FIRST COMMUNITY BANCORP /CA/
Form 10-K
February 28, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ý **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2007

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File No. 00-30747

FIRST COMMUNITY BANCORP

(Exact Name of Registrant as Specified in Its Charter)

California (State or Other Jurisdiction of Incorporation or Organization)	**33-0885320** (I.R.S. Employer Identification Number)
401 West "A" Street **San Diego, California** (Address of Principal Executive Offices)	**92101-7917** (Zip Code)

Registrant's telephone number, including area code: **(619) 233-5588**

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common stock, no par value	**The Nasdaq Stock Market, LLC**

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ý No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No ý

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 shorter 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 ý No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "Accelerated Filer and Large Accelerated Filer" in Rule 12b-2 of the Exchange Act. (check one): Large Accelerated filer ý Accelerated filer o Non-Accelerated filer o Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Act.) Yes o No ý

As of June 30, 2007, the aggregate market value of the voting common stock held by non-affiliates of the registrant, computed by reference to the average high and low sales prices on The Nasdaq Stock Market LLC as of the close of business on June 30, 2007, was approximately $1.6 billion. Registrant does not have any nonvoting common equities.

As of February 21, 2008, there were 27,147,419 shares of registrant's common stock outstanding, excluding 1,010,033 shares of unvested restricted stock.

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Items 10, 11, 12, 13 and 14 of Part III of this Annual Report on Form 10-K will be found in the Company's definitive proxy statement for its 2008 Annual Meeting of Shareholders, to be filed pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended, and such information is incorporated herein by this reference.

PART I

ITEM 1. BUSINESS

General

We are a bank holding company registered under the Bank Holding Company Act of 1956, as amended. Our principal business is to serve as a holding company for our banking subsidiary. As of December 31, 2007 and 2006, our sole banking subsidiary is Pacific Western Bank. We refer to Pacific Western herein as the "Bank" and when we say "we", "our" or the "Company", we mean the Company on a consolidated basis with Pacific Western. When we refer to "First Community" or to the holding company, we are referring to the parent company on a stand-alone basis. As of December 31, 2005, our banking subsidiaries were Pacific Western National Bank which we also refer to as Pacific Western, and First National Bank, which we refer to as First National. Pacific Western National Bank converted from a national banking charter to a state bank charter under the name of Pacific Western Bank on September 13, 2006. At the time of its charter conversion, Pacific Western also withdrew from membership in the Federal Reserve System and became a "nonmember" bank. Additionally, on October 26, 2006, following the completion of the acquisition of Community Bancorp Inc. and the subsequent merger of its wholly-owned subsidiary, Community National Bank with and into First National, we completed our plan of consolidation by merging First National, with and into Pacific Western, with Pacific Western as the surviving entity in an "as if" pooling transaction. All references to Pacific Western, or the Bank, prior to September 13, 2006 refer to Pacific Western National Bank, and references on or after September 13, 2006 refer to Pacific Western Bank.

On June 25, 2007 we acquired Business Finance Capital Corporation, or BFCC, a commercial finance company based in San Jose, California, and parent company to BFI Business Finance, or BFI. At the time of the acquisition, BFCC was merged out of existence and BFI became a wholly-owned subsidiary of Pacific Western. On January 4, 2006, we acquired Cedars Bank, or Cedars, which was merged with and into Pacific Western. On May 9, 2006, we acquired Foothill Independent Bancorp, or Foothill. At the time of acquisition Foothill was merged with and into the First Community Bancorp and Foothill's wholly-owned subsidiary, Foothill Independent Bank, was merged with and into Pacific Western.

Pacific Western is a full-service community bank offering a broad range of banking products and services through 60 branch offices located in Los Angeles, Orange, Riverside, San Bernardino and San Diego Counties, California. We accept time and demand deposits, fund loans including real estate, construction, SBA and commercial loans, and offer other business oriented banking products. Our operations are primarily located in Southern California and the Bank focuses on conducting business with small to medium size businesses and the owners and employees of those businesses in our marketplace. We also operate in Arizona, Northern California, the Pacific Northwest, and Texas through our asset-based lending division doing business as First Community Financial, which we refer to as FCF, BFI, and SBA loan production offices. At December 31, 2007, our assets totaled $5.2 billion, of which gross loans, excluding loans held for sale, totaled $4.0 billion. At this date approximately 23% were commercial loans, 53% were commercial real estate loans, 10% were commercial real estate construction loans, 8% were residential real estate construction loans, 5% were residential real estate loans and 1% were consumer and other loans. These percentages include some foreign loans, primarily to individuals or entities with business in Mexico, representing 1% of total loans.

We generate our income primarily from the interest received on the various loan products and investment securities and fees from providing deposit services, foreign exchange services and extending credit. Our major operating expenses are the interest paid by the Bank on deposits and borrowings, employee compensation and general operating expenses. The Bank relies on a foundation of locally generated deposits to fund loans. Our Bank has a relatively low cost of funds due to a high percentage of noninterest-bearing and low cost deposits to total deposits. Our operations, similar to other financial institutions with operations predominately focused in Southern California, are significantly influenced by economic conditions in Southern California, including the strength of the real estate market, the fiscal and regulatory policies of the federal and state government and the regulatory authorities that govern financial institutions. See " Supervision and Regulation." Through our SBA loan production offices and our asset-based lending operations with production and marketing offices in Arizona, Northern California, the Pacific Northwest and Texas, we are also subject to the economic conditions affecting these markets.

We are committed to maintaining premier, relationship-based community banking in Southern California, serving the needs of small to medium-sized businesses and the owners and employees of those businesses, as well as serving the needs of growing businesses that may not yet meet the credit standards of the Bank through tightly controlled asset-based lending and factoring of accounts receivable. The strategy for serving our target markets is the delivery of a finely-focused set of value- added products and services that satisfy the primary needs of our customers, emphasizing superior service and relationships as opposed to transaction volume or low pricing.

Strategic Evolution and Acquisition Strategy

The Company was organized on October 22, 1999 as a California corporation for the purpose of becoming a bank holding company and to acquire all the outstanding capital stock of Rancho Santa Fe National Bank, First National's predecessor.

We have grown rapidly through a series of acquisitions. The following chart summarizes the completed acquisitions since our inception, some of which are described in more detail below. See also Note 2 of the Notes to Consolidated Financial Statements contained in "Item 8. Financial Statements and Supplementary Data" for further details regarding our acquisitions.

Date	Institution/Company Acquired
May 2000	Rancho Santa Fe National Bank
May 2000	First Community Bank of the Desert
January 2001	Professional Bancorp, Inc.
October 2001	First Charter Bank
January 2002	Pacific Western National Bank
March 2002	W.H.E.C., Inc.
August 2002	Upland Bank
August 2002	Marathon Bancorp
September 2002	First National Bank
January 2003	Bank of Coronado
August 2003	Verdugo Banking Company
March 2004	First Community Financial Corporation
April 2004	Harbor National Bank
August 2005	First American Bank
October 2005	Pacific Liberty Bank
January 2006	Cedars Bank
May 2006	Foothill Independent Bancorp
October 2006	Community Bancorp Inc.
June 2007	Business Finance Capital Corporation

We have financed our acquisitions, in part, with cash raised from the sale of our common stock or from the issuance of subordinated debentures. In January 2006, we raised $109.5 million via the sale of 1.9 million shares of our common stock in a registered public offering. The proceeds of the January 2006 offering were used to provide regulatory capital to support the acquisition of Cedars Bank. We have outstanding a total of $138.5 million in subordinated debentures as follows: $8.2 million issued in 2000, $20.6 million issued in 2003, $61.9 million issued in 2004, and $47.8 million acquired in our acquisitions of Foothill and Community Bancorp. In June 2007, we retired $10.3 million of subordinated debentures issued in 2002. See Note 8 of the Notes to Consolidated Financial Statements contained in "Item 8. Financial Statements and Supplementary Data." As described in more detail below, we have also financed certain acquisitions with the exchange of our common stock for the stock of the target company. Below is a summary of the acquisitions which have occurred since the beginning of 2005.

First American Bank Acquisition

On August 12, 2005, we acquired First American Bank, or First American, based in Rosemead, California. We paid approximately $59.7 million in cash to First American shareholders, and caused First American to pay $2.6 million in cash for all outstanding options to purchase First American common stock. The aggregate deal value was approximately $62.3 million. We made this acquisition to expand our presence in Los Angeles County, California. At the time of the acquisition, First American was merged into Pacific Western.

Pacific Liberty

On October 7, 2005, we acquired Pacific Liberty Bank, or Pacific Liberty, based in Huntington Beach, California. We issued 783,625 shares of our common stock to the Pacific Liberty shareholders and caused Pacific Liberty to pay $5.0 million in cash for all outstanding options to purchase Pacific Liberty common stock. The aggregate deal value was approximately $41.6 million. We made this acquisition to expand our presence in Orange County, California. At the time of the acquisition, Pacific Liberty was merged into Pacific Western.

Cedars Bank

On January 4, 2006, we acquired Cedars Bank, or Cedars, based in Los Angeles, California. We paid approximately $120.0 million in cash for all of the outstanding shares of common stock and options of Cedars. We made this acquisition to expand our presence in Los Angeles, California. At the time of the acquisition, Cedars was merged into Pacific Western. In January 2006, we issued 1,891,086 shares of common stock for net proceeds of $109.5 million. We used these proceeds to augment our regulatory capital in support of the Cedars acquisition.

Foothill Independent Bancorp

On May 9, 2006, we acquired Foothill Independent Bancorp, or Foothill, based in Glendora, California. We issued 3,946,865 shares of our common stock to the Foothill shareholders and caused Foothill to pay $10.2 million in cash for all outstanding options to purchase Foothill common stock. The aggregate deal value was approximately $242.5 million. At the time of the acquisition, Foothill was merged with and into the Company and Foothill Independent Bank, a wholly-owned subsidiary of Foothill, was merged with and into Pacific Western. We made this acquisition to expand our presence in Los Angeles, Riverside and San Bernardino Counties of California.

Community Bancorp Inc.

On October 26, 2006, we acquired Community Bancorp Inc., or Community Bancorp, based in Escondido, California. We issued 4,677,908 shares of our common stock to the Community Bancorp shareholders and caused Community Bancorp to pay $6.1 million in cash for all outstanding options to purchase Community Bancorp common stock. The aggregate deal value for financial reporting purposes was approximately $268.7 million. At the time of the acquisition, Community Bancorp was merged with and into the Company and Community National Bank, a wholly-owned subsidiary of Community Bancorp, was merged with and into First National. We made this acquisition to expand our presence in the San Diego and Riverside Counties of California.

BFI Business Finance

On June 25, 2007 we acquired Business Finance Capital Corporation, or BFCC, a commercial finance company based in San Jose, California, and parent company to BFI Business Finance, or BFI. We issued 494,606 shares of our common stock to the BFCC common shareholders, paid $5.9 million in cash to preferred shareholders of BFCC and caused BFCC to pay $1.4 million in cash for all outstanding options to purchase BFCC common stock. The aggregate deal value was $35.0 million. BFI is an asset-based lender that lends primarily to growing businesses throughout California and the northwestern United States. At the time of the acquisition, BFCC was merged out of existence and BFI became a subsidiary of Pacific Western. We made this acquisition, which we refer to as the BFI acquisition, to expand our asset-based lending business and further diversify our loan portfolio.

Banking Business

The Bank is a full-service community bank that offers a broad range of banking products and services, including many types of business and personal money market and checking accounts and other commercial and consumer banking services, including foreign exchange services. We generate our income primarily from the interest received on various loan products and investment securities, and fees from providing deposit services, foreign exchange services and extending credit. The Bank originates several types of loans, including secured and unsecured commercial and consumer loans, commercial real estate mortgage loans, SBA loans and construction loans. We extend credit to customers located primarily in the counties we serve, and through certain programs we also extend credit and make commercial and real estate loans to businesses located in Mexico. Special services, including international banking services, multi-state deposit services and investment services, or requests beyond the lending limits of the Bank can be arranged through correspondent banks. The Bank issues ATM and debit cards, has a network of ATMs and offers access to ATM networks through other major service providers. We focus on providing these banking and financial services throughout Southern California to small and medium-sized businesses and the owners and employees of those businesses. We also provide asset-based lending and factoring of accounts receivable to small businesses located throughout the western United States through BFI based in San Jose, California, FCF based in Phoenix, Arizona and marketing offices in Dallas, Houston and San Antonio, Texas, Bellevue, Washington and Los Angeles and Orange Counties, California.

Through the Bank, the Company concentrates its lending activities in four principal areas:

(1) *Real Estate Loans.* Real estate loans are comprised of construction loans, miniperm loans collateralized by first or junior deeds of trust on specific commercial properties and equity lines of credit. The properties collateralizing real estate loans are principally located in our primary market areas of Los Angeles, Orange, San Bernardino, Riverside and San Diego counties in California and the contiguous communities. Construction loans are comprised of loans on commercial, residential and income producing properties that generally have terms of less than two years and typically bear an interest rate that floats with the Bank's base rate, prime rate or another established index. Miniperm loans finance the purchase and/or ownership of commercial properties, including owner-occupied and income producing properties. Miniperm loans are generally made with an amortization schedule ranging from 15 to 25 years with a lump sum balloon payment due in one to ten years. Equity lines of credit are revolving lines of credit

collateralized by junior deeds of trust on residential real properties. They generally bear a rate of interest that floats with the Bank's base rate or the prime rate and have maturities of five years. From time to time, we purchase participation interests in loans originated by other financial institutions. These loans are subject generally to the same underwriting criteria and approval process as loans originated directly by us.

The Bank's real estate portfolio is subject to certain risks, including, but not limited to (i) the effects of economic downturns in the Southern California economy, (ii) interest rate increases, (iii) reduction in real estate values in Southern California, (iv) increased competition in pricing and loan structure, and (v) environmental risks, including natural disasters. In addition to the foregoing, construction loans are also subject to project specific risks including, but not limited to, (1) construction costs being more than anticipated; (2) construction taking longer than anticipated; (3) failure by developers and contractors to meet project specifications; (4) disagreement between contractors, subcontractors and developers; (5) demand for completed projects being less than anticipated; (6) buyers being unable to secure financing; and (7) loss through foreclosure. When underwriting loans, we strive to reduce the exposure to such risks by (a) reviewing each loan request and renewal individually, (b) using a dual signature approval system for the approval of each loan request for loans over a certain dollar amount, (c) adhering to written loan policies, including, among other factors, minimum collateral requirements, maximum loan-to-value ratio requirements, cash flow requirements and personal guarantees, (d) obtaining secondary appraisals, (e) obtaining external independent credit reviews, (f) evaluating concentrations as a percentage of capital and loans, and (g) conducting environmental reviews, where appropriate. With respect to construction loans, in addition to the foregoing, we attempt to mitigate project specific risks by (A) implementing a controlled disbursement process for loan proceeds in accordance with an agreed upon schedule; (B) conducting project site visits; and (C) adhering to release-price schedules to ensure the prices for which newly-built units to be sold are sufficient to repay the Bank. The risks related to buyer inability to secure financing and loss through foreclosure are not controllable. We review each loan request on the basis of our ability to recover both principal and interest in view of the inherent risks.

(2) *Commercial Loans.* Commercial loans are made to finance operations, to provide working capital, or for specific purposes, such as to finance the purchase of assets, equipment or inventory. Since a borrower's cash flow from operations is generally the primary source of repayment, our policies provide specific guidelines regarding required debt coverage and other important financial ratios. Commercial loans include lines of credit and commercial term loans. Lines of credit are extended to businesses or individuals based on the financial strength and integrity of the borrower and generally (with some exceptions) are collateralized by short-term assets such as accounts receivable, inventory, equipment or real estate and have a maturity of one year or less. Such lines of credit bear an interest rate that floats with the Bank's base rate, the prime rate, LIBOR or another established index. Commercial term loans are typically made to finance the acquisition of fixed assets, refinance short-term debt originally used to purchase fixed assets or, in rare cases, to finance the purchase of businesses. Commercial term loans generally have terms from one to five years. They may be collateralized by the asset being acquired or other available assets and bear interest rates which either float with the Bank's base rate, the prime rate, LIBOR or another established index or is fixed for the term of the loan.

The Bank's portfolio of commercial loans is subject to certain risks, including, but not limited to (i) the effects of economic downturns in the Southern California economy, (ii) interest rate increases, (iii) deterioration of the value of the underlying collateral, and (iv) the deterioration of a borrower's or guarantor's financial capabilities. We strive to reduce the exposure to such risks through (a) reviewing each loan request and renewal individually, (b) using a dual signature approval system, (c) adhering to written loan policies, (d) obtaining external independent credit reviews, and (e) in the case of certain commercial loans to Mexican or foreign entities, third party insurance which limits our exposure to anywhere from 20 to 30 percent of the underlying loan. In addition, loans based on short-term asset values and factoring arrangements are monitored on a daily, weekly, monthly or quarterly basis and may include lockbox or control account arrangements. In general, the Bank receives and reviews financial statements and other documents of borrowing customers on an ongoing basis during the term of the relationship and responds to any deterioration noted.

(3) *SBA Loans.* The Bank makes SBA loans through programs designed by the federal government to assist the small business community in obtaining financing from financial institutions that are given government guarantees as an incentive to make the loans. Our SBA loans fall into two categories, loans originated under the SBA's 7a Program ("7a Loans") and loans originated under the SBA's 504 Program ("504 Loans"). SBA 7a Loans are commercial business loans generally made for the purpose of purchasing real estate to be occupied by the business owner, providing working capital, and/or purchasing equipment, accounts receivable or inventory. SBA 504 Loans are collateralized by commercial real estate and are generally made to business owners for the purpose of purchasing or improving real estate for their use and for equipment used in their business.

SBA lending is subject to federal legislation that can affect the availability and funding of the program. From time to time, this dependence on legislative funding causes limitations and uncertainties with regard to the continued funding of such programs, which could potentially have an adverse financial impact on our business.

