-line excess of loss treaty.

Net written premiums, which are gross written premiums less ceded written premiums, increased 27.4% for the nine months ended September 30, 2003 to $129.4 million, compared with $101.6 million for the nine months ended September 30, 2002. The increase in net written premiums was consistent with the increase in gross written premiums, but was offset partially by higher reinsurance costs.

Net investment income increased to $9.7 million for the nine months ended September 30, 2003, compared with $8.8 million for the nine months ended September 30, 2002, primarily due to the growth in average invested assets, partially offset by a decrease in average yield on fixed-maturity investments.

Net realized investment gain was $1.9 million for the nine months ended September 30, 2003, compared to a net realized investment loss of $0.2 million for the nine months ended September 30, 2002. The net realized investment gain for the nine months ended September 30, 2003 was primarily attributable to the sale of certain of the Company's fixed-maturity securities, preferred stocks and common stocks. The net realized investment loss for the nine months ended September 30, 2002 consists of $2.1 million in other-than-temporary impairment write-downs on certain of the Company's preferred stocks and common stocks and $0.4 million in net realized losses on the sale of certain of the Company's common stocks, partially offset by $2.3 million in net realized gains on the sale of certain of the Company's fixed-maturity securities.

Losses and loss adjustment expenses increased 28.7% to $68.8 million for the nine months ended September 30, 2003, compared with $53.4 million for the nine months ended September 30, 2002. The loss ratio for the nine months ended September 30, 2003 was 62.0, compared with 66.1 for the nine months ended September 30, 2002. 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 2002 and 2003, partially offset by an increase in catastrophe-related losses, which were $3.0 million for the nine months ended September 30, 2003 and $1.2 million for the nine months ended September 30, 2002. This increase in catastrophe-related losses was primarily due to claims the Company received on a series of severe storms in the Midwestern states which occurred in the second quarter of 2003 and claims the Company received related to Hurricane Isabel which occurred in the third quarter of 2003.

Amortization of deferred policy acquisition costs ("ADAC") increased 36.1% to $27.6 million for the nine months ended September 30, 2003 from $20.3 million for the nine months ended September 30, 2002, primarily due to the growth in premiums earned.

Other underwriting expenses increased 12.2% to $6.8 million for the nine months ended September 30, 2003 from $6.0 million for the nine months ended September 30, 2002, primarily due to increases in salary and benefit expenses associated with the hiring of additional underwriting and marketing personnel.

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

The overall GAAP combined ratio, which is the sum of the loss and expense ratios, improved to 93.0 for the nine months ended September 30, 2003 from 98.6 for the nine months ended September 30, 2002. The loss ratio improved to 62.0 for the nine months ended September 30, 2003 from 66.1 for the nine months ended September 30, 2002. The expense ratio, which is calculated by dividing the sum of ADAC and other underwriting expenses by premiums earned, improved to 31.0 for the nine months ended September 30, 2003 from 32.5 for the nine months ended September 30, 2002. 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 underwriting profitability.

Interest expense increased to $1.2 million for the nine months ended September 30, 2003 from $0.1 million for the nine months ended September 30, 2002 primarily due to interest expense on the Company's Trust Preferred Securities.

Income tax expense increased to $5.4 million for the nine months ended September 30, 2003 from $2.7 million for the nine months ended September 30, 2002, primarily due to improved underwriting profitability.

The factors described above resulted in net income for the nine months ended September 30, 2003 of $12.2 million or $0.83 per basic share and $0.82 per diluted share, compared with $6.6 million or $0.57 per basic share and $0.56 per diluted share for the nine months ended September 30, 2002.

Critical Accounting Estimates and Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

The Company has identified that the establishment of reserves for unpaid losses and loss adjustment expenses and the valuation of certain investments are critical accounting estimates because they involve a high degree of judgment. Although variability is inherent in these estimates, the Company believes the amounts provided are appropriate based upon facts available at this time. See the Investment Portfolio section beginning on page 19 for information related to the valuation of investments.

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 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 prospective broadening of coverage by legislative action or judicial interpretation; or the extraordinary future emergence of new types of losses not sufficiently represented in the Company's historical experience, or that cannot yet be quantified. The Company regularly reviews pricing and reserving methodologies to assist in estimating its reserves 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.

