Baldwin & Lyons, Inc.

2002

Annual Report

Baldwin & Lyons, Inc. has, since its founding in 1930, been engaged in marketing and underwriting casualty insurance. Specialty markets are served by the Company's subsidiaries.

Protective Insurance Company, with licenses in all 50 states and all Canadian provinces, provides coverage for large trucking fleets which retain substantial amounts of self-insurance as well as for medium-sized trucking companies on a first dollar or small deductible basis. These trucking products are marketed by the Baldwin & Lyons agency organization directly to trucking clients without broker or agent intermediaries. The agency operations also provide claims handling, loss control and other insurance related services to trucking insureds. In addition, Protective accepts retrocessions from reinsurance companies, principally reinsuring against catastrophes.

Sagamore Insurance Company, which is licensed in 43 states, markets nonstandard private passenger automobile insurance products to individuals, commercial automobile coverage to small trucking fleets and workers' compensation insurance to small businesses. A subsidiary is also maintained in Bermuda to provide captive insurance company benefits to trucking insureds.

Financial Highlights

	Year Ended December 31		
	2002	2001	2000
	(dollars in thousands, except per share data)		
Operating revenue [1]	**$ 124,575**	$ 104,827	$ 100,000
Revenue	**108,130**	109,880	112,473
Operating income	**23,055**	2,106	11,643
Net income	**12,366**	5,390	19,750
Per share data - diluted [2]:			
Income before realized net gains (losses) on investments	**$ 1.57**	$ .14	$ .74
Realized net gains (losses) on investments	**(.73)**	.21	.52
Net income	**.84**	.35	1.26
Book value	**19.43**	18.98	19.21
Dividends	**.32**	.32	.32
Return on average shareholders' equity [3]:			
Operating income	**9.0%**	.8%	4.5%
Net income	**4.8%**	2.1%	7.6%
Combined ratio of insurance subsidiaries (GAAP basis)	**91.3%**	122.8%	102.3%

[1] Operating revenue excludes realized net gains (losses) on investments.

[2] All per share amounts reflect a five-for-four stock split, effective February 17, 2003.

[3] Average shareholders' equity excludes unrealized gains or losses on investments.

To Our Shareholders . . .

There are two main sources of income in the property/casualty insurance business. The first is selling insurance policies that generate premiums and fees in excess of the policies' loss costs plus the expenses involved in selling and servicing activities and in handling policy losses. The excess of premium over losses and expenses is referred to as underwriting income. The second source of income comes from investing money. The premiums on insurance policies are collected by the insurer before (often long before) the losses are paid. Investing that premium until losses are paid allows insurers to earn interest or dividends, referred to as investment income, on the funds held. In addition, the value of the investments may go up or down which, upon sale of the investments or recognition of other than temporary impairment, adds to or detracts from investment income with capital gains or losses.

In 2002, Baldwin and Lyons did a great job of selling insurance that generated premiums in excess of losses and expenses. Our pre-tax underwriting profit was $19.3 million on premiums and fees of $109.6 million. Those are record numbers, far better than we have ever done before. By comparison, in 2001, excluding our $20 million World Trade Center loss, we earned $3.8 million on premiums and fees of $87.2 million. So we sold more business at better prices, while losses and expenses did not proportionately increase. While the marketplace has improved for all insurance companies, our ability to benefit from that improvement did not fortuitously occur. In this case, a rising tide does not lift all boats. Even with today's improved pricing, many in the industry must pay for past mistakes thereby reducing or eliminating profits on current business. We truly "kept our powder dry" during the soft market by not writing business when we did not see the possibility of profit. And the better conditions we see today can be enjoyed today.

The operating side of our business clearly outperformed the investing side. Available yields on fixed income investments are at their lowest levels in over 45 years. Those lower yields have a negative impact on our results. Investment income of $15.0 million reported for 2002 was a decline of $2.7 million, or 15% year-to-year. Every investor has witnessed the overall decline in value of equity securities for the third straight year. With over $100 million invested in equities, we were not immune to that decline. Although we again outperformed the S&P 500 and other measures, capital losses, realized and unrealized, totaled $13.4 million for the year.

Since our superior underwriting profitability offset the decline in investment income, operating income increased to a record $34.3 million pre-tax. This compares to pro-forma operating income (excluding the W.T.C. loss) for 2001 of $21.4 million. Operating earnings per share, after tax and adjusted for the five-for-four stock split effective in February, 2003, increased to $1.57 for 2002, from 2001's $0.99, again without consideration of the W.T.C. loss. Capital losses realized or recognized totaled $0.73 and reduced net income to $0.84 for 2002.

Underwriting and operating profits increased nicely as we did substantially more business while keeping losses and expenses in check. Consolidated gross premium written by our two subsidiary companies, Protective Insurance Company and Sagamore Insurance Company was up 44% to $173 million. The consolidated combined ratio for the year was 91.3%, a 7.5 point decrease from 2001's pro forma 98.8%. Increasing volume while improving the rate of profitability gives a CEO pleasant dreams. And it appears volume will continue to increase, and hopefully my dreams will stay pleasant. Our consolidated premium in force January 1, 2003 increased 38% over that same measure for January 1, 2002. Premium in force is a snapshot of the total annual premium for all policies in effect on a given day. Since there was more in force premium this January, we should earn more premium throughout the year, barring large losses of renewal business. The percentage increase in premium earned, however, will not necessarily match the increase in the in force premium.

The biggest increase in volume in 2002 came from our subsidiary, Protective Insurance Company. Protective writes fleet trucking insurance, group insurance for independent contractors of trucking companies and also assumes reinsurance from other reinsurers and insurance companies. Selling insurance at higher premium rates, to substantially more customers, made for a good year for Protective's fleet trucking specialty. Its gross premiums written increased by an impressive 86%. The independent contractor product increased by 33% and reinsurance assumed by 43%. All products were profitable with Protective reporting an excellent 87.4% combined ratio which, we point out with pride, is among the very best in the industry.

Sagamore increased its volume as well, but at a more modest rate. Total volume for Sagamore's three products of non standard auto insurance, trucking insurance for small fleets and workers compensation insurance for small businesses, increased by 14% for the year. Especially significant is a 45% increase in volume for the 4th quarter of 2002 vs. the fourth quarter a year earlier.