The Bank's portfolio of SBA loans is subject to certain risks, including, but not limited to (i) the effects of economic downturns in the Southern California economy, (ii) interest rate increases, (iii) deterioration of the value of the underlying collateral, and (iv) the deterioration of a borrower's or guarantor's financial capabilities. We strive to reduce the exposure of such risks through (a) reviewing each loan request and renewal individually, (b) using a dual signature approval system, (c) adhering to written loan policies, (d) adhering to SBA written policies and regulations, (e) obtaining secondary appraisals, and (f) obtaining independent credit reviews. In addition, SBA loans normally require monthly installment payments of principal and interest and therefore are continually monitored for past due conditions. In general, the Bank receives and reviews financial statements and other documents of borrowing customers on an ongoing basis during the term of the relationship and responds to any deterioration noted.

(4) *Consumer Loans.* Consumer loans include personal loans, auto loans, boat loans, home improvement loans, revolving lines of credit and other loans typically made by banks to individual borrowers. The Bank's consumer loan portfolio is subject to certain risks, including (i) amount of credit offered to consumers in the market, (ii) interest rate increases, and (iii) consumer bankruptcy laws which allow consumers to discharge certain debts. We strive to reduce the exposure to such risks through the direct approval of all consumer loans by (a) reviewing each loan request and renewal individually, (b) using a dual signature approval system, (c) adhering to written credit policies, and (d) obtaining external independent credit reviews.

As part of our efforts to achieve long-term stable profitability and respond to a changing economic environment in Southern California and in other areas where we operate, we constantly evaluate a variety of options to augment our traditional focus by broadening the services and products we provide. Possible avenues of growth include more branch locations, expanded days and hours of operation and new types of loan and deposit products. To date, we have not expanded into areas of brokerage, annuity, insurance or similar investment products and services and have concentrated primarily on the core businesses of accepting deposits, making loans and extending credit.

Business Concentrations

No individual or single group of related accounts is considered material in relation to our total assets or to the assets or deposits of the Bank, or in relation to the overall business of the Company. However, approximately 76% of our loan portfolio held for investment at December 31, 2007 consisted of real estate-related loans, including construction loans, miniperm loans, commercial real estate mortgage loans and commercial loans secured by commercial real estate. See "Item 7. Management's

Discussion and Analysis of Financial Condition and Results of Operations Financial Condition Loans." Moreover, our business activities are currently focused primarily in Southern California, with the majority of our business concentrated in Los Angeles, Riverside, Orange, San Bernardino and San Diego Counties. Consequently, our results of operations and financial condition are dependent upon the general trends in the Southern California economies and, in particular, the residential and commercial real estate markets. The concentration of our operations in Southern California exposes us to greater risk than other banking companies with a wider geographic base in the event of catastrophes, such as earthquakes, fires and floods in this region. We conduct foreign lending activities including commercial and real estate lending, consisting predominantly of loans to individuals or entities located in Mexico. All of our foreign loans are denominated in U.S. dollars and most are collateralized by assets located in the United States or guaranteed or insured by businesses located in the United States. We have continued to allow our foreign loan portfolio to repay in the ordinary course of business without making any new privately-insured foreign loans other than those under existing commitments. We also conduct asset-based lending and factoring of accounts receivable primarily in Arizona, Northern California, the Pacific Northwest, and Texas.

Competition

The banking business in California, and specifically in the Bank's primary service areas, is highly competitive with respect to originating loans, generating deposits and providing other banking services. The market is dominated by a relatively small number of major banks with a large number of offices and full-service operations over a wide geographic area. Among the advantages such major banks have in comparison to the Bank is their ability to finance and engage in wide-ranging advertising campaigns and to invest in regions of higher yield and demand. These competitors offer certain services which we do not offer directly and by virtue of their greater total capitalization, such banks have substantially higher lending limits than we offer. Other entities, in both the public and private sectors, seeking to raise capital through the issuance and sale of debt or equity securities also compete with us for the acquisition of deposits. In recent years, increased competition has also developed from specialized finance and non-finance companies that offer wholesale finance, credit card and other consumer finance services (including on-line banking services and personal financial software). Competition for deposit and loan products remains strong from both banking and non-banking institutions and this competition directly affects the rates of those products and the terms on which they are offered to consumers and businesses.

Technological innovation continues to contribute to greater competition in domestic and international financial services markets. Technological innovation has, for example, made it possible for non-depository institutions to offer customers automated transfer payment services previously limited to traditional banking products. In addition, customers now expect a choice of several delivery systems and channels, including telephone, mail, home computer, ATMs, self-service branches and in-store branches.

Mergers between financial institutions have placed additional pressure on banks within the industry to consolidate their operations, reduce expenses and increase revenues to remain competitive. In addition, competition has intensified due to federal and state interstate banking laws, which permit banking organizations to expand geographically with fewer restrictions than in the past. These laws allow banks to merge with other banks across state lines, thereby enabling banks to establish or expand banking operations in our most significant markets. The competitive environment is also significantly affected by federal and state legislation which make it easier for non-bank financial institutions to compete with us.

Economic factors, along with legislative and technological changes, will have an ongoing impact on the competitive environment within the financial services industry. We work to anticipate and adapt to dynamic competitive conditions, but we can make no assurance as to the effectiveness of these efforts on our future business or results of operations or as to our continued ability to anticipate and adapt to changing conditions. In order to compete with other financial services providers in our primary service areas, we attempt to use, to the fullest extent possible, the flexibility which our independent status permits, including an emphasis on specialized services, local promotional activity and personal contacts. We strive to offer highly personalized banking services and to continually improve our range of banking services provided and products offered. We believe that through focusing on providing services tailored to meet the needs of our customers and by cross-marketing our products, we can be competitive with and distinguish ourselves from other community banks and financial services providers in our marketplace. However, we can provide no assurance that we will be able to sufficiently improve our services and/or banking products or successfully compete in our primary service areas.

Employees

As of February 15, 2008, Pacific Western had 860 full time equivalent employees and First Community had 21 full time equivalent employees.

Financial and Statistical Disclosure

Certain of our statistical information is presented within "Item 6. Selected Financial Data," "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Item 7A. Qualitative and Quantitative Disclosure About Market Risk." This information should be read in conjunction with the consolidated financial statements contained in "Item 8. Financial Statements and Supplementary Data."

Supervision and Regulation

General

The banking and financial services business in which we engage is highly regulated. Such regulation is intended, among other things, to protect depositors insured by the Federal Deposit Insurance Corporation, or FDIC, and the entire banking system. The commercial banking business is also influenced by the monetary and fiscal policies of the federal government and the policies of the Federal Reserve Bank, or FRB. The FRB implements national monetary policies (with objectives such as curbing inflation and combating recession) by its open-market operations in United States Government securities, by adjusting the required level of reserves for financial intermediaries subject to its reserve requirements and by varying the discount rates applicable to borrowings by depository institutions. The actions of the FRB in these areas influence the growth of bank loans, investments and deposits and also affect interest rates charged on loans and paid on deposits. Indirectly, such actions may also impact the ability of non-bank financial institutions to compete with the Bank. The nature and impact of any future changes in monetary policies cannot be predicted.

The laws, regulations and policies affecting financial services businesses are continuously under review by Congress, state legislatures and federal and state regulatory agencies. From time to time, legislation is enacted which has the effect of increasing the cost of doing business, limiting or expanding permissible activities or affecting the competitive balance between banks and other financial intermediaries. Proposals to change the laws and regulations governing the operations and taxation of banks, bank holding companies and other financial intermediaries are frequently made in Congress, in the California legislature and by various bank regulatory agencies and other professional agencies. Changes in the laws, regulations or policies that impact us cannot necessarily be predicted, but they may have a material effect on our business and earnings.

Bank Holding Company Regulation

As a bank holding company, First Community is registered with and subject to regulation by the FRB under the Bank Holding Company Act of 1956, as amended, or the BHCA. In accordance with

FRB policy, First Community is expected to act as a source of financial strength to the Bank and to commit resources to support the Bank in circumstances where it might not otherwise do so. Similarly, under the cross-guarantee provisions of the Federal Deposit Insurance Act, the FDIC can hold any FDIC-insured depository institution liable for any loss suffered or anticipated by the FDIC in connection with (i) the default of a commonly controlled FDIC-insured depository institution or (ii) any assistance provided by the FDIC to such a commonly controlled institution. Under the BHCA, we are subject to periodic examination by the FRB. We are also required to file with the FRB periodic reports of our operations and such additional information regarding the Company and its subsidiaries as the FRB may require. Pursuant to the BHCA, we are required to obtain the prior approval of the FRB before we acquire all or substantially all of the assets of any bank or ownership or control of voting shares of any bank if, after giving effect to such acquisition, we would own or control, directly or indirectly, more than 5 percent of such bank.

Under the BHCA, we may not engage in any business other than managing or controlling banks or furnishing services to our subsidiaries that the FRB deems to be so closely related to banking as "to be a proper incident thereto." We are also prohibited, with certain exceptions, from acquiring direct or indirect ownership or control of more than 5 percent of the voting shares of any company unless the company is engaged in banking activities or the FRB determines that the activity is so closely related to banking to be a proper incident to banking. The FRB's approval must be obtained before the shares of any such company can be acquired and, in certain cases, before any approved company can open new offices.

Additionally, bank holding companies that meet certain eligibility requirements prescribed by the BHCA and elect to operate as financial holding companies may engage in, or own shares in companies engaged in, a wider range of nonbanking activities, including securities and insurance activities and any other activity that the FRB, in consultation with the Secretary of the Treasury, determines by regulation or order is financial in nature, incidental to any such financial activity or complementary to any such financial activity and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally. As of the date of this filing, we do not operate as a financial holding company.

The BHCA and regulations of the FRB also impose certain constraints on the redemption or purchase by a bank holding company of its own shares of stock.

Our earnings and activities are affected by legislation, by regulations and by local legislative and administrative bodies and decisions of courts in the jurisdictions in which we and the Bank conduct business. For example, these include limitations on the ability of the Bank to pay dividends to us and our ability to pay dividends to our shareholders. It is the policy of the FRB that bank holding companies should pay cash dividends on common stock only out of income available over the past year and only if prospective earnings retention is consistent with the organization's expected future needs and financial condition. The policy provides that bank holding companies should not maintain a level of cash dividends that undermines the bank holding company's ability to serve as a source of strength to its banking subsidiaries. Various federal and state statutory provisions limit the amount of dividends that subsidiary banks and savings associations can pay to their holding companies without regulatory approval. In addition to these explicit limitations, the federal regulatory agencies have general authority to prohibit a banking subsidiary or bank holding company from engaging in an unsafe or unsound banking practice. Depending upon the circumstances, the agencies could take the position that paying a dividend would constitute an unsafe or unsound banking practice. In addition, as discussed below under " Regulation of the Bank", a bank holding company such as the Company is required to maintain minimum ratios of Tier 1 capital and total capital to total risk-weighted assets, as well as a minimum ratio of Tier 1 capital to total adjusted quarterly average assets as defined in such regulations.

In addition, banking subsidiaries of bank holding companies are subject to certain restrictions imposed by federal law in dealings with their holding companies and other affiliates. Subject to certain exceptions set forth in the Federal Reserve Act, a bank can make a loan or extend credit to an affiliate, purchase or invest in the securities of an affiliate, purchase assets from an affiliate, accept securities of an affiliate as collateral for a loan or extension of credit to any person or company, issue a guarantee or accept letters of credit on behalf of an affiliate only if the aggregate amount of the above transactions of such subsidiary does not exceed 10 percent of such subsidiary's capital stock and surplus on an individual basis or 20 percent of such subsidiary's capital stock and surplus on an aggregate basis. Such transactions must be on terms and conditions that are consistent with safe and sound banking practices. A bank holding company and its subsidiaries generally may not purchase a "low-quality asset," as that term is defined in the Federal Reserve Act, from an affiliate. Such restrictions also prevent a holding company and its other affiliates from borrowing from a banking subsidiary of the holding company unless the loans are secured by collateral.

The FRB has cease and desist powers over parent bank holding companies and non-banking subsidiaries where the action of a parent bank holding company or its non-financial institutions represent an unsafe or unsound practice or violation of law. The FRB has the authority to regulate debt obligations, other than commercial paper, issued by bank holding companies by imposing interest ceilings and reserve requirements on such debt obligations.

Regulation of the Bank

The Bank is extensively regulated under both federal and state law.

Pacific Western is insured by the FDIC, which currently insures non-IRA deposits of each insured bank to a maximum of $100,000 per depositor and IRA deposits of each insured bank to a maximum of $250,000 per depositor. For this protection, Pacific Western, as is the case with all insured banks, pays a quarterly statutory assessment and is subject to the rules and regulations of the FDIC. Additionally, Pacific Western is a state-chartered bank and is regulated by the California Department of Financial Institutions, or DFI.

Various requirements and restrictions under federal and state law affect the operations of the Bank. Federal and state statutes and regulations relate to many aspects of the Bank's operations, including standards for safety and soundness, reserves against deposits, interest payable on certain deposit products, investments, mergers and acquisitions, borrowings, dividends, locations of branch offices, fair lending requirements, Community Reinvestment Act activities and loans to affiliates.

Further, each of the Company and the Bank is required to maintain certain levels of capital. The FRB and the FDIC have substantially similar risk-based capital ratio and leverage ratio guidelines for banking organizations. The guidelines are intended to ensure that banking organizations have adequate capital given the risk levels of assets and off-balance sheet financial instruments. Under the guidelines, banking organizations are required to maintain minimum ratios for Tier 1 capital and total capital to risk-weighted assets (including certain off-balance sheet items, such as letters of credit). For purposes of calculating the ratios, a banking organization's assets and some of its specified off-balance sheet commitments and obligations are assigned to various risk categories. A depository institution's or holding company's capital, in turn, is classified in one of three tiers, depending on type:

> *Core Capital (Tier 1).* Tier 1 capital includes common equity, retained earnings, qualifying non-cumulative perpetual preferred stock, a limited amount of qualifying cumulative perpetual stock at the holding company level, minority interests in equity accounts of consolidated subsidiaries, and qualifying trust preferred securities less goodwill, most intangible assets and certain other assets.

Supplementary Capital (Tier 2). Tier 2 capital includes, among other things, perpetual preferred stock and trust preferred securities not meeting the Tier 1 definition, qualifying mandatory convertible debt securities, qualifying subordinated debt, and allowances for possible credit losses, subject to limitations.

Market Risk Capital (Tier 3). Tier 3 capital includes qualifying unsecured subordinated debt.

The following are the regulatory capital guidelines and the actual capitalization levels for Pacific Western and the Company as of December 31, 2007:

	Adequately Capitalized	**Well Capitalized**	**Pacific Western**	**Company Consolidated**
	(greater than or equal to)			
Total risk-based capital ratio	8.00%	10.00%	12.90%	11.92%
Tier 1 risk-based capital ratio	4.00%	6.00%	11.65%	10.67%
Tier 1 leverage capital ratio	4.00%	5.00%	12.07%	11.06%

The Company issued subordinated debentures to trusts that were established by us or entities we have acquired, which, in turn, issued trust preferred securities, which totaled $131.0 million at December 31, 2007. We retired $10.0 million of our trust preferred securities during 2007. Our trust preferred securities are currently included in our Tier I capital for purposes of determining the Company's Tier I and total risk-based capital ratios. The FRB has promulgated a modification of the capital regulations affecting trust preferred securities. Under this modification, effective March 31, 2009, the Company will be required to use a more restrictive formula to determine the amount of trust preferred securities that can be included in regulatory Tier I capital. At that time, the Company will be allowed to include in Tier I capital an amount of trust preferred securities equal to no more than 25% of the sum of all core capital elements, which is generally defined as shareholders' equity, less goodwill net of any related deferred income tax liability. The regulations currently in effect through December 31, 2008 limit the amount of trust preferred securities that can be included in Tier I capital to 25% of the sum of core capital elements without a deduction for goodwill. We have determined that our Tier I capital ratios would remain above the well-capitalized level had the modification of the capital regulations been in effect at December 31, 2007. We expect that our Tier I capital ratios will be at or above the existing well capitalized levels on March 31, 2009, the first date on which the modified capital regulations must be applied.

The FDIC and FRB risk-based capital guidelines are based upon the 1988 capital accord of the Basel Committee on Banking Supervision, or BIS. The BIS is a committee of central banks and bank supervisors/regulators from the major industrialized countries that develops broad policy guidelines that each country's supervisors can use to determine the supervisory policies they apply. The BIS has been working for a number of years on revisions to the 1988 capital accord and in June 2004 released the final version of its proposed new capital framework, with an update in November 2005, or BIS II. BIS II proposes two approaches for setting capital standards for credit risk an internal ratings-based approach tailored to individual institutions' circumstances (which for many asset classes is itself broken into a "foundation" approach and an "advanced" or "A-IRB" approach, the availability of which is subject to additional restrictions) and a standardized approach that bases risk weightings on external credit assessments to a much greater extent than permitted in existing risk-based capital guidelines. BIS II also would set capital requirements for operational risk and refine the existing capital requirements for market risk exposures.

The U.S. banking and thrift agencies are developing proposed revisions to their existing capital adequacy regulations and standards based on BIS II. In September 2006, the agencies issued a notice of proposed rulemaking setting forth a definitive proposal for implementing BIS II in the United States that would apply only to internationally active banking organizations defined as those with consolidated total assets of $250 billion or more or consolidated on-balance sheet foreign exposures of

$10 billion or more but that other U.S. banking organizations could elect but would not be required to apply. In November 2007, the agencies adopted a definitive final rule for implementing BIS II in the United States that would apply only to internationally active banking organizations, or "core banks" defined as those with consolidated total assets of $250 billion or more or consolidated on-balance sheet foreign exposures of $10 billion or more. The final rule will be effective as of April 1, 2008. At the same time, the agencies announced their intention to issue a proposed rule that provide other U.S. banking organizations an option to adopt a "standardized approach" under BIS II. This new proposal, which is intended to be finalized before the core banks may start their first transition period year under BIS II, will replace the agencies' earlier proposed amendments to existing risk-based capital guidelines to make them more risk sensitive (formerly referred to as the "BIS I-A" approach).

The Company is not required to comply with BIS II. The Company determined that it will not adopt the BIS II approach when it becomes effective.

