

Commissioner Sean Dilweg
Office of the Commissioner of Insurance
State of Wisconsin
125 South Webster St.
Madison, WI 53703

Re: The Appraisal Committee's Valuation Sheboygan Falls Mutual Insurance Company
(Sheboygan Falls) Case Number 08-C31480

Dear Commissioner Dilweg:

On June 16, 2008, you appointed us to serve as members of the Appraisal Committee pursuant to s. 611.76 (3) (c), Wis. Stat. The Appraisal Committee was charged with the responsibility to determine the value of Sheboygan Falls in its proposed conversion that was filed with the Office of the Commissioner of Insurance on April 30, 2008. This letter is intended to serve as our valuation as of the date of conversion as required by s. 611.76 (4m), Wis. Stat.

History

Sheboygan Falls was organized in May 1899, as The Village of Sheboygan Falls Mutual Fire Insurance Company and commenced business on August 18, 1899. In 1934, the present name of the company was adopted. The Manitowoc Mutual Fire Insurance Company and the Mutual Fire Insurance Company of Bloomington were merged into the company on July 1, 1962, and November 1, 1966, respectively. Additionally, the business of German Mutual Fire Insurance Company was reinsured as of November 1, 1964.

Sheboygan Falls is a mutual fire and casualty insurer, which is licensed and writes business only in Wisconsin. The company currently operates on a mutual plan, issuing nonassessable policies, with business being acquired through independent agents. The products are marketed through 671 independent agents in 146 agencies.

The major products marketed by the company include homeowner's, private passenger auto liability, auto physical damage, and commercial multiple peril. The company also writes worker's compensation. The company's certificate of authority was amended to include auto as of May 1990. Its mix of business is 91% personal and 9% commercial, based on direct written premium for the year 2007. In 2007, the company wrote direct premium of \$9,238,231. Sheboygan Falls reported statutory surplus of \$7,144,246 as of December 31, 2007, and \$6,138,409 as of June 30, 2008, both amounts exclude that portion of the Company's reported surplus represented by the \$3.5 million surplus note held by Donegal Mutual Insurance Company.

On December 27, 2006, the company entered into an affiliation agreement with Donegal Mutual Insurance Company (Donegal Mutual), a property and casualty insurer headquartered in Marietta, Pennsylvania.

The Office of the Commissioner of Insurance (OCI) approved the affiliation agreement in June 2007. Donegal Mutual acquired control of the company on June 7, 2007, when six of the ten board of directors' positions of the company were allocated to current directors of Donegal Mutual through amendments to its articles of incorporation and bylaws. Also on that date, Donegal Mutual purchased a \$3,500,000 surplus note issued by the company.

The potential loss of the affiliation with Donegal Mutual could reasonably be expected to have significant adverse consequences for the financial health of, and future prospects for, Sheboygan Falls. Accordingly, in order to avoid the adverse consequences of a loss of Sheboygan Falls affiliation with Donegal Mutual and to preserve the benefits of such an affiliation, the Board of Directors of Sheboygan Falls proposed a demutualization of Sheboygan Falls to convert from a mutual owned by its policyholders to a stock insurance corporation all of whose capital stock would be acquired by Donegal Mutual. Pursuant to s. 611.76 (4m), Wis. Stat., the valuation is to be determined as of the date of conversion.

Valuation Summary

On July 31, 2008, the consulting services of StoneRidge Advisors, LLC. (Investment Advisors), were engaged to assist us in this valuation of Sheboygan Falls. Please see the attached final report dated September 30, 2008.

As part of the due diligence and review of the value of Sheboygan Falls the following industry accepted valuation methodologies were considered:

- **Public Market Multiples** – this methodology considered current trading multiples of publicly traded companies.
- **M&A Transaction Multiples** – this methodology reviewed valuation multiples paid for similar insurance company transactions.
- **Sum of Parts** – this methodology attempts to approximate the fair market value of the entity including estimated value of marketing organization and the book of business.
- **Discounted Cash Flow** – this methodology attempts to approximate the value of the company based on the discounted future cash flows expected to be generated by the operations of the entity.

Due to several factors, including the relative size of Sheboygan Falls in relation to other industry comparables noted above and the geographic service area limited to the State of Wisconsin, the Appraisal Committee and the Investment Advisors concurred that, in this specific case, the Sum of Parts methodology most closely followed the intent of the Wisconsin demutualization statutes; this analysis implied a valuation based on currently available data of between \$6.3 and \$7.0 million, or approximately 1.03x to 1.14x June 30, 2008, surplus.

On September 30, 2008, at the Appraisal Committee's final open meeting, a unanimous vote has established a value of \$7,200,000 as of the date of conversion. This selection is above the indicated range of the Sum of Parts methodology. In establishing its value, the Appraisal Committee took into consideration the unusual business environment of the 2008, year that has negatively impacted the values of certain assets, the material decline in surplus that the Company experienced during the first six months of 2008, from claims activity above the long term average experience of the Company, the liquidity strength of the Company that offsets any need for sale of assets at their current market value, potential tax benefits the company may have that were not reflected in its reported June 30, 2008 surplus, and the potential increase in surplus through the latter half of 2008 through recovery of asset values and profits from operations. A fairness opinion is being sought by the Appraisal Committee from StoneRidge Advisors, LLC. and will be provided to the Commissioner and duly appointed Administrative Law Judge.

It is our understanding that some additional conversion costs are yet to be recognized and will be approved by OCI that will reduce the total return of equity to be distributed.

Thank you again for the opportunity to serve on this Appraisal Committee and feel free to contact us if we may be of further assistance.

Sincerely,

10/10/08

Date

Randy Blumer

Randy Blumer

Date

Brian Hogan

Date

Richard Keintz

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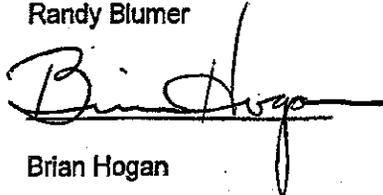
Date

10-9-2008

Date

Date

Randy Blumer



Brian Hogan

Richard Keintz

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Sincerely,

Date

Randy Blumer

Date

Brian Hogan

October 8, 2008

Richard Keintz

Date