That momentum adds to our optimism for 2003. Non standard auto increased writings 18% year-to-year. Small business workers compensation increased by 46%, albeit from a small base. However not everything was up, as small fleet trucking continues to be a competitive pocket of the market with some companies pricing at levels we doubt will prove profitable. We maintained our standard practice of not selling policies when a profit can not reasonably be expected. As a result, our small fleet volume actually fell 10% in premium written and 31% in units insured at year-end. Since today's available investment returns make underwriting profitability a necessity for business continuation, we expect further change in the competitive situation for this product allowing us to recapture some lost business, and more. Most importantly, all of Sagamore's products were profitable in 2002. Its company-wide combined ratio was 96.7%. We also point to that ratio with pride, as it too is superior to that achieved by most writing similar lines of business.

With that brief recap of the excellent operating results of 2002, we will turn our attention to the coming years. The property/casualty insurance industry has seen dramatic change the past few years. For most of the 1990's, we endured a "soft" insurance market, in which pricing declined and then declined some more, ultimately ending at totally unrealistic levels. Just how far prices had declined is now becoming evident, as insurers finally own up to horribly unprofitable years. During those years, insurers rationalized that low prices could be justified by the returns available on the investments made with premium dollars. While true to a point, no practical investment return could have offset the pricing inadequacy seen towards the end of the cycle. Terrible operating results, lower and lower yields on investments, the end of a bull market for equities, and the losses sustained from the World Trade Center disaster effectively ended the soft market. Today, insurers must be serious about making money from underwriting. With the meager investment yields available, continuing underwriting losses can not be meaningfully offset by investment income, and overall non-profitability and its accompanying pain will be felt. It remains to be seen how successful companies will be in shifting from pricing at the past level of whatever it took to sell the policy, to the different, generally much higher level now required to report favorable earnings.

During the insanity of the soft market, your company did not follow the sheep over the cliff. Instead, we chose to write less and less net premium. We remained profitable, although barely so in some years, as the expenses of keeping our capability intact consumed a larger percentage of our revenues. But now, we can take advantage of our retained capability. That capability includes some of the most experienced insurance people in our specialties. Usually, whatever it is, we've "been there and seen that" before. It also includes one of the best databases in the industry which, combined with the knowledge of and experience in our specialties, allows us to select risks intelligently and price to profitability. While we pay attention to what others charge, primarily for marketing purposes, we follow no one and march to our own drummer, establishing our rates with confidence. And that is what allowed us to report the substantial volume increase with the superior operating results of 2002, and further allows us to look with confidence to the coming years.

As we previously stated, all of our products operated at profitable levels in 2002. While we always adjust pricing when and where needed, overall product wide rate increases do not now appear necessary for any of our products. Pricing changes will be more attuned to the individual insured's, or a class of insureds', characteristics or loss experience. As others continue to recognize their need for overall rate increases, we should, and are finding ourselves in a better position versus our competitors. That position combined with our excellent reputation for stability and service will allow us more opportunities.

Protective enjoyed tremendous growth in its fleet trucking specialty. More is yet to come, although less growth resulting from rate increases will be shown in future results. Our retention of renewals has been excellent. That and expected new accounts should produce more gross premiums. Net premiums will increase at an even faster rate, as we will purchase less reinsurance, keeping more for our own account. Our independent contractor product has a major customer that is rapidly expanding its fleet of contractors. Each time that customer expands by adding a contractor, Protective adds a customer. We expect to add many customers in 2003. Our outlook for reinsurance assumed is more moderate. Most of what we reinsure is catastrophe type coverages. We have determined a probable maximum loss that we do not wish to exceed under the worst of circumstances. We then commit to contracts that with all probable losses aggregated do not exceed our self-imposed maximum. Although there are regions and exposures where we yet have room to expand, major expansion might cause us to exceed our pre established probable maximum loss level, and that we will not do. So we look for expansion in each of Protective's products, and as we expand, our challenge is to sustain or improve our operating margins.

Loss ratios for each of Sagamore's products were very good in 2002. Those low loss ratios were the reason for the favorable combined ratios as each product also had expense ratios higher than we ultimately expect. Those expense ratios will be reduced as premiums expand. We can increase premium in each of Sagamore's products without a corresponding increase in expense. Just as with Protective's products, Sagamore needs no wholesale rate increases to achieve profitability. As others raise rates, and as the products of Sagamore become more attractive in the marketplace, we expect to increase market share.

We are also pleased with the strides in technology made by the company. In past reports, we have commented on "Intercom," Sagamore's Internet initiative. In 2002, all products went live with interactive rating providing instant quotes to our agents. Widely accepted, over 50% of Sagamore's quotes are now made over the Internet without involvement of company employees. Even wider Internet usage exists for follow up, service type work for endorsements, billings, payments, electronic fund transfers, etc. The expanded use of "Intercom" has been so successful in terms of efficiencies gained that Sagamore has been able to reduce its number of employees while simultaneously increasing volume. More extensive acceptance and use by agents is expected in the future, and therefore more expense savings will be achieved. Our research and development continues. We have begun test marketing a non standard, low down payment auto policy utilizing even more technology. This system allows an agent to quote, verify underwriting information, bind coverage, and print the policy all at the point of sale, then transmit everything to Sagamore immediately without involvement of Sagamore's personnel. As the best of this technology is integrated into all of Sagamore's products, it will provide the convenience of "do it once" for the agent and should further enhance Sagamore's excellent service reputation, while adding to our internal efficiency. With such initiatives, Sagamore can also expand without fear of outrunning its capabilities. And that allows us to expect more volume, at the same or even more favorable loss ratios, but with better expense ratios.

We wish we could have the same optimism for investment activities. We expect to be significantly cash flow positive in 2003. The earnings on the additional cash generated will largely offset the lower yields expected on the reinvestment of maturing instruments. But a large increase in investment income is not in the cards unless there is an upward movement in investment yields. While we anticipate rates will eventually move up, primarily because they cannot go much lower, we can not predict when or by how much. Nevertheless, in anticipation of better yield opportunities than now exist, we are keeping our fixed income investments in short instruments with our overall portfolio's average maturity being 2.9 years. With that very short average maturity, any upward movement in rates will almost immediately benefit the income statement. As we have stated in the past, we maintain investments in equities at a higher percentage of total investments than the average insurance company. Being underleveraged in premium writings to surplus, we accepted more investment risk. The larger investment in equities has not been particularly rewarding, for while we have outperformed the indices in each of the last three years, that merely means we lost less. However, just as we take a long term view in our underwriting and have shown patience that was ultimately rewarded, we expect our investment patience will likewise be rewarded as the true values of the equities we hold are recognized.