Prompt Corrective Action

The Federal Deposit Insurance Corporation Improvement Act, or FDICIA, requires each federal banking agency to take prompt corrective action to resolve the problems of insured depository institutions, including but not limited to those that fall below one or more prescribed minimum capital ratios. Pursuant to FDICIA, the FDIC promulgated regulations defining the following five categories in which an insured depository institution will be placed, based on the level of its capital ratios: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. Under the prompt corrective action provisions of FDICIA, an insured depository institution generally will be classified as undercapitalized if its total risk-based capital is less than 8% or its Tier 1 risk-based capital or leverage ratio is less than 4%. An institution that, based upon its capital levels, is classified as "well capitalized", "adequately capitalized" or "undercapitalized" may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition or an unsafe or unsound practice warrants such treatment. At each successive lower capital category, an insured depository institution is subject to more restrictions and prohibitions, including restrictions on growth, prohibitions on payment of dividends and restrictions on the acceptance of brokered deposits. Furthermore, if a bank is classified in one of the undercapitalized categories, it is required to submit a capital restoration plan to the federal bank regulator, and the holding company must guarantee the performance of that plan.

In addition to measures taken under the prompt corrective action provisions, commercial banking organizations may be subject to potential enforcement actions by the federal or state banking agencies for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation or any condition imposed in writing by the agency or any written agreement with the agency. Enforcement actions may include the imposition of a conservator or receiver, the issuance of a cease-and-desist order that can be judicially enforced, the termination of insurance of deposits (in the case of a depository institution), the imposition of civil money penalties, the issuance of directives to increase capital, the issuance of formal and informal agreements, the issuance of removal and prohibition orders against institution-affiliated parties. The enforcement of such actions through injunctions or restraining orders may be based upon a judicial determination that the agency would be harmed if such equitable relief was not granted.

Hazardous Waste Clean-Up

Since we are not involved in any business that manufactures, uses or transports chemicals, waste, pollutants or toxins that might have a material adverse effect on the environment, our primary exposure to environmental laws is through our lending activities and through properties or businesses we may own, lease or acquire. Based on a general survey of the Bank's loan portfolio, conversations with local appraisers and the type of lending currently and historically done by the Bank, we are not aware of any potential liability for hazardous waste contamination that would be reasonably likely to have a material adverse effect on the Company as of February 15, 2008.

Sarbanes-Oxley Act

The Sarbanes-Oxley Act of 2002 aims to restore the credibility lost as a result of high profile corporate scandals by addressing, among other issues, corporate governance, auditing and accounting, executive compensation and enhanced and timely disclosure of corporate information. The Nasdaq Stock Market has adopted corporate governance rules intended to allow shareholders to more easily and effectively monitor the performance of companies and directors. The principal provisions of the Sarbanes-Oxley Act, many of which have been interpreted through regulations released in 2003, provide for and include, among other things: (i) the creation of the Public Company Accounting Oversight Board; (ii) auditor independence provisions that restrict non-audit services that accountants may provide to their audit clients; (iii) additional corporate governance and responsibility measures, including the requirement that the chief executive officer and chief financial officer of a public company certify financial statements; (iv) the forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer's securities by directors and senior officers in the twelve month period following initial publication of any financial statements that later require restatement; (v) an increase in the oversight of, and enhancement of certain requirements relating to, audit committees of public companies and how they interact with that company's independent auditors; (vi) requirements that audit committee members must be independent and are barred from accepting consulting, advisory or other compensatory fees from the issuer; (vii) requirements that companies disclose whether at least one member of the audit committee is a "financial expert" (as such term is defined by the SEC) and if not disclosed, why the audit committee does not have a financial expert; (viii) expanded disclosure requirements for corporate insiders, including accelerated reporting of stock transactions by insiders and a prohibition on insider trading during pension blackout periods; (ix) a prohibition on personal loans to directors and officers, except certain loans made by insured financial institutions on nonpreferential terms and in compliance with other bank regulatory requirements; (x) disclosure of a code of ethics and filing a Form 8-K for a change or waiver of such code; (xi) a range of enhanced penalties for fraud and other violations; and (xii) expanded disclosure and certification relating to an issuer's disclosure controls and procedures and internal controls over financial reporting.

As a result of the Sarbanes-Oxley Act, and its implementing regulations, we have incurred substantial costs to interpret and ensure ongoing compliance with the law and its regulations. Future changes in the laws, regulation, or policies that impact us cannot necessarily be predicted and may have a material effect on our business and earnings.

USA Patriot Act

The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, or the Patriot Act, designed to deny terrorists and others the ability to obtain access to the United States financial system, has significant implications for depository institutions, brokers, dealers and other businesses involved in the transfer of money. The Patriot Act, as implemented by various federal regulatory agencies, requires financial institutions, including the Company, to implement new policies and procedures or amend existing policies and procedures with respect to, among other matters, anti-money laundering, compliance, suspicious activity and currency transaction reporting and due diligence on customers. The Patriot Act and its underlying regulations also permit information sharing for counter-terrorist purposes between federal law enforcement agencies and financial institutions, as well as among financial institutions, subject to certain conditions, and require the FRB, the FDIC and other federal banking agencies to evaluate the effectiveness of an applicant in combating money laundering activities when considering applications filed under Section 3 of the BHCA or the Bank Merger Act. The Company has augmented its systems and procedures to accomplish this. We believe that the ongoing cost of compliance with the Patriot Act is not likely to be material to the Company.

Federal Deposit Insurance

Because of favorable loss experience and a healthy reserve ratio in the Deposit Insurance Fund (formerly known as the Bank Insurance Fund), or DIF, of the FDIC, well-capitalized and well-managed banks, including the Bank, have in recent years paid minimal premiums for FDIC insurance. The FDIC notified banks that beginning in 2007, it would increase the premiums for deposit insurance. Concurrently, a deposit premium refund, in the form of credit offsets for future premiums, was granted to banks that were in existence on December 31, 1996 and paid deposit insurance premiums prior to that date. Pacific Western and many of our acquired institutions met the qualifications and we received credits during 2007 which offset all of our 2007 premiums. For 2008, only 90% of the premiums may be offset against these credits. The amount of any future premiums will depend on the DIF loss experience, legislation or regulatory initiatives and other factors, none of which we are in position to predict at this time.

Community Reinvestment Act

The Community Reinvestment Act of 1977, or the CRA, generally requires insured depository institutions to identify the communities they serve and to make loans and investments, offer products, and provide services designed to meet the credit needs of these communities. The CRA also requires banks to maintain comprehensive records of its CRA activities to demonstrate how it is meeting the credit needs of their communities; these documents are subject to periodic examination by the FDIC. During these examinations, the FDIC rates such institutions' compliance with CRA as "Outstanding," "Satisfactory," "Needs to Improve" or "Substantial Noncompliance." The CRA requires the FDIC to take into account the record of a bank in meeting the credit needs of the entire communities served, including low-and moderate income neighborhoods, in determining such rating. Failure of an institution to receive at least a "Satisfactory" rating could inhibit such institution or its holding company from undertaking certain activities. The Bank received a CRA rating of "Satisfactory" as of its most recent examination.

Customer Information Security

The FRB and other bank regulatory agencies have adopted final guidelines for safeguarding confidential, personal customer information. These guidelines require each financial institution, under the supervision and ongoing oversight of its board of directors or an appropriate committee thereof, to create, implement and maintain a comprehensive written information security program designed to ensure the security and confidentiality of customer information, protect against any anticipated threats or hazard to the security or integrity of such information and protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer. We have adopted a customer information security program to comply with such requirements.

Privacy

The Gramm-Leach-Bliley Act of 1999 and the California Financial Information Privacy Act require financial institutions to implement policies and procedures regarding the disclosure of nonpublic personal information about consumers to non-affiliated third parties. In general, the statutes require explanations to consumers on policies and procedures regarding the disclosure of such nonpublic personal information, and, except as otherwise required by law, prohibits disclosing such information except as provided in the Bank's policies and procedures. Pacific Western has implemented privacy policies addressing these restrictions which are distributed regularly to all existing and new customers of the Bank.

Available Information

We maintain an Internet website at www.firstcommunitybancorp.com, and a website for Pacific Western at www.pacificwesternbank.com. At www.firstcommunitybancorp.com and via the "Investor Relations" link at the Bank's website, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to such reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act are available, free of charge, as soon as reasonably practicable after such forms are electronically filed with, or furnished to, the SEC. The public may read and copy any materials we file with the SEC at the SEC's Public Reference Room, located at 450 Fifth Street, NW, Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site at www.sec.gov that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. You may obtain copies of the Company's filings on the SEC site. These documents may also be obtained in print upon request by our shareholders to our Investor Relations Department.

We have adopted a written code of ethics that applies to all directors, officers and employees of the Company, including our principal executive officer and senior financial officers, in accordance with Section 406 of the Sarbanes-Oxley Act of 2002 and the rules of the Securities and Exchange Commission promulgated thereunder. The code of ethics, which we call our Code of Business Conduct and Ethics, is available on our corporate website, www.firstcommunitybancorp.com in the section entitled "Corporate Governance." In the event that we make changes in, or provide waivers from, the provisions of this code of ethics that the SEC requires us to disclose, we intend to disclose these events on our corporate website in such section. In the Corporate Governance section of our corporate website, we have also posted the charters for our Audit Committee and our Compensation, Nominating and Governance Committee, as well as our Corporate Governance Guidelines. In addition, information concerning purchases and sales of our equity securities by our executive officers and directors is posted on our website.

Our Investor Relations Department can be contacted at First Community Bancorp, 275 N. Brea Blvd., Brea, CA 92821, Attention: Investor Relations, telephone 714-671-6800, or via e-mail to investor-relations@firstcommunitybancorp.com.

All website addresses given in this document are for information only and are not intended to be an active link or to incorporate any website information into this document.

Forward-Looking Information

This Annual Report on Form 10-K contains certain forward-looking information about the Company, which statements are intended to be covered by the safe harbor for "forward-looking statements" provided by the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact are forward-looking statements. Such statements involve inherent risks and uncertainties, many of which are difficult to predict and are generally beyond the control of the Company. We caution readers that a number of important factors could cause actual results to differ materially from those expressed in, implied or projected by, such forward-looking statements. Risks and uncertainties include, but are not limited to:

- lower than expected revenues;

- credit quality deterioration or pronounced and sustained reduction in real estate market values could cause an increase in the allowance for credit losses and a reduction in net earnings;

- increased competitive pressure among depository institutions;

- the Company's ability to complete any further acquisitions, to successfully integrate such acquired entities, or to achieve expected synergies and operating efficiencies within expected time-frames or at all;

- the possibility that personnel changes will not proceed as planned;

- the cost of additional capital is more than expected;

- a change in the interest rate environment reduces interest margins;

- asset/liability repricing risks and liquidity risks;

- pending legal matters may take longer or cost more to resolve or may be resolved adversely to the Company;

- general economic conditions, either nationally or in the market areas in which the Company does or anticipates doing business, are less favorable than expected;

- environmental conditions, including natural disasters, may disrupt our business, impede our operations, negatively impact the values of collateral securing the Company's loans or impair the ability of our borrowers to support their debt obligations;

- the economic and regulatory effects of the continuing war on terrorism and other events of war, including the war in Iraq;

- legislative or regulatory requirements or changes adversely affecting the Company's business; and

- changes in the securities markets.

If any of these risks or uncertainties materializes or if any of the assumptions underlying such forward-looking statements proves to be incorrect, our results could differ materially from those expressed in, implied or projected by, such forward-looking statements. We assume no obligation to update such forward-looking statements. For additional information concerning risks and uncertainties related to us and our operations, please refer to Items 1 through 7A of this Annual Report.

ITEM 1A. RISK FACTORS

Ownership of our common stock involves risk. You should carefully consider, in addition to the other information set forth herein, the following risk factors.

Our business is subject to interest rate risk and variations in interest rates may negatively affect our financial performance.

Changes in the interest rate environment may reduce our profits. It is expected that we will continue to realize income from the differential or "spread" between the interest earned on loans, securities and other interest earning assets, and interest paid on deposits, borrowings and other interest bearing liabilities. Net interest spreads are affected by the difference between the maturities and repricing characteristics of interest earning assets and interest bearing liabilities. Changes in market interest rates generally affect loan volume, loan yields, funding sources and funding costs.

While an increase in the general level of interest rates may increase our net interest margin and loan yield, it may adversely affect the ability of certain borrowers with variable rate loans to pay the interest on and principal of their obligations. In addition, an increase in market interest rates on loans is generally associated with a lower volume of loan originations, which may reduce earnings. Following a decline in the general level of interest rates, our ability to maintain a positive net interest spread is dependant on our ability to reduce the interest paid on deposits, borrowings, and other interest bearing liabilities. We cannot provide assurance that we would be able to lower the rates paid on deposit accounts to support our liquidity requirements as lower rates may result in deposit outflows.

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Accordingly, changes in levels of market interest rates could materially and adversely affect our net interest spread, asset quality, loan origination volume, liquidity, and overall profitability. We cannot assure you that we can minimize our interest rate risk.

We face strong competition from financial services companies and other companies that offer banking services which could negatively affect our business.

We conduct our banking operations primarily in Southern California. Increased competition in our market may result in reduced loans and deposits. Ultimately, we may not be able to compete successfully against current and future competitors. Many competitors offer the same banking services that we offer in our service area. These competitors include national banks, regional banks and other community banks. We also face competition from many other types of financial institutions, including without limitation, savings and loan institutions, finance companies, brokerage firms, insurance companies, credit unions, mortgage banks and other financial intermediaries. In particular, our competitors include several major financial companies whose greater resources may afford them a marketplace advantage by enabling them to maintain numerous banking locations and ATMs and conduct extensive promotional and advertising campaigns.

Additionally, banks and other financial institutions with larger capitalization and financial intermediaries not subject to bank regulatory restrictions have larger lending limits and are thereby able to serve the credit needs of larger customers. Areas of competition include interest rates for loans and deposits, efforts to obtain deposits, and range and quality of products and services provided, including new technology driven products and services. Technological innovation continues to contribute to greater competition in domestic and international financial services markets as technological advances enable more companies to provide financial services. We also face competition from out-of-state financial intermediaries that have opened production offices or that solicit deposits in our market areas. If we are unable to attract and retain banking customers, we may be unable to grow the levels of our loans and deposits and our results of operations and financial condition may be adversely affected.

The recent disruption in the credit markets has had the effect of decreasing the overall liquidity in the marketplace. Competition from financial institutions seeking to maintain adequate liquidity has placed upward pressure on the rates paid on certain deposit accounts at the same time the level of market interest rates has declined. To maintain adequate levels of liquidity, without exhausting secondary sources of liquidity, we may incur increased deposit costs.

Changes in economic conditions, in particular an economic slowdown in Southern California, could materially and negatively affect our business.

Our business is directly impacted by factors such as economic, political and market conditions, broad trends in industry and finance, legislative and regulatory changes, changes in government monetary and fiscal policies and inflation, all of which are beyond our control. A deterioration in economic conditions, whether caused by national or local concerns, in particular an economic slowdown in Southern California, could result in the following consequences, any of which could hurt our business materially: loan delinquencies may increase; problem assets and foreclosures may increase; demand for our products and services may decrease; low cost or noninterest bearing deposits may decrease; and collateral for loans made by us, especially real estate, may decline in value, in turn reducing customers' borrowing power, and reducing the value of assets and collateral associated with our existing loans. These circumstances may lead to an increase in nonaccrual and classified loans, which generally results in a provision for credit losses and in turn reduces the Company's net earnings. The State of California continues to face fiscal challenges, the long-term effects of which on the State's economy cannot be predicted.

A downturn in the real estate market could negatively affect our business.

There has been a slow-down in the real estate market due to disruptions in the credit markets, the effects of which are not yet completely known or quantified. At December 31, 2007, 53% of our loans were secured by commercial real estate, 10% were secured by commercial real estate construction projects, 8% were secured by residential real estate construction projects and 5% were secured by residential real estate. We have observed tighter credit underwriting and higher premiums on liquidity, both which may place downward pressure on real estate values. Any further downturn in the real estate market could negatively affect our business because a significant portion of our loans is secured by real estate. Our ability to recover on defaulted loans by selling the real estate collateral would then be diminished and we would be more likely to suffer losses on defaulted loans. Substantially all of our real property collateral is located in Southern California. If there is a significant decline in real estate values, especially in Southern California, the collateral for our loans would provide less security. Real estate values could be affected by, among other things, an economic slowdown, an increase in interest rates, earthquakes and other natural disasters particular to California.

We are dependent on key personnel and the loss of one or more of those key personnel may materially and adversely affect our prospects.

We currently depend heavily on the services of our chairman, John Eggemeyer, our chief executive officer, Matthew Wagner, and a number of other key management personnel. The loss of Mr. Eggemeyer's or Mr. Wagner's services or that of other key personnel could materially and adversely affect our results of operations and financial condition. Our success also depends, in part, on our ability to attract and retain additional qualified management personnel. Competition for such personnel is strong in the banking industry and we may not be successful in attracting or retaining the personnel we require.

We are subject to extensive regulation which could adversely affect our business.

Our operations are subject to extensive regulation by federal and state governmental authorities, and we are subject to various laws and judicial and administrative decisions imposing requirements and restrictions on part or all of our operations. Because our business is highly regulated, the laws, rules and regulations applicable to us are subject to regular modification and change. There are currently proposed laws, rules and regulations that, if adopted, would impact our operations. There can be no assurance that these proposed laws, rules and regulations, or any other laws, rules or regulations, will not be adopted in the future, which could (i) make compliance much more difficult or expensive, (ii) restrict our ability to originate, broker or sell loans or accept certain deposits, (iii) further limit or restrict the amount of commissions, interest or other charges earned on loans originated or sold by us, or (iv) otherwise adversely affect our business or prospects for business. Additionally, in order to conduct certain activities, including acquisitions, we are required to obtain regulatory approval. There can be no assurance that any required approvals can be obtained, or obtained without conditions or on a timeframe acceptable to us. For more information, please see the section entitled "Item 1. Business Supervision and Regulation" above.

We are exposed to transactional, country and legal risk related to our foreign loans that is in addition to risks we face on loans to U.S. based borrowers.