In the first quarter of 2003, the Company received an unexpected increase in the number of new claims reported relating to four policies issued to a single insured between January 1, 1980 and April 1, 1983. The insured is a manufacturer of safety equipment including industrial masks and the new claims reported allege existing and potential bodily injury due to a medical condition called silicosis. The original policies covered products and completed operations only and were issued with a $500,000 indemnity policy aggregate limit of liability. As of September 30, 2003, the Company believes that its ultimate obligations for these claims are included in its best estimate for unpaid losses and loss adjustment expense reserves.

In October 2003, the Eighteenth Circuit Court in the State of Michigan entered a judgment of $4.9 million against one of the Company's insureds, which judgment the Company has appealed. While the Company issued only a $1.0 million policy limit, the insured could allege the Company is responsible for this entire judgment. This policy is applicable to the Company's reinsurance program that provides coverage for losses and loss adjustment expenses, including judgments in excess of policy limits, of $2.75 million in excess of $0.25 million. The Company believes that the judgment has no merit and the likelihood of a loss in excess of the Company's reinsurers limit of liability of $3.0 million is remote. Therefore, the Company has not included any amounts over its reinsurers limit of liability of $3.0 million in its unpaid losses and loss adjustment expenses at September 30, 2003.

During the first nine months of 2003, the Company increased incurred losses and loss adjustment expenses attributable to insured events of prior years by $2.0 million. This increase was primarily due to an increase of $1.9 million in estimates for loss and loss adjustment expense reserves for the exited automobile lines of business. In 2003, the Company experienced an unanticipated increase in paid allocated loss adjustment expenses on its remaining open commercial automobile liability claims. Consequently, combined with the unanticipated 2003 activity and review of open claims, the Company increased its estimates for loss and loss adjustment expense reserves. The remaining increase of $0.1 million in incurred losses and loss adjustment expenses attributable to insured events of prior years related to the Company's core commercial property and casualty lines of business. This increase consisted of a reduction in the Company's estimate for the commercial property lines of

business by $2.1 million relating primarily to the 2002 accident year, partially offset by an increase in the Company's estimate for the commercial liability lines of business of $2.2 million due to the development of outstanding claim reserves on claims occurring in various accident years.

Liquidity and Capital Resources

PAGI is a holding company, the principal asset of which is the common stock of Penn-America Insurance Company. At September 30, 2003, PAGI's capital structure consisted of common stockholders' equity of $127.6 million and Company Obligated Mandatorily Redeemable Preferred Securities of Subsidiary Trusts Holding Solely Junior Subordinated Debentures ("Trust Preferred Securities") of $30.0 million.

On May 15, 2003, Penn-America Statutory Trust II ("the Trust II"), a business trust subsidiary formed by PAGI, issued $15 million of floating rate trust preferred securities. These securities have a thirty-year maturity, with a provision that allows the Company to call these securities at par after five years from the date of issuance. Cash distributions will be paid quarterly in arrears at a rate of 410 basis points over three-month London Interbank Offered Rates. Distributions on these securities can be deferred for up to five years, but in the event

of such deferral, the Company may not declare or pay cash dividends on its common stock. The Company guarantees all obligations of the Trust II with respect to distributions and payments of these securities.

Proceeds from the sale of these securities by the Trust II were used to acquire $15 million of Floating Rate Junior Subordinated Deferrable Interest Rate Debentures issued by the Company. These debentures have the same terms with respect to maturity, payments, and distributions as the floating rate trust preferred securities issued by the Trust II. The proceeds from these debentures will be used to support growth in the Company's insurance operations and for general corporate purposes.

On July 1, 2003, the Company adopted Statement of Financial Accounting Standards No. 150 ("SFAS 150"), Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. SFAS 150 establishes standards for classifying and measuring certain financial instruments with characteristics of both liabilities and equity. The Company's Trust Preferred Securities are classified as a liability on the Consolidated Balance Sheets and the related distributions are recorded as interest expense on the Consolidated Statements of Operations, which is in accordance with SFAS 150. Therefore, the adoption of SFAS 150 had no effect on the Company's financial statements.

PAGI's principal source of cash to meet short-term and long-term liquidity needs, including the payment of dividends to stockholders, corporate expenses and interest on its debentures, is dividends from Penn-America Insurance Company. PAGI has no planned capital expenditures that could have an

impact on its long-term liquidity needs.