This has been an enjoyable year for the employees of Baldwin and Lyons. Expanding the business, achieving record earnings while doing so and building capability for the future is satisfying. For all of our investors, we hope your investing patience has been rewarded by what has been accomplished and by what can be expected in the future. My fellow employees and I thank you for your support and will strive not to disappoint.

Gary W. Miller
Chairman & CEO

Indianapolis
February 21, 2003

Selected Financial Data

	Year Ended December 31				
	2002	2001	2000	1999	1998
	(Dollars in thousands, except per share data)				
Net premiums written	**$ 109,453**	$ 82,645	$ 77,214	$ 72,033	$ 71,943
Net premiums earned	**104,392**	83,138	77,439	69,114	68,862
Net investment income	**14,964**	17,626	19,049	18,891	19,060
Realized net gains (losses) on investments	**(16,445)**	5,053	12,473	5,625	2,855
Losses and loss expenses incurred	**68,107**	81,870 [5]	57,470	44,911	42,537
Net income	**12,366**	5,390	19,750	18,616	16,895
Earnings per share -- net income [1, 4]	**.84**	0.35	1.26	1.10	0.98
Cash dividends per share [4]	**.32**	.32	.32	.32	.32
Investment portfolio [3]	**448,520**	439,434	442,060	440,797	456,735
Total assets	**644,462**	601,109	552,164	530,677	544,369
Shareholders' equity	**284,588**	288,360	294,000	284,783	288,592
Book value per share [1, 4]	**19.43**	18.98	19.21	17.20	16.73
Underwriting ratios [2]:					
Losses and loss expenses	**65.2%**	98.5%	74.2%	65.0%	61.8%
Underwriting expenses	**26.1%**	24.3%	28.1%	29.6%	32.0%
Combined	**91.3%**	122.8%	102.3%	94.6%	93.8%

[1] Earnings and book value per share are adjusted for the dilutive effect of stock options outstanding.

[2] Data is for all coverages combined and is presented based upon generally accepted accounting principles.

[3] Includes money market instruments classified with cash in the Consolidated Balance Sheets.

[4] All per share amounts have been adjusted for the five-for-four stock split effective February 17, 2003.

[5] Includes $20,000 relating to the events of September 11, 2001.

LIQUIDITY AND CAPITAL RESOURCES

The primary sources of the Company's liquidity are (1) funds generated from insurance operations, (2) net investment income and (3) maturing investments. The Company generally experiences positive cash flow resulting from the fact that premiums are collected on insurance policies in advance of the disbursement of funds in payment of claims. Operating costs of the insurance subsidiaries, other than loss and loss expense payments and commissions paid to the parent company, generally average less than 30% of premiums earned on a consolidated basis and the remaining amount is available for investment for varying periods of time depending on the type of insurance coverage provided. During extended periods of declining net premium volume, however, operating cash flows may turn negative as loss settlements on claim reserves established in prior years exceed net premium revenue and receipts of investment income. During 2002, positive cash flow from operations totaled $38.1 million compared to 16.2 million in 2001, as improved market conditions allowed the Company to expand its market share in all of its major lines of business.

For several years, the Company's investment philosophy has emphasized the purchase of short-term bonds with maximum quality and liquidity. As interest rates have declined and yield curves have not provided a strong incentive to lengthen maturities in recent years, the Company has maintained its short-term position with respect to the vast majority of its fixed maturity investments. The average life of the Company's bond and short-term investment portfolio was 2.9 years and 3.8 years for 2002 and 2001, respectively. The Company also remains an active participant in the equity securities market using funds which are not considered necessary to fund current operations. The long-term nature of the Company's equity investments allows it to invest in positions where ultimate value, and not short-term market fluctuations, is the most important feature. Investments made by the Company's domestic insurance subsidiaries are regulated by guidelines promulgated by the National Association of Insurance Commissioners which are designed to provide protection for both policyholders and shareholders.

The Company's assets at December 31, 2002 included $46.7 million in short-term investments which are readily convertible to cash without market penalty and an additional $76.8 million of fixed income investments maturing in less than one year. The Company believes that these liquid investments, plus the expected cash flow from current operations, are far more than sufficient to provide for projected claim payments and operating cost demands. In addition, the Company's reinsurance program is structured to avoid serious cash drains that might accompany catastrophic losses. In the event competitive conditions produce inadequate premium rates and the Company chooses to restrict volume, the liquidity of its investment portfolio would permit it to continue to pay claims as settlements are reached without requiring the disposal of investments at a loss, regardless of interest rates in effect at the time.

Net premiums written by the Company's U.S. insurance subsidiaries for 2002 equaled approximately 32% of the combined statutory surplus of these subsidiaries. Premium writings of 200% to 300% of surplus are generally considered acceptable by regulatory authorities. Further, the statutory capital of each of the insurance subsidiaries substantially exceeds minimum risk based capital requirements set by the National Association of Insurance Commissioners. Accordingly, the Company has the ability to significantly increase its business without seeking additional capital to meet statutory guidelines.

Shareholders' equity decreased to $284.6 million at December 31, 2002, from $288.4 million at December 31, 2001, including $9.0 million in treasury share purchases, $4.6 million of cash dividends to shareholders, and a $2.7 million decrease in unrealized net gains on investments. Book value per common share outstanding increased 2.4% to $19.43 at December 31, 2002 from $18.98 per share at December 31, 2001.

In connection with the treasury stock purchases mentioned above, the Company established short-term borrowing facilities with two banks during 2002 in the total amount of $17 million. Drawings under these facilities totaled $10 million in 2002 with repayments of $2.5 million, leaving $7.5 million outstanding at December 31, 2002. These borrowing facilities expire in 2003 but are expected to be renewed.