A portion of our loan portfolio is represented by credit we extend and loans we make to businesses located outside the United States, predominantly in Mexico. These loans, which include commercial loans, real estate loans and credit extensions for the financing of international trade, are subject to risks in addition to risks we face with our loans to businesses located in the United States including, but not limited to transaction risk, country risk and legal risk. While these loans are denominated in U.S. dollars, the ability of the borrower to repay may be affected by fluctuations in the borrower's home country currency relative to the U.S. dollar. Additionally, while most of our foreign loans are insured by U.S.-based institutions, guaranteed by a U.S.-based entity, or collateralized with U.S.-based assets or real property, our ability to collect in the event of default is subject to a number of conditions, as well as deductibles and co-payments with respect to insurance, and we may not be successful in obtaining partial or full repayment or reimbursement from the insurers. Furthermore, foreign laws may restrict our ability to foreclose on, take a security interest in, or seize collateral located in the foreign country.

We are exposed to risk of environmental liabilities with respect to properties to which we take title.

In the course of our business, we may own or foreclose and take title to real estate, and could be subject to environmental liabilities with respect to these properties. We may be held liable to a governmental entity or to third parties for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination, or may be required to investigate or clean up hazardous or toxic substances, or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. In addition, as the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. If we ever become subject to significant environmental liabilities, our business, financial condition, liquidity and results of operations could be materially and adversely affected.

Our ability to pay dividends is restricted by law and contractual arrangements and depends on capital distributions from the Bank which are subject to regulatory limits.

Our ability to pay dividends to our shareholders is subject to the restrictions set forth in California law. In addition, our ability to pay dividends to our shareholders is restricted in specified circumstances under indentures governing the trust preferred securities we have issued and under the revolving credit agreement to which we are a party. See "Item 5. Market for Registrant's Common Equity and Related Stockholder Matters Dividends" in Part II of this Annual Report for more information on these restrictions. We cannot assure you that we will meet the criteria specified under California law or under these agreements in the future, in which case we may reduce or stop paying dividends on our common stock.

The primary source of our income from which we pay dividends is the receipt of dividends from the Bank.

The availability of dividends from the Bank is limited by various statutes and regulations. It is possible, depending upon the financial condition of the Bank and other factors, that the Board of Governors of the Federal Reserve System, the FDIC and/or the DFI could assert that payment of dividends or other payments is an unsafe or unsound practice. In the event the Bank is unable to pay dividends to us, it is likely that we, in turn, would have to reduce or stop paying dividends on our common stock. Our failure to pay dividends on our common stock could have a material adverse effect on the market price of our common stock. See "Item 1. Business Supervision and Regulation" above for additional information on the regulatory restrictions to which we and the Bank are subject.

Only a limited trading market exists for our common stock which could lead to price volatility.

Our common stock was designated for quotation on The Nasdaq Stock Market in June 2000 and trading volumes since that time have been modest. The limited trading market for our common stock may cause fluctuations in the market value of our common stock to be exaggerated, leading to price volatility in excess of that which would occur in a more active trading market of our common stock. In addition, even if a more active market in our common stock develops, we cannot assure you that such a market will continue or that shareholders will be able to sell their shares.

Our allowance for credit losses may not be adequate to cover actual losses.

In accordance with accounting principles generally accepted in the United States, we maintain an allowance for loan losses to provide for loan defaults and non-performance and a reserve for unfunded loan commitments which, when combined, we refer to as the allowance for credit losses. Our allowance for credit losses may not be adequate to cover actual credit losses, and future provisions for credit losses could materially and adversely affect our operating results. Our allowance for credit losses is based on prior experience, as well as an evaluation of the risks in the current portfolio. The amount of future losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates that may be beyond our control, and these losses may exceed current estimates. Our federal and state regulators, as an integral part of their examination process, review our loans and allowance for credit losses. While we believe our allowance for credit losses is appropriate for the risk identified in the Company's loan portfolio, we cannot assure you that we will not further increase the allowance for credit losses, that it will be sufficient to cover losses, or that regulators will not require us to increase this allowance. Any of these occurrences could materially and negatively affect our earnings. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in Part II of this Annual Report for more information.

Our acquisitions may subject us to unknown risks.

We have completed 19 acquisitions since May 2000, including the acquisition of two bank subsidiaries around which the Company was initially formed. Certain events may arise after the date of an acquisition, or we may learn of certain facts, events or circumstances after the closing of an acquisition, that may affect our financial condition or performance or subject us to risk of loss. These events include, but are not limited to: litigation resulting from circumstances occurring at the acquired entity prior to the date of acquisition; loan downgrades and credit loss provisions resulting from underwriting of certain acquired loans determined not to meet our credit standards; personnel changes that cause instability within a department; delays in implementing new policies or procedures, or the failure to apply new policies or procedures; and, other events relating to the performance of our business. Acquisitions involve inherent uncertainty and we cannot determine all potential events, facts and circumstances that could result in loss, or give assurances that our investigation or mitigation efforts will be sufficient to protect against any such loss.

Concentrated ownership of our common stock creates a risk of sudden changes in our share price.

As of February 15, 2008, directors and members of our executive management team owned or controlled approximately 10.8% of our common stock, excluding shares that may be issued to executive officers upon vesting of restricted stock awards. Investors who purchase our common stock may be subject to certain risks due to the concentrated ownership of our common stock. The sale by any of our large shareholders of a significant portion of that shareholder's holdings could have a material adverse effect on the market price of our common stock. In addition, the registration of any significant amount of additional shares of our common stock will have the immediate effect of increasing the public float of our common stock and any such increase may cause the market price of our common stock to decline or fluctuate significantly.

Our largest shareholder is a registered bank holding company and the activities and regulation of such shareholder may affect the permissible activities of the Company.

Castle Creek Capital, LLC, which we refer to as Castle Creek, is controlled by our chairman, John M. Eggemeyer, and beneficially owned approximately 6.7% of the Company as of February 15, 2008. Castle Creek is a registered bank holding company under the BHCA and is regulated by the FRB. Under FRB guidelines, holding companies must be a "source of strength" for their subsidiaries. See "Item 1. Business Supervision and Regulation Bank Holding Company Regulation" above for more information. Regulation of Castle Creek by the FRB may adversely affect the activities and strategic plans of the Company should the FRB determine that Castle Creek or any other company in which Castle Creek has invested has engaged in any unsafe or unsound banking practices or activities. While we have no reason to believe that the FRB is proposing to take any action with respect to Castle Creek that would adversely affect the Company, we remain subject to such risk.

A natural disaster could harm the Company's business.

Historically, California, in which a substantial portion of the Company's business is located, has been susceptible to natural disasters, such as earthquakes, floods and wild fires. These natural disasters could harm the Company's operations through interference with communications, including the interruption or loss of the Company's computer systems, which could prevent or impede the Company from gathering deposits, originating loans and processing and controlling its flow of business, as well as through the destruction of facilities and the Company's operational, financial and management information systems. Additionally, natural disasters could negatively impact the values of collateral securing the Company's loans and interrupt our borrowers' abilities to conduct their businesses in a manner to support their debt obligations, either of which could result in losses and increased provisions for credit losses.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

As of February 15, 2008, we had a total of 83 properties consisting of 60 operating branch offices, 1 annex office, 3 operations centers, 10 loan offices, and 9 other properties of which 4 are subleased. We own 6 locations and the remaining properties are leased. Almost all properties are located in Southern California. Pacific Western's principal office is located at 401 West A Street, San Diego, CA 92101-7917.

For additional information regarding properties of the Company and Pacific Western, see "Item 8. Financial Statements and Supplementary Data."

ITEM 3. LEGAL PROCEEDINGS

On June 8, 2004, the Company was served with an amended complaint naming First Community and Pacific Western as defendants in a class action lawsuit filed in Los Angeles Superior Court pending as Gilbert et. al v. Cohn et al, Case No. BC310846 (the "Gilbert Litigation"). A former officer of First Charter Bank, N.A. ("First Charter"), which the Company acquired in October 2001, was also named as a defendant. That former officer left First Charter in May of 1997 and later became a principal of Four Star Financial Services, LLC ("Four Star"), an affiliate of 900 Capital Services, Inc. ("900 Capital").

On April 18, 2005, the plaintiffs filed the second amended class action complaint. The second amended complaint alleged that the former officer of First Charter improperly induced several First Charter customers to invest in 900 Capital or affiliates of 900 Capital and further alleges that Four Star, 900 Capital and some of their affiliated entities perpetuated their fraud upon investors through various accounts at First Charter, First Community and Pacific Western with those banks' purported knowing participation in and/or willful ignorance of the scheme. The key allegations in the second amended complaint dated back to the mid-1990s and the second amended complaint alleged several counts for relief including aiding and abetting, conspiracy, fraud, breach of fiduciary duty, relief pursuant to the California Business and Professions Code, negligence and relief under the California Securities Act stemming from an alleged fraudulent scheme and sale of securities issued by 900 Capital and Four Star. In disclosures provided to the parties, plaintiffs have asserted that the named plaintiffs have suffered losses well in excess of $3.85 million, and plaintiffs have asserted that "losses to the class total many tens of millions of dollars." On June 15, 2005, we filed a demurrer to the second amended complaint, and on August 22, 2005, the Court sustained our demurrer as to each of the counts therein, granting plaintiffs leave to amend on four of the six counts, and dismissing the other counts outright.

On August 12, 2005, the Company was notified by Progressive Casualty Insurance Company ("Progressive"), its primary insurance carrier with respect to the Gilbert Litigation that Progressive had determined that, based upon the allegations in the second amended complaint filed in the Gilbert Litigation, there was no coverage with respect to the Gilbert Litigation under the Company's insurance policy with Progressive. Progressive also notified the Company that it was withdrawing its agreement to fund defense costs for the Gilbert Litigation and reserving its right to seek reimbursement from the Company for any defense costs advanced pursuant to the insurance policy. Through December 31, 2005, Progressive had advanced to the Company approximately $690,000 of defense costs with respect to the Gilbert Litigation.

On August 12, 2005, Progressive filed an action in federal district court for declaratory relief, currently pending as Progressive Casualty Insurance Company, etc., v. First Community Bancorp, etc., et al., Case No. 05-5900 SVW (MAWx) (the "Progressive Litigation"), seeking a declaratory judgment with respect to the parties' rights and obligations under Progressive's policy with the Company. On October 11, 2005, the Company filed in federal court a motion to dismiss or stay the Progressive Litigation.

In November 2005, along with certain other defendants, we reached an agreement in principle with respect to the Gilbert Litigation. That agreement is reflected in a written Stipulation of Settlement dated February 9, 2007, which has been executed by all the parties to that settlement. The settlement is subject to approval by the Los Angeles Superior Court and a certain level of participation in the settlement by class members. A hearing on the motion for final approval of the settlement is currently pending before the Superior Court. Assuming all conditions to final consummation of the settlement are met, First Community's contribution to the settlement will be $775,000, which was accrued in 2005.

While we believe that this settlement, if finalized, will end our exposure to the underlying claims by participating class members, we cannot be certain that all conditions to the settlement will be satisfied or that we will not be subject to further claims by parties related to the same claims who did not participate in the settlement.

In connection with the Gilbert Litigation settlement, we also reached a settlement with Progressive Casualty Insurance Co. in the Progressive Litigation. The settlement with Progressive, which includes an additional contribution by Progressive under First Community's policy toward the settlement of the Gilbert Litigation and a dismissal by Progressive of any claims against First Community for reimbursement, is contingent upon the consummation of the Gilbert Litigation settlement.

In the ordinary course of our business, we are party to various other legal actions, which we believe are incidental to the operation of our business. Although the ultimate outcome and amount of liability, if any, with respect to these other legal actions to which we are currently a party cannot presently be ascertained with certainty, in the opinion of management, based upon information currently available to us, any resulting liability is not likely to have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to the shareholders of the Company, through the solicitation of proxies or otherwise, during the fourth quarter of the year ended December 31, 2007.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Marketplace Designation, Sales Price Information and Holders

Our common stock is listed on The Nasdaq Stock Market LLC and trades under the symbol "FCBP." The following table summarizes the high and low sale prices for each quarterly period ended since January 1, 2006 for our common stock, as quoted and reported by The Nasdaq Stock Market:

	Sales Prices	
	High	Low
Quarter Ended		
2006:		
First quarter	$ 61.65	$ 53.95
Second quarter	$ 61.35	$ 55.02
Third quarter	$ 59.52	$ 51.87
Fourth quarter	$ 58.11	$ 51.30
2007:		
First quarter	$ 58.50	$ 50.29
Second quarter	$ 58.02	$ 53.94
Third quarter	$ 58.96	$ 48.20
Fourth quarter	$ 62.56	$ 39.25

As of February 15, 2008, the closing price of our common stock on Nasdaq was $32.79 per share. As of that date, based on the records of our transfer agent, there were approximately 2,571 record holders of our common stock.

Dividends

Our ability to pay dividends to our shareholders is subject to the restrictions set forth in the California General Corporation Law, or the CGCL. The CGCL provides that a corporation may make a distribution to its shareholders if the corporation's retained earnings equal or exceed the amount of the proposed distribution. The CGCL further provides that, in the event that sufficient retained earnings are not available for the proposed distribution, a corporation may nevertheless make a distribution to its shareholders if the sum of the assets of the corporation (exclusive of goodwill, capitalized research and development expenses and deferred charges) would be at least equal to $1^1/_4$ times its liabilities (not including deferred taxes, deferred income and other deferred credits). Our ability to pay dividends is also subject to certain other limitations. See "Item 1. Business Supervision and Regulation" in Part I of this Annual Report on Form 10-K and Note 18 of the Notes to Consolidated Financial Statements contained in "Item 8. Financial Statements and Supplementary Data."

In addition, our ability to pay dividends is limited by certain provisions of our credit agreement with U.S. Bank, N.A. This agreement provides that we may not declare or pay any dividend on the Company's common stock in any quarter if an Event of Default (as defined in the agreement) has occurred or will occur as a result of such payment. In addition, the agreement prevents us from paying a dividend in the event we no longer own 100% of Pacific Western.

Our ability to pay dividends to our shareholders is also limited by certain covenants contained in the indentures governing trust preferred securities issued by us or entities that we have acquired, and the debentures underlying the trust preferred securities. Generally the indentures provide that if an Event of Default (as defined in the indentures) has occurred and is continuing, or if we are in default with respect to any obligations under our guarantee agreement which covers payments of the obligations on the trust preferred securities, or if we give notice of any intention to defer payments of interest on the debentures underlying the trust preferred securities, then we may not, among other restrictions, declare or pay any dividends (other than a dividend payable by the Bank to the holding company) with respect to our common stock.

First Community's primary source of income is the receipt of dividends from the Bank. The availability of dividends from the Bank is limited by various statutes and regulations. It is possible, depending upon the financial condition of the bank in question, and other factors, that the FRB, the FDIC or the DFI could assert that payment of dividends or other payments is an unsafe or unsound practice. Pacific Western is subject to restrictions under certain federal and state laws and regulations governing banks which limit its ability to transfer funds to the holding company through intercompany loans, advances or cash dividends. Dividends paid by state banks such as Pacific Western are regulated by the DFI under its general supervisory authority as it relates to a bank's capital requirements. A state bank may declare a dividend without the approval of the DFI as long as the total dividends declared in a calendar year do not exceed either the retained earnings or the total of net earnings for three previous fiscal years less any dividend paid during such period. During 2007, First Community received dividends of $140.5 million from the Bank. At December 31, 2007, the Bank's retained earnings totaled $99.2 million. Of this amount, $46.1 million may be dividended to the holding company without regulatory approval and the remaining amount of $53.1 million may be dividended to the holding company only with the approval of the DFI. In January 2008, the Bank paid a dividend to the holding company of $45.0 million. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity" and Note 18 of the Notes to Consolidated Financial Statements contained in "Item 8. Financial Statements and Supplementary Data."

Holders of Company common stock are entitled to receive dividends declared by the Board of Directors out of funds legally available under state law governing the Company and certain federal laws and regulations governing the banking and financial services business. During 2007, 2006 and 2005, the Company paid $37.5 million, $30.0 million and $16.0 million, respectively, in cash dividends on common stock. Since January 2006, we have declared the following quarterly dividends:

Record Date	Pay Date	Amount per Share
February 16, 2006	February 28, 2006	$0.25
May 16, 2006	May 31, 2006	$0.32
August 16, 2006	August 30, 2006	$0.32
November 16, 2006	November 30, 2006	$0.32
February 16, 2007	February 28, 2007	$0.32
May 16, 2007	May 31, 2007	$0.32
August 16, 2007	August 31, 2007	$0.32
November 16, 2007	November 30, 2007	$0.32
February 15, 2008	February 29, 2008	$0.32

We can provide no assurance that we will continue to declare dividends on a quarterly basis or otherwise. The declaration of dividends by the Company is subject to the discretion of our Board of Directors. Our Board of Directors will take into account such matters as general business conditions, our financial results, capital requirements, contractual, legal and regulatory restrictions on the payment of dividends by us to our shareholders or by our subsidiary to the holding company, and such other factors as our Board of Directors may deem relevant.

Please see "Item 1. Business Regulation and Supervision," in Part I of this Annual Report on Form 10-K for further discussion of potential regulatory limitations on the holding company's receipt of funds from the Bank, as well as "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity" and Note 18 of the Notes to Consolidated Financial Statements contained in "Item 8. Financial Statements and Supplementary Data" for a discussion of other factors affecting the availability of dividends and limitations on the ability to declare dividends.

Securities Authorized for Issuance Under Equity Compensation Plans

The following table provides information as of December 31, 2007, regarding securities issued and to be issued under our equity compensation plans that were in effect during fiscal 2007:

Plan Category	Plan Name	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
		(a)	(b)	(c)
Equity compensation plans approved by security holders	The First Community Bancorp 2003 Stock Incentive Plan(1)	2,312(2)	$ 18.91	647,895(3)
Equity compensation plans not approved by security holders	None			

(1)
The First Community Bancorp 2003 Stock Incentive Plan (the "Incentive Plan") was last approved by the shareholders of the Company at our 2004 Annual Meeting of Shareholders and amended at our 2006 Annual Meeting of Shareholders.

(2)
Amount represents outstanding options only and does not include the 861,269 shares of unvested time-based and performance-based restricted stock awarded since 2003 and outstanding as of December 31, 2007 with an exercise price of zero.