Penn-America'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 dependent on the ability of Penn-America Insurance Company to pay dividends to PAGI.

The Company'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 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 2003 is $11,026,200. For the nine months ended September 30, 2003, ordinary dividends paid by Penn-America Insurance Company to PAGI were $1,900,000. 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 statutory surplus, which, in turn, is dependent upon Penn-America Insurance Company and Penn-Star Insurance Company generating net income in excess of dividends paid to PAGI. As of September 30, 2003, Penn-America Insurance Company's statutory surplus was $118,452,000, and included unassigned surplus of $32,912,000.

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

Penn-America and Penn-Star are required by law to maintain a certain minimum level of statutory surplus. Statutory 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, 2002, the statutory 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 statutory surplus at December 31, 2002 was $110,262,000 and its regulatory action level was $22,532,000. Penn-Star Insurance Company's statutory surplus at December 31, 2002 was $37,356,000 and its regulatory action level was $8,276,000.

The Company has generated positive cash flows from operations to meet its short-term liquidity requirements. Net cash provided by operating activities was $37.3 million for the nine months ended September 30, 2003 and $36.0 million for the nine months ended September 30, 2002.

Net cash used by investing activities was $29.4 million for the nine months ended September 30, 2003 and $20.3 million for the nine months ended September 30, 2002.

Net cash provided by financing activities was $13.8 million for the nine months ended September 30, 2003 due primarily to the issuance of $15.0 million of Trust Preferred Securities in the second quarter of 2003, compared to net cash used by financing activities of $1.1 million for the nine months ended September 30, 2002.

Investment Portfolio

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. The Company outsources the management of its investment portfolio to Gen Re New England Asset Management, Inc. ("NEAMS"). In accordance with the asset management agreement between the Company and NEAMS, all investment transactions are approved by the Investment Committee of the Company within 60 days of their initiation by NEAMS. At September 30, 2003, the Company held a total of $354.4 million in cash and investments. Of this amount, cash and cash equivalents represented $31.5 million, equity securities, consisting of preferred stocks and mutual funds invested in adjustable rate mortgages, represented $11.6 million, and fixed-maturity securities represented $311.3 million.

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

The Company's cash and investment portfolio mix as of September 30, 2003 was as follows:

Fixed maturities:	
U.S. Treasury securities and obligations of U.S. government agencies	4.8%
Corporate securities	27.0
Mortgage-backed securities	23.2
Other structured securities	9.2
Municipal securities	23.6
Total fixed maturities	87.8
Cash and cash equivalents	8.9

Equity securities	3.3
	100.0%

The Company's fixed-maturity portfolio of $311.3 million was 87.8% of the total cash and investments as of September 30, 2003. Approximately 94.3% of these securities were rated "A" or better by Standard & Poor's. Standard & Poor's rates publicly traded securities in 20 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 mutual funds invested in adjustable rate mortgages, were $11.6 million or 3.3% of total cash and investments as of September 30, 2003.

The quality of the fixed-maturity portfolio as of September 30, 2003 was as follows:

"AAA"	56.8%
"AA"	15.0
"A"	22.5
"BBB"	4.8
Below "BBB"	0.9
	100.0%

As of September 30, 2003, the investment portfolio contained $114.8 million of mortgage-backed, asset-backed and collateralized mortgage obligations. 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 real estate or mortgages in the investment portfolio as of September 30, 2003. The quality of the Company's mortgage-backed, asset-backed and collateralized mortgage obligations as of September 30, 2003 was as follows:

"AAA"	87.6%
"AA"	10.7
"A"	1.2
"BBB"	0.5
	100.0%

As of September 30, 2003, the Company's investment portfolio contained

corporate fixed-maturity and preferred stock securities with a market value of $100.4 million. A summary of these securities by industry segment is as follows:

Financial institutions	29.8%
Consumer, non-cyclical	21.9
Utilities	20.7
Communications	10.7
Industrial	4.7
Consumer, cyclical	3.9
Energy	3.4
Basic materials	3.3
Technology	1.6
	100.0%

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, 2003:

(in thousands)	Number of Securities	Fair Value	Book Value	Gross Unrealized Losses
Fixed-maturity securities	36	$ 55,909	$ 56,544	$ 635
Equity securities	3	8,257	8,282	25

As of September 30, 2003, the Company's fixed-maturity investment portfolio had 36 securities with $635 thousand of gross unrealized losses. No single issuer had a gross unrealized loss position of greater than $175 thousand or 3% of its original cost. The Company held two preferred stocks and a mutual fund invested in adjustable rate mortgages, included in equity securities, in a gross unrealized loss position totaling $25,000 as of September 30, 2003.