As more fully discussed in Note G to the consolidated financial statements, at December 31, 2002, $55.7 million, or 19.6% of shareholders' equity, represented net assets of the Company's insurance subsidiaries which, at that time, could not be transferred in the form of dividends, loans or advances to the parent company because of minimum statutory capital requirements. However, management believes that these restrictions pose no material liquidity concerns for the Company. The financial strength and stability of the subsidiaries permit ready access by the parent company to short-term and long-term sources of credit. The parent company's assets included cash and marketable investments of approximately $39.9 million at December 31, 2002.

RESULTS OF OPERATIONS

2002 Compared to 2001

Direct premiums written for 2002 totaled $164.7 million, an increase of $50.4 million (44%) from 2001. This increase is primarily attributable to increases in fleet trucking and independent contractor programs of $35.2 million (86%) and $9.0 million (33%), respectively, from 2001 levels. Direct premium writings from the Company's private passenger automobile and small business workers' compensation programs also increased by $5.4 million (18%) and $2.0 million (46%), respectively. These increases were partially offset by a $1.2 million (10%) decrease in direct premium written for the Company's small trucking fleet program. Large trucking fleet volume increased primarily from the addition of 23 new accounts during 2002, bringing Protective’s total excess trucking client count to 71 accounts. Premium rate increases also contributed to higher large trucking fleet premium in 2002 although rate increases on renewals were not as significant as in 2001. The higher premium volume from the independent contractor program resulted from the addition of contractors by existing accounts. Increases in private passenger automobile and small business workers' compensation were due primarily to geographic expansion, although modest rate increases were implemented in both divisions during 2002. The decrease in small trucking fleet premium resulted from continuing competitive market pressures within that segment.

Premiums assumed from other reinsurers totaled $8.1 million during 2002, an increase of $2.5 million (43%) from 2001. Premiums assumed for 2001 included $1.0 million of reinstatement premiums attributable to losses reported that year. Without these reinstatement premiums, reinsurance assumed volume would have increased 74% from the prior year. Improved pricing in this market allowed the Company to increase its participation via several new treaties since the 2001 period. Premium volume for this division is limited by the Company’s intention to expose itself to a maximum loss of $10 million from a single catastrophic event. Further, the Company’s participation in reinsurance assumed in the future will be restricted should pricing become less favorable.

Premiums ceded to reinsurers increased $26.2 million (70%) during 2002 to $63.8 million. The percentage of premiums ceded to direct premiums written increased to 39% for 2002 from 33% for 2001 consistent with the increase in direct premiums written for the more heavily reinsured large trucking fleet program discussed above. While the average ceding rate for large fleet trucking was lower in 2002, a significantly higher portion of consolidated premium revenue was concentrated in this product line, resulting in the increase in the overall average ceding rate.

After giving effect to changes in unearned premiums, net premiums earned increased 26% to $104.4 million for 2002 from $83.1 million for 2001. Net premiums earned from all trucking-related insurance products increased by $18.6 million (44%). Net premiums earned from the Company's voluntary reinsurance assumed and small workers' compensation programs increased $2.1 million (37%) and $.7 million (26%), respectively. These increases were partially offset by a $.3 million (1%) decrease in premiums earned from private passenger automobile.

Net investment income decreased $2.7 million (15.1%) during 2002 reflecting lower overall pre-tax yields while average invested assets increased 5%. The average pre-tax yield on invested assets dropped to 4.1% this year from 5.0% during 2001. The largest decline in yields came from short-term investments which averaged 1.4% during 2002 compared to 3.7% last year. Average bond yields also declined from 6.0% in 2001 to 5.1% in 2002. The short-term nature of the Company’s bond portfolio results in a rapid recognition of changes in interest rates, either positive or negative. The steady decline in interest rates over the past few years continues to impact the average yield of the bond portfolio, as noted above. After-tax yields were 2.9% and 3.6% for 2002 and 2001, respectively, in line with pre-tax yield changes.

Realized net capital losses were $16.4 million in 2002 compared to gains of $5.1 million for 2001. The current year's net loss consisted of losses on equity securities of $13.7 million, losses on fixed maturities of $1.9 million, and losses on other investments of $.8 million. The losses on equity securities include approximately $13.7 million of losses actually realized by disposal of securities which were considered to have little potential for near-term recovery as well as $5.8 million of gains realized on sales. In addition, unrealized losses on securities still owned which had experienced a decline in market value of more than 20% for more than six months were reclassified as realized losses during 2002 in the following amounts: equity securities, $5.8 million; fixed income securities, $.9 million and other investments $1.1 million. The losses realized during 2002 reflect the continuing bear market which has resulted from an unusual combination of factors coming together at approximately the same time. These factors included, in no particular order, the unwinding of one of the great speculative bubbles of all time (fueled largely by internet and technology stocks in which the Company had zero participation), the attack of September 11, 2001 and the significant change in security measures and attendant economic friction that resulted therefrom, an ongoing recession, a disputed U.S. Presidential election, corporate collapses and bankruptcies of historic proportion, corporate malfeasance and fraud which has resulted in massive changes in corporate governance regulations, evidence of wrongdoing on the part of major securities firms, the collapse of the merchant energy industry in the U.S. and, most recently, the imminent commencement of armed conflict with Iraq. The largest single losses realized on investments actually sold were $4.2 million realized on the sale of Vanguard Index Trust 500 Fund (S&P 500 index fund) and $1.6 million on Trenwick Group, Inc. common stock. The largest single losses reported as realized on investments still owned were $1.4 million on PICO Holdings, Inc. and $1.2 million on El Paso Corp., both common stocks.