(3)
The total number of shares of common stock that have been approved for issuance pursuant to awards granted or which may be granted in the future under the Incentive Plan is 3,500,000 shares. In addition to options issued under the Incentive Plan, the number of securities remaining available for future issuance has been reduced by 1,402,423 shares which represents the sum of the number of unvested shares of time-based and performance-based restricted stock awards outstanding at December 31, 2007 and the number of vested shares of time-based and performance-based restricted stock as of December 31, 2007. In February 2008 the Company awarded to employees 179,765 shares of time-based restricted stock awards. Through February 15, 2008, 24,666 shares were forfeited. This combined activity reduced the shares available for issuance under the Incentive Plan to 492,796.

Recent Sales of Unregistered Securities and Use of Proceeds

None.

Repurchases of Common Stock

On August 2, 2007, our Board of Directors authorized the Company to repurchase shares of First Community Bancorp common stock worth up to $150.0 million over the next twelve months. The program may be modified, postponed or terminated at any time. Pursuant to this authorization we repurchased 1,206,100 shares at an average cost of $44.99 per share during the fourth quarter of 2007.

Pursuant to the existing and prior authorized stock repurchase programs we repurchased 2,491,538 shares of our common stock at an average cost of $49.48 per share during 2007.

In addition to the Company's share repurchase program, through the Company's Directors Deferred Compensation Plan, or the DDCP, participants in the plan may invest amounts deferred in the Company's common stock. The Company has the discretion whether to track purchases of common stock as if made, or to fully fund the DDCP via purchases of stock with deferred amounts. Purchases of Company common stock by the rabbi trust of the DDCP are considered repurchases of common stock by the Company since the rabbi trust is an asset of the Company. Actual purchases of Company common stock via the DDCP are made through open market purchases pursuant to the terms of the DDCP, which includes a predetermined formula and schedule for the purchase of such stock in accordance with Rule 10b5-1 of the Securities Exchange Act of 1934. Pursuant to the terms of the DDCP, generally purchases are actually made or deemed to be made in the open market on the 15th of the month (or the next trading day) following the day on which deferred amounts are contributed to the DDCP, beginning March 15 of each year.

The following table presents stock purchases made during the fourth quarter of 2007 under our publicly announced share repurchase programs and purchases made by the DDCP:

			Publicly Announced Share Repurchase Programs		
	Total Shares Purchased	**Average Price Per Share**	**Total Shares Purchased**	**Average Price Paid per Share**	**Approximate Dollar Value of Shares that May Yet Be Purchased**
October 1 - October 31, 2007	370,000	$ 48.70	370,000	$ 48.70	
November 1 - November 30, 2007	836,100	$ 43.34	836,100	$ 43.34	
December 1 - December 31, 2007(1)	4,941	$ 40.15		$	
Total	1,211,041	$ 44.97	1,206,100	$ 44.99	$ 36,247,000

(1) Represents shares purchased by the DDCP.

Five-Year Stock Performance Graph

The following chart compares the yearly percentage change in the cumulative shareholder return on our common stock based on the closing price during the five years ended December 31, 2007, with (1) the Total Return Index for The Nasdaq Stock Market LLC (U.S. Companies) (the "NASDAQ Composite") and (2) the Total Return Index for NASDAQ Bank Stocks (the "NASDAQ Bank Index"). This comparison assumes $100 was invested on December 31, 2002, in our common stock and the comparison groups and assumes the reinvestment of all cash dividends prior to any tax effect and retention of all stock dividends. First Community's total cumulative return was 39.7% over the five year period ending December 31, 2007 compared to 105.22% and 25.8% for the NASDAQ Composite and NASDAQ Bank Index.

	Period Ending					
Index	**12/31/02**	**12/31/03**	**12/31/04**	**12/31/05**	**12/31/06**	**12/31/07**
First Community Bancorp	$ 100	$ 112.05	$ 135.27	$ 175.86	$ 172.74	$ 139.70
NASDAQ Composite	100	149.75	164.64	168.60	187.83	205.22
NASDAQ Bank Index	100	130.51	144.96	141.92	159.42	125.80

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth certain of our financial and statistical information for each of the years in the five-year period ended December 31, 2007. This data should be read in conjunction with our audited consolidated financial statements as of December 31, 2007 and 2006, and for each of the years in the three-year period ended December 31, 2007, and related Notes to Consolidated Financial Statements contained in "Item 8. Financial Statements and Supplementary Data."

	At or for the Years Ended December 31,				
	2007	2006	2005	2004	2003
	(In thousands, except per share amounts and percentages)				
Results of Operations(1):					
Interest income	$ 350,981	$ 301,597	$ 183,352	$ 140,147	$ 112,881
Interest expense	85,866	59,640	22,917	14,417	12,647
NET INTEREST INCOME	265,115	241,957	160,435	125,730	100,234
Provision for credit losses	3,000	9,600	1,420	465	300
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	262,115	232,357	159,015	125,265	99,934
Noninterest income	32,914	16,466	13,778	17,221	19,637
Noninterest expense	142,259	121,455	87,302	81,827	65,820
EARNINGS BEFORE INCOME TAXES AND EFFECT OF ACCOUNTING CHANGE	152,770	127,368	85,491	60,659	53,751
Income taxes	62,444	51,512	35,125	24,296	21,696
NET EARNINGS BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE	90,326	75,856	50,366	36,363	32,055
Cumulative effect on prior years (to December 31, 2005) of changing the method of accounting for stock-based compensation forfeitures		142			
NET EARNINGS	$ 90,326	$ 75,998	$ 50,366	$ 36,363	$ 32,055
Share Data:					
Earnings per common share (EPS):					
Basic	$ 3.16	$ 3.23	$ 3.05	$ 2.34	$ 2.08
Diluted	3.15	3.21	2.98	2.27	2.02
Dividends declared per share	1.28	1.21	0.97	0.85	0.68
Book value per share(2)	$ 40.65	$ 39.42	$ 27.30	$ 22.98	$ 21.24
Shares outstanding at the end of the year(2)	28,002	29,636	18,347	16,268	15,893
Average shares outstanding for basic EPS	28,572	23,476	16,536	15,521	15,382
Average shares outstanding for diluted EPS	28,676	23,680	16,894	15,987	15,868
Ending Balance Sheet Data:					
Assets	$ 5,179,040	$ 5,553,323	$ 3,226,411	$ 3,049,453	$ 2,429,981
Time deposits in financial institutions	420	501	90	$ 525,027	

At September 30, 2018, our holdings of obligations of states and political subdivisions included general obligation bonds with an aggregate fair value of $163.4 million and an amortized cost of $159.7 million. Our holdings at September 30, 2018 also included special revenue bonds with an aggregate fair value of $80.5 million and an amortized cost of $78.1 million. With respect to both categories of those bonds at September 30, 2018, we held no securities of any issuer that comprised more than 10% of our holdings of either bond category. Education bonds and water and sewer utility bonds represented 54% and 27%, respectively, of our total investments in special revenue bonds based on the carrying values of these investments at September 30, 2018. Many of the issuers of the special revenue bonds we held at September 30, 2018 have the authority to impose ad valorem taxes. In that respect, many of the special revenue bonds we held at September 30, 2018 are similar to general obligation bonds.

The amortized cost and estimated fair values of our fixed maturities at December 31, 2017 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
		(in thousands)		
Held to Maturity				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 71,736	$ 804	$ 547	$ 71,993
Obligations of states and political subdivisions	137,581	11,162	112	148,631
Corporate securities	108,025	2,860	731	110,154
Mortgage-backed securities	49,313	516	157	49,672
Totals	$ 366,655	$ 15,342	$ 1,547	$ 380,450

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	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
		(in thousands)		
Available for Sale				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 44,759	$ 20	$ 730	$ 44,049
Obligations of states and political subdivisions	128,478	3,942	303	132,117
Corporate securities	105,254	1,011	526	105,739
Mortgage-backed securities	259,923	445	3,327	257,041
Totals	$ 538,414	$ 5,418	$ 4,886	$ 538,946

At December 31, 2017, our holdings of obligations of states and political subdivisions included general obligation bonds

with an aggregate fair value of $190.7 million and an amortized cost of $181.4 million. Our holdings at December 31, 2017 also included special revenue bonds with an aggregate fair value of $90.0 million and an amortized cost of $84.7 million. With respect to both categories of those bonds at December 31, 2017, we held no securities of any issuer that comprised more than 10% of that category. Education bonds and water and sewer utility bonds represented 53% and 26%, respectively, of our total investments in special revenue bonds based on their carrying values at December 31, 2017. Many of the issuers of the special revenue bonds we held at December 31, 2017 have the authority to impose ad valorem taxes. In that respect, many of the special revenue bonds we held are similar to general obligation bonds.

We made reclassifications from available for sale to held to maturity of certain fixed maturities at fair value on November 30, 2013. We segregated within accumulated other comprehensive loss the net unrealized losses of $15.1 million arising prior to the November 30, 2013 reclassifications. We are amortizing this balance over the remaining life of the related securities as an adjustment to yield in a manner consistent with the accretion of discount on the same fixed maturities. We recorded amortization of $912,229 and $909,044 in other comprehensive (loss) income during the nine months ended September 30, 2018 and 2017, respectively. At September 30, 2018 and December 31, 2017, net unrealized losses of $8.9 million and $9.8 million, respectively, remained within accumulated other comprehensive loss.

We show below the amortized cost and estimated fair value of our fixed maturities at September 30, 2018 by contractual maturity. Expected maturities may differ from contractual maturities because issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
	(in thousands)	
Held to maturity		
Due in one year or less	$ 8,783	$ 8,768
Due after one year through five years	70,790	70,505
Due after five years through ten years	136,673	135,068

Due after ten years	141,766	142,645
Mortgage-backed securities	42,221	41,188
Total held to maturity	$ 400,233	$ 398,174
Available for sale		
Due in one year or less	$ 39,265	$ 39,465
Due after one year through five years	86,468	85,156
Due after five years through ten years	116,791	114,026
Due after ten years	19,261	19,337
Mortgage-backed securities	276,973	267,043
Total available for sale	$ 538,758	$ 525,027

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The cost and estimated fair values of our equity securities at September 30, 2018 were as follows:

	Cost	Gross Gains	Gross Losses	Estimated Fair Value
		(in thousands)		
Equity securities	$ 49,416	$ 9,207	$ 650	$ 57,973

The cost and estimated fair values of our equity securities at December 31, 2017 were as follows:

	Cost	Gross Gains	Gross Losses	Estimated Fair Value
		(in thousands)		
Equity securities	$ 44,219	$ 6,505	$ 279	$ 50,445

Gross realized gains and losses from investments before applicable income taxes for the three and nine months ended September 30, 2018 and 2017 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(in thousands)		(in thousands)	
Gross realized gains:				
Fixed maturities	$ 5	$ 87	$ 16	$ 138
Equity securities	2,976	513	6,246	4,142
	2,981	600	6,262	4,280
Gross realized losses:				
Fixed maturities	25	39	70	69
Equity securities	(508)		2,130	3
	(483)	39	2,200	72
Net realized gains	$ 3,464	$ 561	$ 4,062	$ 4,208

We recognized $3.9 million of gains and $1.6 million of losses on equity securities held at September 30, 2018 in net realized investment gains for the nine months ended September 30, 2018.

We held fixed maturities with unrealized losses representing declines that we considered temporary at September 30, 2018 as follows:

	Less Than 12 Months		More Than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses

	(in thousands)			
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 65,701	$ 1,017	$ 48,064	$ 2,771
Obligations of states and political subdivisions	58,935	1,586	16,385	861
Corporate securities	179,587	5,150	39,074	2,473
Mortgage-backed securities	144,615	3,200	159,788	7,800
Totals	$ 448,838	$ 10,953	$ 263,311	$ 13,905

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We held fixed maturities and equity securities with unrealized losses representing declines that we considered temporary at December 31, 2017 as follows:

	Less Than 12 Months		More Than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)			
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 24,024	$ 287	$ 33,987	$ 990
Obligations of states and political subdivisions	10,223	120	14,127	295
Corporate securities	35,204	253	31,561	1,004
Mortgage-backed securities	100,534	817	124,062	2,667
Equity securities	4,292	279		
Totals	$ 174,277	$ 1,756	$ 203,737	$ 4,956

We make estimates concerning the valuation of our investments and the recognition of other-than-temporary declines in the value of our investments. For equity securities, we measure investments at fair value and, beginning January 1, 2018, we recognize changes in fair value in our results of operations. With respect to a debt security that is in an unrealized loss position, we first assess if we intend to sell the debt security. If we determine we intend to sell the debt security, we recognize the impairment loss in our results of operations. If we do not intend to sell the debt security, we determine whether it is more likely than not that we will be required to sell the debt security prior to recovery. If we determine it is more likely than not that we will be required to sell the debt security prior to recovery, we recognize the impairment loss in our results of operations. If we determine it is more likely than not that we will not be required to sell the debt security prior to recovery, we then evaluate whether a credit loss has occurred with respect to that security. We determine whether a credit loss has occurred by comparing the amortized cost of the debt security to the present value of the cash flows we expect to collect. If we expect a cash flow shortfall, we consider that a credit loss has occurred. If we determine that a credit loss has occurred, we consider the impairment to be other than temporary. We then recognize the amount of the impairment loss related to the credit loss in our results of operations, and we recognize the remaining portion of the impairment loss in our other comprehensive income, net of applicable taxes. In addition, we may write down securities in an unrealized loss position based on a number of other factors, including when the fair value of an investment is significantly below its cost, when the financial condition of the issuer of a security has deteriorated, the occurrence of industry, issuer or geographic events that have negatively impacted the value of a security and rating agency downgrades. We held 565 debt securities that were in an unrealized loss position at September 30, 2018. Based upon our analysis of general market conditions and underlying factors impacting these debt securities, we considered these declines in value to be temporary.

We amortize premiums and discounts on debt securities over the life of the security as an adjustment to yield using the effective interest method. We compute realized investment gains and losses using the specific identification method.

We amortize premiums and discounts on mortgage-backed debt securities using anticipated prepayments.

Our investment in affiliate represents our 48.2% ownership interest in DFSC. We account for our investment in DFSC using the equity method of accounting. Under this method, we record our investment at cost, with adjustments for our share of DFSC s earnings and losses as well as changes in the equity of DFSC due to unrealized gains and losses. We include our share of DFSC s net income in our results of operations. We have compiled the following summary financial information for DFSC at September 30, 2018 and December 31, 2017 and for the three and nine months ended September 30, 2018 and 2017, respectively, from the financial statements of DFSC. The financial information of DFSC at September 30, 2018 and 2017 and for the three and nine months then ended is unaudited.

	September 30, 2018	December 31, 2017
	(in thousands)	
Balance sheets:		
Total assets	$ 543,086	$ 567,935
Total liabilities	$ 460,292	$ 487,604
Stockholders equity	82,794	80,331
Total liabilities and stockholders equity	$ 543,086	$ 567,935

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(in thousands)		(in thousands)	
Income statements:				
Net income	$ 1,519	$ 837	$ 4,464	$ 2,122

6 - Segment Information

We evaluate the performance of our personal lines and commercial lines segments based upon the underwriting results of our insurance subsidiaries using statutory accounting principles (SAP) that various state insurance departments prescribe or permit. Our management uses SAP to measure the performance of our insurance subsidiaries instead of United States generally accepted accounting principles (GAAP). SAP financial measures are considered non-GAAP financial measures under applicable SEC rules because they include or exclude certain items that the most comparable GAAP financial measures do not ordinarily include or exclude.

Financial data by segment for the three and nine months ended September 30, 2018 and 2017 is as follows:

	Three Months Ended September 30,	
	2018	2017
	(in thousands)	
Revenues:		
Premiums earned:		
Commercial lines	$ 84,251	$ 80,724
Personal lines	103,410	96,560
Premiums earned	187,661	177,284
Net investment income	6,620	5,980
Realized investment gains	3,464	561
Equity in earnings of DFSC	733	404
Other	1,426	1,487
Total revenues	$ 199,904	$ 185,716
Income before income tax expense:		
Underwriting (loss) income:		
Commercial lines	$ 2,125	$ 8,998
Personal lines	(12,210)	(8,919)
SAP underwriting (loss) income	(10,085)	79
GAAP adjustments	332	644
GAAP underwriting (loss) income	(9,753)	723
Net investment income	6,620	5,980
Realized investment gains	3,464	561
Equity in earnings of DFSC	733	404

Other		213		844
Income before income tax expense	$	1,277	$	8,512

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	Nine Months Ended September 30, 2018	2017
	(in thousands)	
Revenues:		
Premiums earned:		
Commercial lines	$ 251,029	$ 236,437
Personal lines	304,111	285,018
Premiums earned	555,140	521,455
Net investment income	19,341	17,385
Realized investment gains	4,062	4,208
Equity in earnings of DFSC	2,153	1,023
Other	4,326	4,197
Total revenues	$ 585,022	$ 548,268
(Loss) income before income tax (benefit) expense:		
Underwriting (loss) income:		
Commercial lines	$ (17,935)	$ 12,670
Personal lines	(42,358)	(31,816)
SAP underwriting loss	(60,293)	(19,146)
GAAP adjustments	5,106	6,423
GAAP underwriting loss	(55,187)	(12,723)
Net investment income	19,341	17,385
Realized investment gains	4,062	4,208
Equity in earnings of DFSC	2,153	1,023
Other	1,040	1,947
(Loss) income before income tax (benefit) expense	$ (28,591)	$ 11,840

7 - Borrowings
Lines of Credit

In July 2018, we renewed our existing credit agreement with Manufacturers and Traders Trust Company (M&T) relating to a $60.0 million unsecured revolving line of credit. The line of credit expires in July 2021. We have the right to request a one-year extension of the credit agreement as of each anniversary date of the credit agreement. At September 30, 2018, we had $25.0 million in outstanding borrowings from M&T and had the ability to borrow an additional $35.0 million at interest rates equal to M&T s current prime rate or the then current LIBOR rate plus 2.25%. The interest rate on our outstanding borrowings from M&T is adjustable quarterly, and, at September 30, 2018, that interest rate was 4.51%. We pay a fee of 0.25% per annum on the loan commitment amount regardless of usage. The credit agreement requires our compliance with certain covenants. These covenants include minimum levels of our net worth, leverage ratio, statutory surplus and the A.M. Best ratings of our insurance subsidiaries. With the exception of a requirement that we maintain a minimum interest coverage ratio, we complied with all requirements of the credit agreement during the nine months ended September 30, 2018. M&T waived the minimum interest coverage ratio requirement at September 30, 2018 and December 31, 2018.