Forward-Looking Statements

Certain information included in management's discussion and analysis of financial condition and results of operations and elsewhere in this report are not historical facts but are forward-looking statements including, but not limited to, such matters as anticipated financial performance, business prospects, technological developments, new and existing products, expectations for market segment and growth and similar matters. In connection with the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, the Company provides the following cautionary remarks regarding important factors which, among others, could cause the Company's actual results and experience to differ materially from the anticipated results or other expectations expressed in the Company's forward-looking statements. The risks and uncertainties that may affect the operations, performance, results of the Company's business, and the other matters referred to above include, but are not limited to: (1) risks inherent in establishing loss and loss adjustment expense reserves; (2) uncertainties relating to the financial ratings of the Company's insurance subsidiaries; (3) uncertainties relating to government and regulatory policies; (4) uncertainties arising from the cyclical nature of the Company's business; (5) changes in the Company's relationships with, and the capacity of, its general agents; and (6) the risk that the Company's reinsurers may not be able to fulfill their obligations to the Company. For additional disclosure regarding potential risk factors, refer to documents filed by the Company with the Securities and Exchange Commission, including the Company's 2002 Annual Report on Form 10-K.

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES

Quantitative and Qualitative Disclosures About Market Risk

The Company's primary market risk is the potential economic loss principally arising from adverse changes in the market value of its investment portfolio. The major component of market risk affecting the Company's investment portfolio is interest rate risk. As of September 30, 2003, the Company had fixed-maturity, preferred stock and mutual funds invested in adjustable rate mortgages with a market value of $322.9 million at September 30, 2003 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 liability and capital position of the Company. The Company's market risk associated with exposure to interest rate risk at September 30, 2003 has not materially changed from that identified at December 31, 2002.

As of September 30, 2003, the Company believes that its exposure to equity price risk is minimal. The market value of its equity securities, which consist of preferred stocks and mutual funds invested in adjustable rate mortgages, are primarily effected by changes in interest rates. As of December 31, 2002, the Company's exposure to equity price risk was its investment in

common stocks, consisting solely of exchange-traded funds. The Company sold these securities in the first quarter of 2003.

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES

Controls and Procedures

As of September 30, 2003, 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, 2003.

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, 2003.

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. Defaults Upon Senior Securities - None

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

Item 5. Other Information - None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

An Exhibit Index has been filed as part of this report on page E-1

(b) Reports on Form 8-K

On July 2, 2003, the Company filed a current report on Form 8-K announcing the registrant was added to the Russell 2000 Index, a benchmark of small-capitalization stocks compiled by the Frank Russell Company, one of the world's leading investment management and advisory firms.

On July 23, 2003, the Company filed a current report on Form 8-K announcing that the Company released its earnings for the second quarter of 2003.

On August 15, 2003, the Company filed a current report on Form 8-K announcing the availability of its second quarter statements for its insurance subsidiaries, Penn-America Insurance Company and Penn-Star Insurance Company, on the Company's web-site, in hard copy from the Company, or from the Pennsylvania Department of Insurance.

On September 2, 2003, the Company filed a current report on Form 8-K announcing a presentation by Jon S. Saltzman, President and CEO and Joseph F. Morris, Sr. Vice President, CFO and Treasurer at two industry conferences.

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 6, 2003

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

Exhibit No.	Description
10	Endorsement to Property and Casualty Excess of Loss Reinsurance Agreement between Penn-America Insurance Company, Penn-Star Insurance Company and American Re-Insurance Company effective May 1, 2003 to December 31, 2003.
31.1	Certification of Chief Executive Officer as adopted pursuant to section 302(a) of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer as adopted pursuant to section 302(a) of the Sarbanes-Oxley Act of 2002.
32	Certification of Chief Executive Officer and Chief Financial Officer of Penn-America Group, Inc., dated November 3, 2003 in accordance with 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of Sarbanes-Oxley Act of 2002.