Losses and loss expenses incurred during 2002 decreased $13.8 million (17%) to $68.1 million. Losses and loss expenses for 2001 included $20 million related to the events of September 11, 2001 ("WTC loss"). Adjusting 2001 losses and loss expenses for the WTC loss, losses and loss expenses for 2002 were $6.2 million (10%) higher due mainly to the increased premium volume during 2002. The 2002 consolidated loss and loss expense ratio was 68.5% compared to 74.4% for 2001, after adjustment for the WTC loss. All of the Company's individual product lines contributed to the more favorable loss and loss expense ratio as summarized in the table insert. The improved loss and loss expense ratios for the Company's private passenger automobile, small fleet trucking and small business workers' compensation programs are due primarily to improved underwriting selection and rate increases. Because of the high limits provided by the Company to its large trucking fleet insureds, the length of time required to settle larger, more complex claims and the volatility of the trucking liability insurance business, the Company believes it is important to have a high degree of conservatism in its reserving process. As claims are settled in years subsequent to their occurrence, the Company's claim handling process has, historically, tended to produce savings from the reserves provided. The Company believes that favorable loss developments are attributable to the Company's long-standing policy of reserving for losses realistically and a willingness to settle claims based upon a seasoned evaluation of its exposures. Changes in both gross premium volumes and the Company's reinsurance structure for its large trucking fleets can have a significant impact on future loss developments and, as a result, loss and loss expense ratios may not be consistent year to year.

Loss and loss expense ratios:

	2002	2001
Fleet trucking	**68.6%**	79.0%
Private passenger automobile	**63.9**	69.5
Small fleet trucking	**50.1**	71.5
Voluntary reinsurance assumed	**61.5**	430.0
Small business workers' compensation	**54.7**	74.2
All lines	**65.2**	98.5
All lines without WTC	**65.2**	74.4

Other operating expenses for 2002, before credits for allowances from reinsurers, increased $5.4 million (16%) to $39.8 million. Gross expenses increased at a much lower rate than the increase in premium volume because much of the Company's expense structure is fixed and does not vary directly with volume. In general, only commissions to independent agents, premium taxes and other acquisition costs vary directly with premium volume. Personnel related expenses, including amounts allocated to loss expenses and investment income, increased 7% due mainly to annual cost of living and merit wage adjustments and staffing increases necessitated by the increased premium volume. Direct commission expense increased $1.4 million (19%) primarily as the result of increased participation in voluntary reinsurance assumed treaties. Substantially all fleet trucking business is produced by direct sales efforts of Baldwin & Lyons, Inc. employees and, accordingly, this business does not incur commission expense on a consolidated basis. Instead, the operating expenses of the agency operations, including salaries and bonuses of salesmen, travel expenses, etc. are included in operating expenses. In general, commissions paid by the insurance subsidiaries to the parent company exceed related acquisition costs incurred in the production of fleet trucking business. Ceding commission allowances from reinsurers increased $4.8 million (37%), resulting from increased premium volume ceded under reinsurance agreements covering Protective's fleet trucking business. The ratio of net operating expenses of the insurance subsidiaries to net premiums earned was 26.1% during 2002 compared to 24.3% for 2001, reflecting higher commissions including bonus commissions measured, in part, on underwriting profitability and from slightly lower rates for ceding commissions received from reinsurers. Including the agency operations, and after elimination of inter-company commissions, the ratio of other operating expenses to operating revenue was 17.8% for 2002 compared with 20.6% for 2001.

The effective federal tax rate for consolidated operations for 2002 was 30.6%. This rate is lower than the statutory rate primarily because of tax-exempt investment income.

As a result of the factors mentioned above, net income for 2002 was $12.4 million compared to $5.4 million for 2001. Diluted earnings per share increased to $.84 in 2002 from $.35 in 2001. 2001 results included losses related to the events of September 11, 2001 equal to $.84 per share. Earnings per share from operations before realized gains or losses on investments was $1.57 in 2002 compared to $.14 in 2001.

2001 Compared to 2000

Direct premiums written for 2001 totaled $114.3 million, an increase of $17.2 million (18%) from 2000. This increase is primarily attributable to increases in fleet trucking and independent contractor programs of $13.9 million (52%) and $4.8 million (21%), respectively, from 2000 levels. Direct premium writings from the Company's small business workers' compensation and small trucking fleet programs also increased by $2.2 million and $1.8 million, respectively. These increases were partially offset by a $5.6 million (16%) decrease in direct premium written for the Company's private passenger automobile program. Large trucking fleet and independent contractor volume increases resulted roughly equally from the addition of new accounts as well as rate increases on renewed accounts. Increases in small business workers' compensation and small fleet were due primarily to geographic expansion, although rates were increased in both divisions during 2001. The decrease in private passenger automobile premium resulted from an effort to reunderwrite the program during 2001, including the implementation of significant rate increases and the termination of producers of unprofitable business.

Premiums assumed from other reinsurers totaled $5.7 million during 2001, an increase of $1.5 million (35%) from 2000. Premiums assumed for 2001 and 2000 included $1.0 million and $1.7 million, respectively, of reinstatement premiums attributable to losses reported in those years. Without these reinstatement premiums, reinsurance assumed volume would have increased 85% from the prior year. Pricing in this market began to improve toward the end of 2000 and throughout 2001, and the Company's participation increased as a result.

Premiums ceded to reinsurers increased $13.5 million (56%) during 2001 to $37.7 million. The percentage of premiums ceded to direct premiums written increased to 33% for 2001 from 25% for 2000 consistent with the increase in direct premiums written for the more heavily reinsured large trucking fleet program discussed above.

After giving effect to changes in unearned premiums, net premiums earned increased 7% to $83.1 million for 2001 from $77.4 million for 2000. Net premiums earned from all trucking-related insurance products increased by $8.3 million (25%). Net premiums earned from the Company's small workers' compensation and voluntary reinsurance assumed programs increased $1.7 million (155%) and $1.1 million (25%), respectively. These increases were partially offset by a $5.7 million (15%) decrease in premiums earned from private passenger automobile.

Net investment income decreased $1.4 million (7.5%) during 2001 reflecting lower overall pre-tax yields on slightly higher average invested assets. The average pre-tax yield on invested assets was 5.0% and 5.5% for 2001 and 2000, respectively. After-tax yields were 3.6% and 3.9% for 2001 and 2000, respectively.

Realized net capital gains were $5.1 million in 2001 compared to $12.5 million for 2000. The current year's net gain consisted of gains on equity securities of $7.3 million and losses on fixed maturities and other investments of $2.2 million. The decrease in realized gains during 2001 was generally reflective of the substantially less robust stock market during 2001 for reasons described in the comparison of 2002 to 2001. Gains from equity trading during 2000, of $16.0 million, were unusually high as the result of more favorable market conditions. Realized net gains for 2001 and 2000 included other than temporary write downs totaling $2.1 million and $5.0 million, respectively. The largest single losses realized on investments actually sold during 2001 were $1.0 million on PICO Holdings, Inc. and $.4 million on Capital Transamerican Corp. common stocks. The largest single losses reported as realized on investments still owned were $.6 million on Loral Space and Communication and $.5 million on Great Lakes Chemical Company common stocks.