Atlantic States is a member of the FHLB of Pittsburgh. Through its membership, Atlantic States has the ability to issue debt to the FHLB of Pittsburgh in exchange for cash advances. Atlantic States had $35.0 million in outstanding advances at September 30, 2018. The interest rate on the advances was 2.32% at September 30, 2018. The table below presents the amount of FHLB of Pittsburgh stock Atlantic States purchased, collateral pledged and assets related to Atlantic States membership in the FHLB of Pittsburgh at September 30, 2018.

FHLB of Pittsburgh stock purchased and owned	$ 1,631,800
Collateral pledged, at par (carrying value $40,947,302)	41,858,302
Borrowing capacity currently available	3,817,595

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MICO is a member of the Federal Home Loan Bank (FHLB) of Indianapolis. During the second quarter of 2018, MICO terminated its line of credit with the FHLB of Indianapolis.

Subordinated Debentures

Donegal Mutual holds a $5.0 million surplus note that MICO issued to increase MICO s statutory surplus. The surplus note carries an interest rate of 5.00%, and any repayment of principal or payment of interest on the surplus note requires prior approval of the Michigan Department of Insurance and Financial Services.

8 - Share-Based Compensation

We measure all share-based payments to employees, including grants of stock options, and use a fair-value-based method for the recording of related compensation expense in our results of operations. In determining the expense we record for stock options granted to directors and employees of our subsidiaries and affiliates, we estimate the fair value of each option award on the date of grant using the Black-Scholes option pricing model. The significant assumptions we utilize in applying the Black-Scholes option pricing model are the risk-free interest rate, the expected term, the dividend yield and the expected volatility.

We charged compensation expense related to our stock compensation plans against income before income taxes of $317,526 and $411,450 for the three months ended September 30, 2018 and 2017, respectively, with a corresponding income tax benefit of $66,680 and $144,008, respectively. We charged compensation expense related to our stock compensation plans against income before income taxes of $1.4 million and $1.6 million for the nine months ended September 30, 2018 and 2017, respectively, with a corresponding income tax benefit of $285,578 and $564,075, respectively. At September 30, 2018, we had $1.4 million of unrecognized compensation expense related to nonvested share-based compensation granted under our stock compensation plans that we expect to recognize over a weighted average period of approximately 1.4 years.

We received cash from option exercises under all stock compensation plans during the three months ended September 30, 2018 and 2017 of $217,112 and $765,127, respectively. We received cash from option exercises under all stock compensation plans during the nine months ended September 30, 2018 and 2017 of $695,762 and $2.9 million, respectively. We realized actual tax benefits for the tax deductions related to those option exercises of $2,516 and $42,411 for the three months ended September 30, 2018 and 2017, respectively. We realized actual tax benefits for the tax deductions related to those option exercises of $21,319 and $220,767 for the nine months ended September 30, 2018 and 2017, respectively.

9 - Fair Value Measurements

We account for financial assets using a framework that establishes a hierarchy that ranks the quality and reliability of the inputs, or assumptions, we use in the determination of fair value, and we classify financial assets and liabilities carried at fair value in one of the following three categories:

Level 1 quoted prices in active markets for identical assets and liabilities;

Level 2 directly or indirectly observable inputs other than Level 1 quoted prices; and

Level 3 unobservable inputs not corroborated by market data.

For investments that have quoted market prices in active markets, we use the quoted market price as fair value and include these investments in Level 1 of the fair value hierarchy. We classify publicly-traded equity securities as Level 1. When quoted market prices in active markets are not available, we base fair values on quoted market prices of comparable instruments or price estimates we obtain from independent pricing services and include these investments in Level 2 of the fair value hierarchy. We classify our fixed maturity investments as Level 2. Our fixed maturity investments consist of U.S. Treasury securities and obligations of U.S. government corporations and agencies, obligations of states and political subdivisions, corporate securities and mortgage-backed securities.

We present our investments in available-for-sale fixed maturity and equity securities at estimated fair value. The estimated fair value of a security may differ from the amount that could be realized if we sold the security in a forced transaction. In addition, the valuation of fixed maturity investments is more subjective when markets are less liquid, increasing the potential that the estimated fair value does not reflect the price at which an actual transaction would occur. We utilize nationally recognized independent pricing services to estimate fair values or obtain market quotations for substantially all of our fixed maturity and equity investments. These pricing services utilize market quotations for fixed maturity and equity

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securities that have quoted prices in active markets. For fixed maturity securities that generally do not trade on a daily basis, the pricing services prepare estimates of fair value measurements based predominantly on observable market inputs. The pricing services do not use broker quotes in determining the fair values of our investments. Our investment personnel review the estimates of fair value the pricing services provide to verify that the estimates we obtain from the pricing services are representative of fair values based upon our investment personnel s general knowledge of the market, their research findings related to unusual fluctuations in value and their comparison of such values to execution prices for similar securities. Our investment personnel regularly monitor the market, current trading ranges for similar securities and the pricing of specific investments. Our investment personnel review all pricing estimates that we receive from the pricing services against their expectations with respect to pricing based on fair market curves, security ratings, interest rates, security types and recent trading activity. Our investment personnel periodically review documentation with respect to the pricing services pricing methodology that they obtain to determine if the primary pricing sources, market inputs and pricing frequency for various security types are reasonable. At September 30, 2018, we received two estimates per security from the pricing services, and we priced substantially all of our Level 1 and Level 2 investments using those prices. In our review of the estimates the pricing services provided at September 30, 2018, we did not identify any material discrepancies, and we did not make any adjustments to the estimates the pricing services provided.

We present our cash and short-term investments at estimated fair value. We classify these items as Level 1.

The carrying values we report in our balance sheet for premium receivables and reinsurance receivables and payables for premiums and paid losses and loss expenses approximate their fair values. The carrying amounts we report in our balance sheets for our subordinated debentures and borrowings under lines of credit approximate their fair values. We classify these items as Level 3.

We evaluate our assets and liabilities to determine the appropriate level at which to classify them for each reporting period.

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The following table presents our fair value measurements for our investments in available-for-sale fixed maturity and equity securities at September 30, 2018:

	Fair Value	Fair Value Measurements Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(in thousands)		
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 42,528	$	$ 42,528	$
Obligations of states and political subdivisions	82,674		82,674	
Corporate securities	132,782		132,782	
Mortgage-backed securities	267,043		267,043	
Equity securities	42,228	42,228		
Total investments in the fair value hierarchy	567,255	42,228	525,027	
Investment measured at net asset value	15,745			
Totals	$ 583,000	$ 42,228	$ 525,027	$

We did not transfer any investments between Levels 1 and 2 during the nine months ended September 30, 2018.

The following table presents our fair value measurements for our investments in available-for-sale fixed maturity and equity securities at December 31, 2017:

	Fair Value	Fair Value Measurements Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(in thousands)		
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 44,049	$	$ 44,049	$
Obligations of states and political subdivisions	132,117		132,117	
Corporate securities	105,739		105,739	
Mortgage-backed securities	257,041		257,041	

Equity securities	36,736	36,736				
Total investments in the fair value hierarchy	575,682	36,736		538,946		
Investment measured at net asset value	13,709					
Totals	$ 589,391	$ 36,736	$	538,946	$	

10 - Income Taxes

At September 30, 2018 and December 31, 2017, respectively, we had no material unrecognized tax benefits or accrued interest and penalties. Tax years 2015 through 2018 remained open for examination at September 30, 2018. We provide a valuation allowance when we believe it is more likely than not that we will not realize some portion of our tax assets. We established a valuation allowance of $264,467 related to a portion of the net operating loss carryforward of Le Mars at January 1, 2004 and a valuation allowance of $77.1 million for our net state operating loss carryforward. We have determined that we are not required to establish a valuation allowance for our other deferred tax assets of $30.0 million and $23.1 million at September 30, 2018 and December 31, 2017, respectively, because it is more likely than not that we will realize these deferred tax assets through reversals of existing temporary differences, future taxable income and the implementation of tax planning strategies.

Our deferred tax assets include a net operating loss carryforward of $2.0 million related to Le Mars, which will begin to expire in 2020 if not previously utilized. This carryforward is subject to an annual limitation of approximately $376,000.

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11 - Liability for Losses and Loss Expenses
The establishment of an appropriate liability for losses and loss expenses is an inherently uncertain process, and we can provide no assurance that our insurance subsidiaries ultimate liability for losses and loss expenses will not exceed their loss and loss expense reserves and have an adverse effect on our results of operations and financial condition. Furthermore, we cannot predict the timing, frequency and extent of adjustments to our insurance subsidiaries estimated future liabilities, because the historical conditions and events that serve as a basis for our insurance subsidiaries estimates of ultimate claim costs may change. As is the case for substantially all property and casualty insurance companies, our insurance subsidiaries have found it necessary in the past to increase their estimated future liabilities for losses and loss expenses in certain periods, and, in other periods, their estimated future liabilities for losses and loss expenses have exceeded their actual liabilities for losses and loss expenses. Changes in our insurance subsidiaries estimate of their liability for losses and loss expenses generally reflect actual payments and their evaluation of information received subsequent to the prior reporting period.

We summarize activity in our insurance subsidiaries liability for losses and loss expenses as follows:

	Nine Months Ended September 30,	
	2018	2017
	(in thousands)	
Balance at January 1	$ 676,672	$ 606,665
Less reinsurance recoverable	(293,271)	(259,147)
Net balance at January 1	383,401	347,518
Incurred related to:		
Current year	404,150	351,812
Prior years	28,913	5,014
Total incurred	433,063	356,826
Paid related to:		
Current year	214,825	201,849
Prior years	140,806	133,587
Total paid	355,631	335,436
Net balance at end of period	460,833	368,908
Plus reinsurance recoverable	319,147	275,442
Balance at end of period	$ 779,980	$ 644,350

Our insurance subsidiaries recognized an increase in their liability for losses and loss expenses of prior years of $28.9 million and $5.0 million for the nine months ended September 30, 2018 and 2017, respectively. Our insurance subsidiaries made no significant changes in their reserving philosophy or claims management personnel, and our insurance subsidiaries have made no significant offsetting changes in estimates that increased or decreased their loss and loss expense reserves in those periods. During the first quarter of 2018, our insurance subsidiaries received new information on previously-reported commercial automobile and personal automobile claims that led our insurance subsidiaries to conclude that their prior actuarial assumptions did not fully anticipate recent changes in severity and reporting trends. Our insurance subsidiaries have encountered increasing difficulties in projecting the ultimate severity of automobile losses over recent accident years, which our insurance subsidiaries attribute to worsening litigation trends and an increased delay in the reporting to our insurance subsidiaries of information with respect to the severity of claims. As a result, our insurance subsidiaries actuaries have increased their projections of the ultimate cost of our insurance subsidiaries prior-year commercial automobile and personal automobile losses, and our insurance subsidiaries added $13.0 million to their reserves for personal automobile and $19.1 million to their reserves for commercial automobile for accident years prior to 2018. Modest adverse development related to higher-than-expected severity in the homeowners and commercial multi-peril lines of business was offset by lower-than-expected severity in the workers compensation line of business in accident years prior to 2018. The 2018 development represented 7.5% of the December 31, 2017 net carried reserves. The majority of the 2018 development related to increases in the liability for losses and loss expenses of prior years for Atlantic States and Southern. The 2017 development represented 1.4% of the December 31, 2016 net carried reserves and resulted primarily from higher-than-expected severity in the commercial multi-peril and commercial automobile liability lines of business, offset by lower-than-expected severity in the workers compensation line of business, in accident years prior to 2017. The majority of the 2017 development related to increases in the liability for losses and loss expenses of prior years for Atlantic States and Peninsula.

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Short-duration contracts are contracts for which our insurance subsidiaries receive premiums that they recognize as revenue over the period of the contract in proportion to the amount of insurance protection our insurance subsidiaries provide. Our insurance subsidiaries consider the policies they issue to be short-duration contracts. We consider the material lines of business of our insurance subsidiaries to be personal automobile, homeowners, commercial automobile, commercial multi-peril and workers compensation.

Our insurance subsidiaries determine incurred but not reported (IBNR) reserves by subtracting the cumulative loss and loss expense amounts our insurance subsidiaries have paid and the case reserves our insurance subsidiaries have established at the balance sheet date from their actuaries estimate of the ultimate cost of losses and loss expenses. Accordingly, the IBNR reserves of our insurance subsidiaries include their actuaries projections of the cost of unreported claims as well as their actuaries projected development of case reserves on known claims and reopened claims. Our insurance subsidiaries methodology for estimating IBNR reserves has been in place for many years, and, other than the reserve strengthening actions we describe above, their actuaries made no significant changes to that methodology during the nine months ended September 30, 2018.

The actuaries for our insurance subsidiaries generally prepare an initial estimate for ultimate losses and loss expenses for the current accident year by multiplying earned premium by an expected loss ratio for each line of business our insurance subsidiaries write. Expected loss ratios represent the actuaries expectation of losses at the time our insurance subsidiaries price and write their policies and before the emergence of any actual claims experience. The actuaries determine an expected loss ratio by analyzing historical experience and adjusting for loss cost trends, loss frequency and severity trends, premium rate level changes, reported and paid loss emergence patterns and other known or observed factors.

The actuaries use a variety of actuarial methods to estimate the ultimate cost of losses and loss expenses. These methods include paid loss development, incurred loss development and the Bornhuetter-Ferguson method. The actuaries base their selection of a point estimate on a judgmental weighting of the estimates each of these methods produce.

The actuaries consider loss frequency and severity trends when they develop expected loss ratios and point estimates. Loss frequency is a measure of the number of claims per unit of insured exposure, and loss severity is a measure of the average size of claims. Factors that affect loss frequency include changes in weather patterns and economic activity. Factors that affect loss severity include changes in policy limits, reinsurance retentions, inflation rates and judicial interpretations.

Our insurance subsidiaries create a claim file when they receive notice of an actual demand for payment, an event that may lead to a demand for payment or when they otherwise determine that a demand for payment could potentially lead to a future demand for payment on another coverage under the same policy or another policy they have issued. In recent years, our insurance subsidiaries have noted an increase in the period of time between the occurrence of a casualty loss event and the date at which they receive notice of a liability claim. Changes in the length of time between the loss occurrence date and the claim reporting date affect the actuaries ability to predict loss frequency accurately and the amount of IBNR reserves our insurance subsidiaries require.

Our insurance subsidiaries generally create a claim file for a policy at the claimant level by type of coverage and generally recognize one count for each claim event. In certain lines of business where it is common for multiple parties to claim damages arising from a single claim event, our insurance subsidiaries recognize one count for each claimant involved in the event. Atlantic States recognizes one count for each claim event, or claimant involved in a multiple-party claim event, related to losses Atlantic States assumes through its participation in its pooling agreement with Donegal Mutual. Our insurance subsidiaries accumulate the claim counts and report them by line of business.

12 - Impact of New Accounting Standards

In May 2014, the Financial Accounting Standards Board (the FASB) issued guidance that requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. While this guidance replaced most existing GAAP revenue recognition guidance, the scope of the guidance excludes insurance contracts. The new standard was effective on January 1, 2018. The standard permits the use of either the retrospective or the cumulative effect transition method. Because the accounting for insurance contracts is outside of the scope of this standard, the adoption of this guidance did not have a significant impact on our financial position, results of operations or cash flows.

In January 2016, the FASB issued guidance that generally requires entities to measure equity investments at fair value and recognize changes in fair value in their results of operations. This guidance also simplifies the impairment assessment of equity investments without readily determinable fair values by requiring entities to perform a qualitative assessment to identify impairment. The FASB issued other disclosure and presentation improvements related to financial instruments within the guidance. The guidance was effective for annual and interim reporting periods beginning after December 15, 2017. As a result of the adoption of this guidance on January 1, 2018, we transferred $4.9 million of net unrealized gains from accumulated other comprehensive income (AOCI) to retained earnings. We recognized $3.9 million of gains and $1.6 million of losses on equity securities held at September 30, 2018 in net realized investment gains for the nine months ended September 30, 2018.

In February 2016, the FASB issued guidance that requires lessees to recognize leases, including operating leases, on the lessee s balance sheet, unless a lease is considered a short-term lease. This guidance also requires entities to make new judgments to identify leases. The guidance is effective for annual and interim reporting periods beginning after December 15, 2018 and permits early adoption. We are in the process of evaluating the impact of the adoption of this guidance on our financial position, results of operations and cash flows.

In June 2016, the FASB issued guidance that amends previous guidance on the impairment of financial instruments by adding an impairment model that requires an entity to recognize expected credit losses as an allowance rather than impairments as credit losses are incurred. The intent of this guidance is to reduce complexity and result in a more timely recognition of expected credit losses. The guidance is effective for annual and interim reporting periods beginning after December 15, 2019. We are in the process of evaluating the impact of the adoption of this guidance on our financial position, results of operations and cash flows.

In January 2017, the FASB issued guidance that simplifies the measurement of goodwill by modifying the goodwill impairment test previous guidance required. The guidance requires an entity to perform its annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and recognize impairment for the amount by which the reporting unit s carrying amount exceeds its fair value. The guidance is effective for annual and interim reporting periods beginning after December 15, 2019 and permits early adoption. We do not expect the adoption of this guidance to have a significant impact on our financial position, results of operations or cash flows.

In February 2018, the FASB issued updated guidance that allows entities to reclassify the stranded tax effects in AOCI resulting from the Tax Cuts and Jobs Act of 2017 (the TCJA) from AOCI to retained earnings. Current guidance requires entities to report the effect of a change in tax laws or tax rates on deferred tax balances in income from continuing operations in the accounting period that includes the period of enactment, even if the entities originally charged or credited related income tax effects directly to AOCI. If an entity elects to reclassify the stranded tax effects, the guidance requires the reclassification to include the effect of the change in the U.S. federal corporate income tax rate on the gross deferred tax amounts and related valuation allowances, if any, related to items in AOCI at the date of the enactment of TCJA. The guidance is effective for annual and interim reporting periods beginning after December 15, 2018 and permits early adoption. We adopted this guidance effective on the December 22, 2017 date of the enactment of the TCJA. The adoption of this guidance did not have a significant impact on our financial position, results of operations or cash flows.