Losses and loss expenses incurred during 2001 increased $24.4 million (42%) to $81.9 million, including a $20 million loss related to the events of September 11, 2001. The 2001 consolidated loss and loss expense ratio was 98.5% compared to 74.2% for 2000. Adjusted for the September 11, 2001 loss, the consolidated loss and loss expense ratio was 74.4%. While the adjusted consolidated loss ratio remained virtually unchanged, individual product lines varied from year-to-year as less favorable loss development in the Company's large fleet trucking product was offset by significant improvement in the Company's private passenger automobile division. The loss and loss expense ratio for private passenger automobile dropped from 94.5% during 2000 to 69.5% during 2001.

Other operating expenses for 2001, before credits for allowances from reinsurers, decreased $.3 million (1%) to $34.4 million despite the increase in premium volume described above. Personnel related expenses, including amounts allocated to loss expenses and investment income, increased less than 1% as staff reductions occasioned by the increased use of technology substantially offset wage increases and higher employee benefit expenses. Direct commission expense decreased $.4 million (5%) primarily as the result of lower direct premiums from the Company's private passenger automobile product which carries higher commission rates than the Company's remaining products. Ceding commission allowances from reinsurers increased $4.1 million (47%), resulting from increased premium volume ceded under reinsurance agreements covering Protective's fleet trucking business. The ratio of net operating expenses of the insurance subsidiaries to net premiums earned was 24.3% during 2001 compared to 28.0% for 2000, reflecting the higher ceding commission received from reinsurers. Including the agency operations, and after elimination of inter-company commissions, the ratio of other operating expenses to operating revenue was 20.6% for 2001 compared with 26.0% for 2000.

The effective federal tax rate for consolidated operations for 2001 was 16.3%. This rate is lower than the statutory rate primarily because of tax-exempt investment income.

As a result of the factors mentioned above, net income for 2001 was $5.4 million compared to $19.8 million for 2000. Earnings per share decreased to $.35 in 2001 from $1.26 in 2000 due primarily to the losses related to the events of September 11, 2001. Earnings per share from operations before realized gains on investments was $.14 in 2001 compared to $.74 in 2000.

Critical Accounting Policies

The Company's significant accounting policies are discussed in Note A to the Consolidated Financial Statements. The following discussion is provided to highlight areas of the Company's accounting policies which are both material and subject to significant degrees of estimation.

Investment Valuation

Approximately 70% of the Company's assets are composed of investments at December 31, 2002. Less than .5% of these investments, consisting of limited partnership investments in real estate and venture capital assets, do not have readily determinable market values. For these investments, we estimate fair value by reference to the underlying assets of the limited partnerships. In addition, approximately $8.1 million of marketable bonds owned at December 31, 2002 (1.8% of invested assets), are rated below investment grade. All marketable securities are included in the Company's balance sheet at current fair market value.

In determining if and when a decline in market value below cost is other than temporary, we first make an objective analysis of each individual security where current market value is less than cost. For any security where the unrealized loss exceeds 20% of original or adjusted cost, and where that decline has existed for a period of at least six months, the decline is treated as an other than temporary impairment, without any subjective evaluation as to possible future recovery. The only exception exists where substantial recovery to cost has actually occurred prior to the issuance of the financial statements. For individual issues where the decline in value is less than 20% but the amount of the decline is considered significant, a similar objective evaluation is conducted but, in these cases, we will also evaluate the market conditions, trends of earnings, price multiples and other key measures for the securities to determine if it appears that the decline is other than temporary. For any decline which is considered to be other than temporary, we recognize an impairment loss in the current period operating results as an addition to realized capital losses. Declines which are considered to be temporary are recorded as a reduction in shareholders' equity, net of related federal income tax credits.

It is important to note that all investments included in the Company's financial statements are valued at current fair market values. The evaluation process for determination of other than temporary decline in value of investments does not change these valuations but, rather, determines when the decline in value will be recognized in the income statement (other than temporary decline) as opposed to a charge to shareholders' equity (temporary decline). Subsequent recoveries in value of investments which have incurred an other than temporary impairment adjustment are accounted for as unrealized gains until the security is actually disposed. This evaluation process is subject to risks and uncertainties since it is not always clear what has caused a decline in value of an individual security or since some declines may be associated with general market conditions or economic factors which relate to an industry, in general, but not necessarily to an individual issue. The Company has attempted to minimize many of these uncertainties by adopting a largely objective evaluation process which results in automatic income statement recognition of any investment which, over a six month period, is unable to recover from a 20% decline in value from our cost basis. However, to the extent that certain declines in value are reported as unrealized at December 31, 2002, it is possible that future earnings charges will result should the declines in value increase or persist or should the security actually be disposed of while market values are less than cost. At December 31, 2002, the total gross unrealized loss included in the Company's investment portfolio was $3.8 million. No individual issue constituted a material amount of this total. Had this entire amount been considered other than temporary at December 31, 2002, realized capital losses would have increased by $.32 per share for the year. There would, however, have been no impact on total shareholders equity or book value per share since the decline in value of these securities was already recognized as a reduction to shareholders equity at December 31, 2002.

Reinsurance Recoverable

Amounts recoverable under the terms of reinsurance contracts comprise almost 21% of total Company assets as of December 31, 2002. In order to be able to provide the high limits required by the Company's trucking company insureds, we share a significant amount of the insurance risk of the underlying contracts with various insurance entities through the use of reinsurance contracts. Some reinsurance contracts provide that a loss be shared among the Company and its reinsurers on a predetermined pro-rata basis ("quota-share") while other contracts provide that the Company keep a fixed amount of the loss, similar to a deductible, with reinsurers taking all losses above this fixed amount ("excess of loss"). Some risks are covered by a combination of quota-share and excess of loss contracts. The computation of amounts due from reinsurers is based upon the terms of the various contracts and follows the underlying estimation process for loss and loss expense reserves, as described below. Accordingly, the uncertainties inherent in the loss and loss expense reserving process also affect the amounts recorded as recoverable from reinsurers. Estimation uncertainties are greatest for claims which have occurred but which have not yet been reported to the Company. Further, the high limits provided by the Company's insurance policies for trucking liability and workers' compensation, provide more variability in the estimation process than lines of business with lower coverage limits.

It should be noted, however, that a change in the estimate of amounts due from reinsurers on unpaid claims will not, in itself, result in charges or credits to losses incurred. This is because any change in estimated recovery follows the estimate of the underlying loss. Thus, it is the computation of the underlying loss that is critical.

As with any receivable, credit risk exists in the recoverability of reinsurance. This is even more pronounced than in normal receivable situations since recoverable amounts are not due generally until the loss is settled which, in some cases, may be many years after the contract was written. If a reinsurer is unable, in the future, to meet it's financial commitments under the terms of the contracts, the Company would be responsible for the reinsurer's portion of the loss. The financial condition of each of the Company's reinsurers is initially determined upon the execution of each treaty and only reinsurers with the highest credit ratings available are utilized. However, as noted above, reinsurers are often not called upon to satisfy their obligations for several years and changes in credit worthiness can occur in the interim period. Reviews of the current financial strength of each reinsurer are made continually and, should impairment in the ability of a reinsurer be determined to exist, current year operations would be charged in amounts sufficient to provide for the Company's additional liability. Such charges are included in other operating expenses, rather than losses and loss expenses incurred since the inability of the Company to collect from reinsurers is a credit risk rather than a deficiency associated with the loss reserving process.

Loss and Loss Expense Reserves

The Company's reserves for losses and loss expenses ("reserves") are determined based on complex estimation processes using historical experience, current economic information and, when necessary, available industry statistics. Our reserves are evaluated in three basic categories (1) "case basis", (2) "incurred but not reported" and (3) "loss adjustment expense" reserves. Case basis reserves are established for specific known loss occurrences at amounts dependent upon various criteria such as type of coverage, severity and the underlying policy limits, as examples. Case basis reserves are generally estimated by experienced claims adjusters using established Company guidelines and are subject to review by claims management. Incurred but not reported reserves, which are established for those losses which have occurred, but have not yet been reported to the Company, are not linked to specific claims but are computed on a "bulk" basis. Common actuarial methods are used in the establishment of incurred but not reported loss reserves using company historical loss data, consideration of changes in the Company's business and study of current economic trends affecting ultimate claims costs. Loss adjustment expense reserves, or reserves for the costs associated with the investigation and settlement of a claim, are also bulk reserves representing the Company's estimate of the costs associated with the claims handling process. Loss adjustment expense reserves include amounts ultimately allocable to individual claims as well as amounts required for the general overhead of the claims handling operation that are not specifically allocable to individual claims. Historical analyses of the ratio of loss adjusting expenses to losses paid on prior closed claims and study of current economic trends affecting loss settlement costs are used to estimate the loss adjustment reserve needs related to the established loss reserves. Each of these reserve categories contain elements of uncertainty which assure variability when compared to the ultimate costs to settle the underlying claims for which the reserves are established.

The reserving process requires us to continuously monitor and evaluate the life cycle of claims based on the class of business and the nature of claims. Our claims range from the very routine private passenger automobile "fender bender" to the highly complex and costly third party bodily injury claim involving large tractor-trailer rigs. Reserving for each class of claims requires a set of assumptions based upon historical experience, knowledge of current industry trends and seasoned judgment. The high limits provided in the Company's trucking liability policies provide for greater variation in the reserving process for more serious claims. Court rulings, tort reform (or lack thereof) and trends in jury awards also play a significant role in the estimation process of larger claims. The Company continuously reviews and evaluates loss developments subsequent to each measurement date and adjusts its reserve estimation assumptions, as necessary, in an effort to achieve the best possible estimate of the ultimate remaining loss costs at any point in time. Changes to previously established reserve amounts are charged or credited to losses and loss expenses incurred in the accounting periods in which they are determined.

Forward-Looking Information

Any forward-looking statements in this report, including without limitation, statements relating to the Company's plans, strategies, objectives, expectations, intentions and adequacy of resources, are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Investors are cautioned that such forward-looking statements involve risks and uncertainties including without limitation the following: (i) the Company's plans, strategies, objectives, expectations and intentions are subject to change at any time at the discretion of the Company; (ii) the Company's business is highly competitive and the entrance of new competitors into or the expansion of the operations by existing competitors in the Company's markets and other changes in the market for insurance products could adversely affect the Company's plans and results of operations; and (iii) other risks and uncertainties indicated from time to time in the Company's filings with the Securities and Exchange Commission.

Federal Income Tax Considerations

The liability method is used in accounting for federal income taxes. Using this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The provision for deferred federal income tax was based on items of income and expense that were reported in different years in the financial statements and tax returns and were measured at the tax rate in effect in the year the difference originated. Net deferred tax liabilities of $5.8 million and $9.9 million were recorded at December 31, 2002 and 2001, respectively. The net deferred tax liability at December 31, 2002 included $4.6 million in special tax deposits covered under Section 847 of the Internal Revenue Code, as explained in the following paragraph, which compares to $4.3 million in special tax deposits at December 31, 2001. Adjusted for the special deposits, a net deferred tax liability of $10.3 million was recorded at December 31, 2002 compared to a net deferred tax liability of $14.2 million at December 31, 2001. The decrease in deferred federal taxes payable is primarily attributable to the decrease in unrealized capital gains in the investment portfolio.

A provision in the Technical and Miscellaneous Revenue Act of 1988 created a mechanism which allows for a recognizable deferred tax asset specifically for property and casualty loss reserves discounted for tax purposes. Adopted as Section 847 of the Internal Revenue Code, this provision allows an insurer to take a special tax deduction equal to the discount on post 1986 accident year loss and loss expense reserves while making "special estimated tax payments" equal to the amount of the tax benefit derived from the special deduction. The "special estimated tax payments" can be carried forward for fifteen years to offset taxes arising from decreases in the special deduction and can be treated as regular estimated payments or refunded at the end of the carryforward period. Based upon the concerns regarding the recognition of deferred tax assets, the Company adopted the provisions of Section 847 for all tax years 1987 and subsequent and has taken deductions for the entire amount of discount on post-1986 loss reserves. As mentioned above, special Section 847 estimated tax deposits totaling $4.6 million have been paid in connection with this election.