In August 2018, the FASB issued guidance that modifies disclosure requirements related to fair value measurements. The guidance removes the requirements to disclose the amounts of, and reasons for, transfers between Level 1 and Level 2 of the fair value hierarchy. The guidance is effective for annual and interim reporting periods beginning after December 15, 2019 and permits early adoption. We do not expect the adoption of this guidance to have a significant impact on our financial position, results of operations or cash flows.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.
We recommend that you read the following information in conjunction with the historical financial information and the footnotes to that financial information we include in this Quarterly Report on Form 10-Q. We also recommend you read Management s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2017.

Critical Accounting Policies and Estimates

We combine our financial statements with those of our insurance subsidiaries and present our financial statements on a consolidated basis in accordance with GAAP.

Our insurance subsidiaries make estimates and assumptions that can have a significant effect on amounts and disclosures we report in our financial statements. The most significant estimates relate to the reserves of our insurance subsidiaries for property and casualty insurance unpaid losses and loss expenses. While we believe our estimates and the estimates of our insurance subsidiaries are appropriate, the ultimate amounts of these liabilities may differ from the estimates we provided. We regularly review our methods for making these estimates and we reflect any adjustment we consider necessary in our current results of operations.

Liability for Unpaid Losses and Loss Expenses

Liabilities for losses and loss expenses are estimates at a given point in time of the amounts an insurer expects to pay with respect to incurred policyholder claims based on facts and circumstances the insurer knows at that point in time. At the time of establishing its estimates, an insurer recognizes that its ultimate liability for losses and loss expenses will exceed or be less than such estimates. Our insurance subsidiaries base their estimates of liabilities for losses and loss expenses on assumptions as to future loss trends, expected claims severity, judicial theories of liability and other factors. However, during the loss adjustment period, our insurance subsidiaries may learn additional facts regarding individual claims, and, consequently, it often becomes necessary for our insurance subsidiaries to refine and adjust their estimates for these liabilities. We reflect any adjustments to the liabilities for losses and loss expenses of our insurance subsidiaries in our consolidated results of operations in the period in which our insurance subsidiaries make adjustments to their estimates.

Our insurance subsidiaries maintain liabilities for the payment of losses and loss expenses with respect to both reported and unreported claims. Our insurance subsidiaries establish these liabilities for the purpose of covering the ultimate costs of settling all losses, including investigation and litigation costs. Our insurance subsidiaries base the amount of their liability for reported losses primarily upon a case-by-case evaluation of the type of risk involved, knowledge of the circumstances surrounding each claim and the insurance policy provisions relating to the type of loss the policyholder incurred. Our insurance subsidiaries determine the amount of their liability for unreported claims and loss expenses on the basis of historical information by line of insurance. Our insurance subsidiaries account for inflation in the reserving function through analysis of costs and trends and reviews of historical reserving results. Our insurance subsidiaries monitor their liabilities closely and recompute them periodically using new information on reported claims and a variety of statistical techniques. Our insurance subsidiaries do not discount their liabilities for losses and loss expenses.

Reserve estimates can change over time because of unexpected changes in assumptions related to our insurance subsidiaries external environment and, to a lesser extent, assumptions related to our insurance subsidiaries internal operations. For example, our insurance subsidiaries have encountered difficulties in projecting the ultimate severity of automobile losses over recent accident years, which we attribute to worsening litigation trends and an increased delay in the reporting of information with respect to the severity of claims to our insurance subsidiaries. These trend changes give rise to greater uncertainty as to the pattern of future loss settlements on automobile claims. Assumptions related to our insurance subsidiaries external environment include the absence of significant changes in tort law and the legal environment that increase liability exposure, consistency in judicial interpretations of insurance coverage and policy provisions and the rate of loss cost inflation. Internal assumptions include consistency in the recording of premium and loss statistics, consistency in the recording of claims, payment and case reserving methodology, accurate measurement of the impact of rate changes and changes in policy provisions, consistency in the quality and characteristics of business written within a given line of business and consistency in reinsurance coverage and collectability of reinsured losses, among other items. To the extent our insurance subsidiaries determine that underlying factors impacting their assumptions have changed, our insurance subsidiaries make adjustments in their reserves that they consider appropriate for such changes. Accordingly, our insurance subsidiaries ultimate liability for unpaid losses and loss expenses will likely differ from the amount recorded at September 30, 2018. For every 1% change in our insurance subsidiaries estimate for loss and loss expense reserves, net of reinsurance recoverable, the effect on our pre-tax results of operations would be approximately $4.6 million.

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The establishment of appropriate liabilities is an inherently uncertain process and we can provide no assurance that our insurance subsidiaries ultimate liability will not exceed our insurance subsidiaries loss and loss expense reserves and have an adverse effect on our results of operations and financial condition. Furthermore, we cannot predict the timing, frequency and extent of adjustments to our insurance subsidiaries estimated future liabilities, because the historical conditions and events that serve as a basis for our insurance subsidiaries estimates of ultimate claim costs may change. As is the case for substantially all property and casualty insurance companies, our insurance subsidiaries have found it necessary in the past to increase their estimated future liabilities for losses and loss expenses in certain periods and, in other periods, their estimated future liabilities for losses and loss expenses have exceeded their actual liabilities for losses and loss expenses. Changes in our insurance subsidiaries estimates of their liability for losses and loss expenses generally reflect actual payments and their evaluation of information received subsequent to the prior reporting period.

Excluding the impact of severe weather events, our insurance subsidiaries have noted stable amounts in the number of claims incurred and a slight downward trend in the number of claims outstanding at period ends relative to their premium base in recent years across most of their lines of business. However, the amount of the average claim outstanding has increased over the past several years due to various factors such as rising medical loss costs and increased litigation trends. We have also experienced a general slowing of settlement rates in litigated claims. Our insurance subsidiaries could have to make further adjustments to their estimates in the future. However, on the basis of our insurance subsidiaries internal procedures, which analyze, among other things, their prior assumptions, their experience with similar cases and historical trends such as reserving patterns, loss payments, pending levels of unpaid claims and product mix, as well as court decisions, economic conditions and public attitudes, we believe that our insurance subsidiaries have made adequate provision for their liability for losses and loss expenses.

Atlantic States participation in the pool with Donegal Mutual exposes Atlantic States to adverse loss development on the business of Donegal Mutual that the pool includes. However, pooled business represents the predominant percentage of the net underwriting activity of both companies, and Donegal Mutual and Atlantic States share proportionately any adverse risk development relating to the pooled business. The business in the pool is homogeneous and each company has a pro-rata share of the entire pool. Since the predominant percentage of the business of Atlantic States and Donegal Mutual is pooled and the results shared by each company according to its participation level under the terms of the pooling agreement, the intent of the underwriting pool is to produce a more uniform and stable underwriting result from year to year for each company than either would experience individually and to spread the risk of loss between the companies.

Donegal Mutual and our insurance subsidiaries operate together as the Donegal Insurance Group and share a combined business plan designed to achieve market penetration and underwriting profitability objectives. The products our insurance subsidiaries and Donegal Mutual offer are generally complementary, thereby allowing Donegal Insurance Group to offer a broader range of products to a given market and to expand Donegal Insurance Group s ability to service an entire personal lines or commercial lines account. Distinctions within the products of Donegal Mutual and our insurance subsidiaries generally relate to specific risk profiles targeted within similar classes of business, such as preferred tier products compared to standard tier products, but we do not allocate all of the standard risk gradients to one company. Therefore, the underwriting profitability of the business the individual companies write directly will vary. However, because the pool homogenizes the risk characteristics of the predominant percentage of the business Donegal Mutual and Atlantic States write directly and each company shares the underwriting results according to each company s participation percentage, each company realizes its percentage share of the underwriting results of the pool.

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Our insurance subsidiaries unpaid liability for losses and loss expenses by major line of business at September 30, 2018 and December 31, 2017 consisted of the following:

	September 30, 2018	December 31, 2017
	(in thousands)	
Commercial lines:		
Automobile	$ 99,404	$ 74,299
Workers compensation	111,500	103,318
Commercial multi-peril	86,719	71,011
Other	5,019	4,119
Total commercial lines	302,642	252,747
Personal lines:		
Automobile	135,956	110,512
Homeowners	20,013	18,508
Other	2,222	1,634
Total personal lines	158,191	130,654
Total commercial and personal lines	460,833	383,401
Plus reinsurance recoverable	319,147	293,271
Total liability for unpaid losses and loss expenses	$ 779,980	$ 676,672

We have evaluated the effect on our insurance subsidiaries unpaid loss and loss expense reserves and our stockholders equity in the event of reasonably likely changes in the variables we consider in establishing the loss and loss expense reserves of our insurance subsidiaries. We established the range of reasonably likely changes based on a review of changes in accident-year development by line of business and applied those changes to our insurance subsidiaries loss reserves as a whole. The range we selected does not necessarily indicate what could be the potential best or worst case or the most likely scenario. The following table sets forth the estimated effect on our insurance subsidiaries unpaid loss and loss expense reserves and our stockholders equity in the event of reasonably likely changes in the variables we considered in establishing the loss and loss expense reserves of our insurance subsidiaries:

Percentage Change in Loss and Loss Expense Reserves Net of Reinsurance	Adjusted Loss and Loss Expense Reserves Net of Reinsurance at September 30, 2018	Percentage Change in Stockholders Equity at September 30, 2018(1)	Adjusted Loss and Loss Expense Reserves Net of Reinsurance at December 31, 2017	Percentage Change in Stockholders Equity at December 31, 2017(1)
		(dollars in thousands)		
(10.0)%	$414,750	8.8%	$345,061	6.8%

(7.5)	426,271	6.6	354,646	5.1
(5.0)	437,791	4.4	364,231	3.4
(2.5)	449,312	2.2	373,816	1.7
Base	460,833		383,401	
2.5	472,354	(2.2)	392,986	(1.7)
5.0	483,875	(4.4)	402,571	(3.4)
7.5	495,395	(6.6)	412,156	(5.1)
10.0	506,916	(8.8)	421,741	(6.8)

(1) Net of income tax effect.

Non-GAAP Information

We prepare our consolidated financial statements on the basis of GAAP. Our insurance subsidiaries also prepare financial statements based on statutory accounting principles state insurance regulators prescribe or permit (SAP). SAP financial measures are considered non-GAAP financial measures under applicable SEC rules because the SAP financial measures include or exclude certain items that the most comparable GAAP financial measures do not ordinarily include or exclude. Our calculation of non-GAAP financial measures may differ from similar measures other companies use, so investors should exercise caution when comparing our non-GAAP financial measures to the non-GAAP financial measures other companies use.

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Because our insurance subsidiaries do not prepare GAAP financial statements, we evaluate the performance of our personal lines and commercial lines segments utilizing SAP financial measures that reflect the growth trends and underwriting results of our insurance subsidiaries. The SAP financial measures we utilize are net premiums written and statutory combined ratio.

Net Premiums Written

We define net premiums written as the amount of full-term premiums our insurance subsidiaries record for policies effective within a given period less premiums our insurance subsidiaries cede to reinsurers. Net premiums earned is the most comparable GAAP financial measure to net premiums written. Net premiums earned represent the sum of the amount of net premiums written and the change in net unearned premiums during a given period. Our insurance subsidiaries earn premiums and recognize them as revenue over the terms of their policies, which are one year or less in duration. Therefore, increases or decreases in net premiums earned generally reflect increases or decreases in net premiums written in the preceding 12-month period compared to the comparable period one year earlier.

The following table provides a reconciliation of our net premiums earned to our net premiums written for the three and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net premiums earned	$ 187,662	$ 177,284	$ 555,140	$ 521,455
Change in net unearned premiums	(3,144)	5,194	20,583	36,296
Net premiums written	$ 184,518	$ 182,478	$ 575,723	$ 557,751

Statutory Combined Ratio

The combined ratio is a standard measurement of underwriting profitability for an insurance company. The combined ratio does not reflect investment income, net realized investment gains or losses, federal income taxes or other non-operating income or expense. A combined ratio of less than 100% generally indicates underwriting profitability.

The statutory combined ratio is a non-GAAP financial measure that is based upon amounts determined under SAP. We calculate our statutory combined ratio as the sum of:

- the statutory loss ratio, which is the ratio of calendar-year net incurred losses and loss expenses to net premiums earned;
- the statutory expense ratio, which is the ratio of expenses incurred for net commissions, premium taxes and underwriting expenses to net premiums written; and
- the statutory dividend ratio, which is the ratio of dividends to holders of workers compensation policies to net premiums earned.

The calculation of our statutory combined ratio differs from the calculation of our GAAP combined ratio. In calculating our GAAP combined ratio, we do not deduct installment payment fees from incurred expenses, and we base the expense ratio on net premiums earned instead of net premiums written. Differences between our GAAP loss ratio and our statutory loss ratio result from anticipating salvage and subrogation recoveries for our GAAP loss ratio but not for our statutory loss ratio.

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Combined Ratios

The following table presents comparative details with respect to our GAAP and statutory combined ratios for the three and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	**2017**	**2018**	**2017**
GAAP Combined Ratios (Total Lines)				
Loss ratio (non-weather)	63.7%	54.2%	68.5%	58.2%
Loss ratio (weather-related)	11.3	10.3	9.5	10.2
Expense ratio	29.6	34.3	31.3	33.3
Dividend ratio	0.6	0.8	0.6	0.7
Combined ratio	105.2%	99.6%	109.9%	102.4%
Statutory Combined Ratios				
Commercial lines:				
Automobile	114.6%	116.6%	133.7%	110.5%
Workers compensation	83.6	67.6	86.6	78.5
Commercial multi-peril	96.0	86.7	101.2	96.6
Total commercial lines	97.5	86.9	104.8	91.8
Personal lines:				
Automobile	115.8	103.8	114.5	105.8
Homeowners	110.3	117.0	112.0	115.2
Total personal lines	111.4	107.5	112.6	108.2
Total commercial and personal lines	105.2	98.2	109.0	100.8

Results of Operations Three Months Ended September 30, 2018 Compared to Three Months Ended September 30, 2017

Net Premiums Earned. Our insurance subsidiaries net premiums earned for the third quarter of 2018 were $187.7 million, an increase of $10.4 million, or 5.9%, compared to $177.3 million for the third quarter of 2017, reflecting increases in net premiums written during 2018 and 2017.

Net Premiums Written. Our insurance subsidiaries net premiums written for the three months ended September 30, 2018 were $184.5 million, an increase of $2.0 million, or 1.1%, from the $182.5 million of net premiums written for the third quarter of 2017. We attribute the increase primarily to the impact of premium rate increases and an increase in the writing of new accounts in commercial lines of business. Personal lines net premiums written decreased $3.2 million, or 3.0%, for the third quarter of 2018 compared to the third quarter of 2017. We attribute the decrease in personal lines primarily to net attrition as a result of underwriting measures our insurance subsidiaries have implemented to slow new policy growth and to increase pricing on renewal policies. Commercial lines net premiums written increased $5.2 million, or 6.8%, for the third quarter of 2018 compared to the third quarter of 2017. We attribute the increase in commercial lines primarily to premium rate increases throughout 2017 and 2018 and increased writings of new commercial accounts.

Investment Income. Our net investment income increased to $6.6 million for the third quarter of 2018, compared to $6.0 million for the third quarter of 2017. We attribute the increase primarily to an increase in average invested assets.

Net Realized Investment Gains. Net realized investment gains for the third quarter of 2018 were $3.5 million, compared to $561,429 for the third quarter of 2017. The net realized investment gains for the third quarter of 2018 resulted primarily from unrealized gains within our equity securities portfolio and a limited partnership that invests in equity securities. New accounting guidance we adopted on January 1, 2018 requires us to measure equity investments at fair value and recognize changes in fair value in our results of operations. The net realized investment gains for the third quarter of 2017 resulted primarily from strategic sales of equity securities within our investment portfolio and unrealized gains within a limited partnership that invests in equity securities. We did not recognize any impairment losses in our investment portfolio during the third quarters of 2018 or 2017.

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Equity in Earnings of DFSC. Our equity in the earnings of DFSC was $732,768 for the third quarter of 2018, compared to $403,647 for the third quarter of 2017. We attribute the increase in DFSC s earnings primarily to higher net interest income related to loan portfolio growth that DFSC achieved during 2017.

Losses and Loss Expenses. Our insurance subsidiaries loss ratio, which is the ratio of incurred losses and loss expenses to premiums earned, for the third quarter of 2018 was 75.0%, an increase from our insurance subsidiaries loss ratio of 64.5% for the third quarter of 2017. On a statutory basis, our insurance subsidiaries commercial lines loss ratio was 67.5% for the third quarter of 2018, compared to 54.0% for the third quarter of 2017, primarily due to increases in the commercial automobile, commercial multiple-peril and workers compensation loss ratios. The personal lines statutory loss ratio of our insurance subsidiaries increased to 81.8% for the third quarter of 2018, compared to 73.7% for the third quarter of 2017. We attribute this increase primarily to an increase in the personal automobile loss ratio. Our insurance subsidiaries experienced adverse loss reserve development of approximately $2.7 million during the third quarter of 2018. Our insurance subsidiaries experienced favorable loss reserve development of approximately $3.4 million during the third quarter of 2017.

Underwriting Expenses. The expense ratio for an insurance company is the ratio of policy acquisition costs and other underwriting expenses to premiums earned. The expense ratio of our insurance subsidiaries was 29.6% for the third quarter of 2018, compared to 34.3% for the third quarter of 2017. We attribute the decrease to lower underwriting-based incentives for the third quarter of 2018 compared to the third quarter of 2017, as well as savings associated with the consolidation of certain operations of Peninsula in July 2018.

Combined Ratio. The combined ratio represents the sum of the loss ratio, the expense ratio and the dividend ratio, which is the ratio of policyholder dividends incurred to premiums earned. Our insurance subsidiaries combined ratios were 105.2% and 99.6% for the three months ended September 30, 2018 and 2017, respectively. We attribute the increase in the combined ratio to an increase in the loss ratio for the third quarter of 2018 compared to the third quarter of 2017.

Interest Expense. Our interest expense for the third quarter of 2018 was $651,768, compared to $466,262 for the third quarter of 2017. We attribute the increase to higher interest rates in effect for borrowings under our lines of credit during the third quarter of 2018 compared to the third quarter of 2017.

Income Taxes. We recorded income tax expense of $70,630 for the third quarter of 2018, which reflects our anticipation of an estimated carryback of our taxable loss in 2018 to prior tax years. Income tax expense was $1.4 million for the third quarter of 2017, representing an effective tax rate of 16.5%. The income tax expense and effective tax rate for the third quarter of 2017 represented an estimate based on our projected annual taxable income.

Net Income and Income Per Share. Our net income for the third quarter of 2018 was $1.2 million, or $.04 per share of Class A common stock on a diluted basis and $.04 per share of Class B common stock, compared to net income of $7.1 million, or $.26 per share of Class A common stock on a diluted basis and $.24 per share of Class B common stock, for the third quarter of 2017. We had 22.7 million and 21.8 million Class A shares outstanding at September 30, 2018 and 2017, respectively. We had 5.6 million Class B shares outstanding at the end of both periods.

Results of Operations Nine Months Ended September 30, 2018 Compared to Nine Months Ended September 30, 2017

Net Premiums Earned. Our insurance subsidiaries net premiums earned for the first nine months of 2018 were $555.1 million, an increase of $33.6 million, or 6.5%, compared to $521.5 million for the first nine months of 2017, reflecting increases in net premiums written during 2018 and 2017.

Net Premiums Written. Our insurance subsidiaries net premiums written for the nine months ended September 30, 2018 were $575.7 million, an increase of $17.9 million, or 3.2%, from the $557.8 million of net premiums written for the first nine months of 2017. We attribute the increase primarily to the impact of premium rate increases and an increase in the writing of new accounts in commercial lines of business. Personal lines net premiums written increased $1.7 million, or 0.6%, for the first nine months of 2018 compared to the first nine months of 2017. We attribute the increase in personal lines primarily to premium rate increases our insurance subsidiaries implemented throughout 2017 and 2018, partially offset by net attrition as a result of underwriting measures our insurance subsidiaries have implemented to slow new policy growth and increased pricing on renewal policies. Commercial lines net premiums written increased $16.2 million, or 6.4%, for the first nine months of 2018 compared to the first nine months of 2017. We attribute the increase in commercial lines primarily to premium rate increases throughout 2017 and 2018 and increased writings of new commercial accounts.

Investment Income. Our net investment income increased to $19.3 million for the first nine months of 2018, compared to $17.4 million for the first nine months of 2017. We attribute the increase primarily to an increase in average invested assets.

Net Realized Investment Gains. Net realized investment gains for the first nine months of 2018 were $4.1 million, compared to $4.2 million for the first nine months of 2017. The net realized investment gains for the first nine months of 2018 resulted primarily from net unrealized gains within our equity securities portfolio and a limited partnership that invests in equity securities. New accounting guidance we adopted on January 1, 2018 requires us to measure equity investments at fair value and recognize changes in fair value in our results of operations. The net realized investment gains for the first nine months of 2017 resulted primarily from strategic sales of equity securities within our investment portfolio and unrealized gains within a limited partnership that invests in equity securities. We did not recognize any impairment losses in our investment portfolio during the first nine months of 2018 or 2017.

Equity in Earnings of DFSC. Our equity in the earnings of DFSC was $2.2 million for the first nine months of 2018, compared to $1.0 million for the first nine months of 2017. We attribute the increase in DFSC s earnings primarily to higher net interest income related to loan portfolio growth that DFSC achieved during 2017.

Losses and Loss Expenses. Our insurance subsidiaries loss ratio, which is the ratio of incurred losses and loss expenses to premiums earned, for the first nine months of 2018 was 78.0%, an increase from our insurance subsidiaries loss ratio of 68.4% for the first nine months of 2017. On a statutory basis, our insurance subsidiaries commercial lines loss ratio was 74.1% for the first nine months of 2018, compared to 60.4% for the first nine months of 2017, primarily due to increases in the commercial automobile, commercial multiple-peril and workers compensation loss ratios. The personal lines statutory loss ratio of our insurance subsidiaries increased to 81.8% for the first nine months of 2018, compared to 75.4% for the first nine months of 2017. We attribute this increase primarily to an increase in the personal automobile loss ratio. In the first nine months of 2018, our insurance subsidiaries added $13.0 million to their loss reserves for personal automobile and $19.1 million to their loss reserves for commercial automobile for accident years prior to 2018 based on new information they received during the first nine months of 2018. Our insurance subsidiaries experienced unfavorable loss reserve development of approximately $5.0 million during the first nine months of 2017.

Underwriting Expenses. The expense ratio for an insurance company is the ratio of policy acquisition costs and other underwriting expenses to premiums earned. The expense ratio of our insurance subsidiaries was 31.3% for the first nine months of 2018, compared to 33.3% for the first nine months of 2017. We attribute the decrease to lower underwriting-based incentives for the first nine months of 2018 compared to the first nine months of 2017, partially offset by a $1.9 million restructuring charge in the second quarter of 2018 for employee termination costs associated with the consolidation of certain operations and closing of the branch office of Peninsula. We expect to achieve annualized expense savings of approximately $3.7 million as a result of implementing the Peninsula consolidation.

Combined Ratio. The combined ratio represents the sum of the loss ratio, the expense ratio and the dividend ratio, which is the ratio of policyholder dividends incurred to premiums earned. Our insurance subsidiaries combined ratios were 109.9% and 102.4% for the nine months ended September 30, 2018 and 2017, respectively. We attribute the increase in the combined ratio to an increase in the loss ratio for the first nine months of 2018 compared to the first nine months of 2017.

Interest Expense. Our interest expense for the first nine months of 2018 was $1.7 million, compared to $1.2 million for the first nine months of 2017. We attribute the increase to higher interest rates in effect for borrowings under our lines of credit during the first nine months of 2018 compared to the first nine months of 2017.

Income Taxes. We recorded an income tax benefit of $10.8 million for the first nine months of 2018 based upon an estimated carryback of our taxable loss in 2018 to prior tax years. We recorded income tax expense of $1.9 million for the first nine months of 2017, representing an effective tax rate of 16.4% . The income tax expense and effective tax rate for the first nine months of 2017 represented an estimate based on our projected annual taxable income.

Net (Loss) Income and (Loss) Earnings Per Share. Our net loss for the first nine months of 2018 was $17.8 million, or $.64 per share of Class A common stock and $.59 per share of Class B common stock, compared to net income of $9.9 million, or $.36 per share of Class A common stock on a diluted basis and $.33 per share of Class B common stock, for the first nine months of 2017. We had 22.7 million and 21.8 million Class A shares outstanding at September 30, 2018 and 2017, respectively. We had 5.6 million Class B shares outstanding at the end of both periods.

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Liquidity and Capital Resources

Liquidity is a measure of an entity s ability to secure enough cash to meet its contractual obligations and operating needs as such obligations and needs arise. Our major sources of funds from operations are the net cash flows we generate from our insurance subsidiaries underwriting results, investment income and investment maturities.

Our operations have historically generated sufficient net positive cash flow to fund our commitments and add to our investment portfolio, thereby increasing future investment returns and enhancing our liquidity. The impact of the pooling agreement between Donegal Mutual and Atlantic States has historically been cash-flow positive because of the consistent underwriting profitability of the pool. Donegal Mutual and Atlantic States settle their respective obligations to each other under the pool monthly, thereby resulting in cash flows substantially similar to the cash flows that would result from each company writing the business directly. We have not experienced any unusual variations in the timing of claim payments associated with the loss reserves of our insurance subsidiaries. We maintain significant liquidity in our investment portfolio in the form of readily marketable fixed maturities, equity securities and short-term investments. We structure our fixed-maturity investment portfolio following a laddering approach, so that projected cash flows from investment income and principal maturities are evenly distributed from a timing perspective, thereby providing an additional measure of liquidity to meet our obligations should an unexpected variation occur in the future. Our operating activities provided net cash flows in the first nine months of 2018 and 2017 of $59.9 million and $62.7 million, respectively.

At September 30, 2018, we had $25.0 million in outstanding borrowings under our line of credit with M&T and had the ability to borrow an additional $35.0 million at interest rates equal to M&T s current prime rate or the then current LIBOR rate plus 2.25%. The interest rate on these borrowings was 4.51% at September 30, 2018. At September 30, 2018, Atlantic States had $35.0 million in outstanding advances with the FHLB of Pittsburgh. The interest rate on these advances was 2.32% at September 30, 2018.

The following table shows our expected payments for significant contractual obligations at September 30, 2018:

	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
			(in thousands)		
Net liability for unpaid losses and loss expenses of our insurance subsidiaries	$ 460,833	$ 213,966	$ 214,535	$ 16,560	$ 15,772
Subordinated debentures	5,000				5,000
Borrowings under lines of credit	60,000	35,000	25,000		
Total contractual obligations	$ 525,833	$ 248,966	$ 239,535	$ 16,560	$ 20,772

We estimate the date of payment for the net liability for unpaid losses and loss expenses of our insurance subsidiaries based on historical experience and expectations of future payment patterns. We show the liability net of reinsurance recoverable on unpaid losses and loss expenses to reflect expected future cash flows related to such liability. Amounts Atlantic States assumes pursuant to the pooling agreement with Donegal Mutual represent a substantial portion of our insurance subsidiaries gross liability for unpaid losses and loss expenses, and amounts Atlantic States cedes pursuant to the pooling agreement represent a substantial portion of our insurance subsidiaries reinsurance recoverable on unpaid losses and loss expenses. We include cash settlement of Atlantic States assumed liability from the pool in monthly settlements of pooled activity, as we net amounts ceded to and assumed from the pool. Although Donegal Mutual and we do not anticipate any changes in the pool participation levels in the foreseeable future, any such change would be prospective in nature and therefore would not impact the timing of expected payments by Atlantic States for its percentage share of pooled losses occurring in periods prior to the effective date of such change.

We discuss in Note 7 Borrowings our estimate of the timing of the amounts payable for the borrowings under our lines of credit based on their contractual maturities. The borrowings under our lines of credit carry interest rates that vary as we discuss in Note 7 Borrowings. With the exception of a requirement that we maintain a minimum interest coverage ratio, we complied with all requirements of the credit agreement during the nine months ended September 30, 2018. M&T waived the minimum interest coverage ratio requirement at September 30, 2018. Based upon the interest rates in effect at September 30, 2018, our annual interest cost associated with the borrowings under our lines of credit is approximately $2.1 million. For every 1% change in the interest rate associated with the borrowings under our lines of credit, the effect on our annual interest cost would be approximately $600,000.

We discuss in Note 7 Borrowings our estimate of the timing of the amounts payable for the subordinated debentures based on their contractual maturity. The subordinated debentures carry an interest rate of 5%, and any repayment of principal or payment of interest on the subordinated debentures requires prior approval of the Michigan Department of Insurance and Financial Services. Our annual interest cost associated with the subordinated debentures is $250,000.

On July 18, 2013, our board of directors authorized a share repurchase program pursuant to which we have the authority to purchase up to 500,000 shares of our Class A common stock at prices prevailing from time to time in the open market subject to the provisions of applicable rules of the SEC and in privately negotiated transactions. We did not purchase any shares of our Class A common stock under this program during the nine months ended September 30, 2018 or 2017. We have purchased a total of 57,658 shares of our Class A common stock under this program from its inception through September 30, 2018.

On October 18, 2018, our board of directors declared quarterly cash dividends of 14.25 cents per share of our Class A common stock and 12.50 cents per share of our Class B common stock, payable on November 15, 2018 to our stockholders of record as of the close of business on November 1, 2018. We are not subject to any restrictions on our payment of dividends to our stockholders, although there are state law restrictions on the payment of dividends by our insurance subsidiaries to us. Dividends from our insurance subsidiaries are our principal source of cash for payment of dividends to our stockholders. Our insurance subsidiaries are subject to regulations that restrict the payment of dividends from statutory surplus and may require prior approval of their domiciliary insurance regulatory authorities. Our insurance subsidiaries are also subject to risk based capital (RBC) requirements that limit their ability to pay dividends to us. Our insurance subsidiaries statutory capital and surplus at December 31, 2017 exceeded the amount of statutory capital and surplus necessary to satisfy regulatory requirements, including the RBC requirements, by a significant margin. Our insurance subsidiaries paid $6.0 million in dividends to us during the first nine months of 2018. Amounts remaining available for distribution to us as dividends from our insurance subsidiaries without prior approval of their domiciliary insurance regulatory authorities in 2018 are $20.3 million from Atlantic States, $5.5 million from Southern, $2.3 million from Le Mars, $1.6 million from Peninsula, $0 from Sheboygan and $1.3 million from MICO, or a total of approximately $31.0 million.

At September 30, 2018, we had no material commitments for capital expenditures.

Equity Price Risk

Our portfolio of marketable equity securities, which we carry on our consolidated balance sheets at estimated fair value, has exposure to the risk of loss resulting from an adverse change in prices. We manage this risk by having our investment personnel perform an analysis of prospective investments and regular reviews of our portfolio of equity securities.

Credit Risk

Our portfolio of fixed-maturity securities and, to a lesser extent, our portfolio of short-term investments is subject to credit risk, which we define as the potential loss in market value resulting from adverse changes in the borrower s ability to repay its debt. We manage this risk by having our investment personnel perform an analysis of prospective investments and regular reviews of our portfolio of fixed-maturity securities. We also limit the percentage and amount of our total investment portfolio that we invest in the securities of any one issuer.

Our insurance subsidiaries provide property and casualty insurance coverages through independent insurance agencies. We bill the majority of this business directly to the insured, although we bill a portion of our commercial business through licensed insurance agents to whom our insurance subsidiaries extend credit in the normal course of business.

Because the pooling agreement does not relieve Atlantic States of primary liability as the originating insurer, Atlantic States is subject to a concentration of credit risk arising from the business it cedes to Donegal Mutual. Our insurance subsidiaries maintain reinsurance agreements with Donegal Mutual and with a number of other major unaffiliated authorized reinsurers.

Impact of Inflation

We establish property and casualty insurance premium rates before we know the amount of unpaid losses and loss expenses or the extent to which inflation may impact such losses and expenses. Consequently, our insurance subsidiaries attempt, in establishing rates, to anticipate the potential impact of inflation.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Our market risk generally represents the risk of gain or loss that may result from the potential change in the fair value of the securities we hold in our investment portfolio as a result of fluctuations in prices and interest rates and, to a lesser extent, our debt obligations. We manage our interest rate risk by maintaining an appropriate relationship between the average duration of our investment portfolio and the approximate duration of our liabilities, i.e., policy claims of our insurance subsidiaries and our debt obligations.

There have been no material changes to our quantitative or qualitative market risk exposure from December 31, 2017 through September 30, 2018.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). Based on such evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that, at September 30, 2018, our disclosure controls and procedures were effective in recording, processing, summarizing and reporting, on a timely basis, information we are required to disclose in the reports that we file or submit under the Exchange Act, and our disclosure controls and procedures were also effective to ensure that information we disclose in the reports we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There has been no change in our internal control over financial reporting during the quarter covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to affect materially, our internal control over financial reporting.

Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995

We base all statements contained in this Quarterly Report on Form 10-Q that are not historic facts on our current expectations. Such statements are forward-looking in nature (as defined in the Private Securities Litigation Reform Act of 1995) and necessarily involve risks and uncertainties. Forward-looking statements we make may be identified by our use of words such as will, expects, intends, plans, anticipates, believes, seeks, estimates and sim expressions. Our actual results could vary materially from our forward-looking statements. The factors that could cause our actual results to vary materially from the forward-looking statements we have previously made include, but are not limited to, adverse and catastrophic weather events, our ability to maintain profitable operations, the adequacy of the loss and loss expense reserves of our insurance subsidiaries, business and economic conditions in the areas in which we and our insurance subsidiaries operate, interest rates, competition from various insurance and other financial businesses, terrorism, the availability and cost of reinsurance, legal and judicial developments, changes in regulatory requirements, our ability to integrate and manage successfully the companies we may acquire from time to time and the other risks that we describe from time to time in our filings with the SEC. We disclaim any obligation to update such statements or to announce publicly the results of any revisions that we may make to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

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Part II. Other Information

Item 1. Legal Proceedings.
None.

Item 1A. Risk Factors.
Our business, results of operations and financial condition, and, therefore, the value of our Class A common stock and our Class B common stock, are subject to a number of risks. For a description of certain risks, we refer to Risk Factors in our 2017 Annual Report on Form 10-K that we filed with the SEC on March 9, 2018. There have been no material changes in the risk factors we disclosed in that Form 10-K Report during the nine months ended September 30, 2018.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.
None.

Item 3. Defaults upon Senior Securities.
None.

Item 4. Removed and Reserved.

Item 5. Other Information.
None.

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Item 6. Exhibits.

Exhibit No.	Description
Exhibit 31.1	Certification of Chief Executive Officer
Exhibit 31.2	Certification of Chief Financial Officer
Exhibit 32.1	Statement of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 of Title 18 of the United States Code
Exhibit 32.2	Statement of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 of Title 18 of the United States Code
Exhibit 101.INS	XBRL Instance Document
Exhibit 101.SCH	XBRL Taxonomy Extension Schema Document
Exhibit 101.PRE	XBRL Taxonomy Presentation Linkbase Document
Exhibit 101.CAL	XBRL Taxonomy Calculation Linkbase Document
Exhibit 101.LAB	XBRL Taxonomy Label Linkbase Document
Exhibit 101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

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Signatures

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.

	DONEGAL GROUP INC.
November 9, 2018	**By:** /s/ Kevin G. Burke Kevin G. Burke, President and Chief Executive Officer
November 9, 2018	**By:** /s/ Jeffrey D. Miller Jeffrey D. Miller, Executive Vice President and Chief Financial Officer