Impact of Inflation

To the extent possible, the Company attempts to recover the costs of inflation by increasing the premiums it charges. A majority of the Company's premiums are charged as a percentage of an insured's gross revenue or payroll. As these charging bases increase with inflation, premium revenues are immediately increased. The remaining premium rates charged are adjustable only at periodic intervals and often require state regulatory approval. Such periodic increases in premium rates may lag far behind cost increases.

To the extent inflation influences yields on investments, the Company is also affected. The Company maintains a sizable portion of its investment portfolio in short-term instruments and changes in current market interest rates correspondingly affect yields on these investments. Further, as inflation affects current market rates of return, previously committed investments may rise or decline in value depending on the type and maturity of investment. (See comments under Market Risk, following.)

Inflation must also be considered by the Company in the creation and review of loss and loss adjustment expense reserves since portions of these reserves are expected to be paid over extended periods of time. The anticipated effect of inflation is implicitly considered when estimating liabilities for losses and loss adjustment expenses.

Market Risk

The Company operates solely within the property and casualty insurance industry and, accordingly, has significant invested assets which are exposed to various market risks. These market risks relate to interest rate fluctuations, foreign currency translation and equities market prices. All of the Company's invested assets are classified as available for sale and are listed as such in Note B to the consolidated financial statements.

The most significant of the three identified market risks relates to prices in the equities market. Though not the largest category of the Company's invested assets, equity securities have the greatest potential for short-term price fluctuation. The market value of the Company's equity positions at December 31, 2002 was $105.4 million or approximately 24% of invested assets, including money market instruments classified as cash. Funds invested in the equities market are not considered to be assets necessary for the Company to conduct its daily operations and, therefore, can be committed for extended periods of time. The long-term nature of the Company's equity investments allows it to invest in positions where ultimate value, and not short-term market fluctuations, is the most important feature.

The Company's fixed maturity portfolio totaled $290.2 million at December 31, 2002. Over half of this portfolio is made up of U. S. Government and government agency obligations and state and municipal debt securities, 94% of the portfolio matures within 5 years and the average life of the Company's fixed maturity investments is approximately 2.9 years. Although the Company is exposed to interest rate risk on its fixed maturity investments, given the anticipated duration of the Company's liabilities (principally insurance loss and loss expense reserves) relative to investment maturities, even a 100 to 200 basis point increase in interest rates would not have a significant impact on the Company's ability to conduct daily operations or to meet its obligations.

There is an inverse relationship between interest rate fluctuations and the fair value of the Company's fixed maturity investments. Additionally, the fair value of interest rate sensitive instruments may be affected by the financial strength of the issuer, prepayment options, relative values of alternative investments, liquidity of the investment and other general market conditions. The Company monitors its sensitivity to interest rate risk by measuring the change in fair value of its fixed maturity investments relative to hypothetical changes in interest rates. As previously indicated, several other factors can impact the fair values of fixed maturity investments and, therefore, significant variations in market interest rates could produce quite different results from the hypothetical estimates presented in the following summary.

We estimate that a 100 basis point increase in market interest rates would have resulted in a pre-tax loss in the fair value of fixed maturity investments of approximately $5.6 million at December 31, 2002. Similarly, a 100 basis point decrease in market interest rates would have resulted in an estimated pre-tax gain in the fair value of these instruments of approximately $6.0 million at December 31, 2002. Note, however, that the hypothetical loss mentioned above would only be realized if the Company was obligated to sell bonds prior to maturity, which is extremely unlikely. The aggregate value of money market and short-term investments, bonds maturing within twelve months and expected positive cash flow from operations for 2003 is equal to more than 100% of net loss and loss expense reserves at December 31, 2002.

The Company's exposure to foreign currency risk is not material.

COMMON STOCK MARKET PRICES AND DIVIDENDS

	Class A		Class B		Cash Dividends Declared
	High	Low	High	Low	
Year ended December 31:					
2002:					
Fourth Quarter	**$19.488**	**$16.192**	**$20.799**	**$16.792**	**$.08**
Third Quarter	**18.360**	**15.600**	**19.056**	**15.256**	**.08**
Second Quarter	**20.144**	**16.608**	**23.072**	**16.944**	**.08**
First Quarter	**18.216**	**17.000**	**21.288**	**16.000**	**.08**
2001:					
Fourth Quarter	18.398	16.193	21.352	13.520	.08
Third Quarter	19.560	15.200	21.200	13.200	.08
Second Quarter	19.920	16.600	21.024	16.400	.08
First Quarter	18.300	15.000	23.000	16.000	.08

The Company’s Class A and Class B common stocks are traded on The NASDAQ Stock Market® under the symbols BWINA and BWINB, respectively. The Class A and Class B common shares have identical rights and privileges except that Class B shares have no voting rights other than on matters for which Indiana law requires class voting. As of December 31, 2002, there were approximately 400 record holders of Class A Common Stock and approximately 500 record holders of Class B Common Stock.

The table above sets forth the range of high and low sale prices for the Class A and Class B Common Stock for 2002 and 2001, as reported by the National Association of Security Dealers, Inc. and published in the financial press. The quotations reflect interdealer prices without retail markup, markdown or commission and do not necessarily represent actual transactions. All per share amounts have been adjusted for a five-for-four stock split, effective February 17, 2003.

The Company expects to continue its policy of paying regular cash dividends although there is no assurance as to future dividends because they are dependent on future earnings, capital requirements and financial conditions and are subject to regulatory restrictions as described in Note G to the consolidated financial statements.

Report of Ernst & Young LLP
Independent Auditors

Shareholders and Board of Directors
Baldwin & Lyons, Inc.

We have audited the accompanying consolidated balance sheets of Baldwin & Lyons, Inc. and subsidiaries as of December 31, 2002 and 2001, and the related consolidated statements of income, changes in equity other than capital and cash flows for each of the three years in the period ended December 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Baldwin & Lyons, Inc. and subsidiaries at December 31, 2002 and 2001, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States.

Ernst & Young LLP

Indianapolis, Indiana
February 21, 2003

Consolidated Balance Sheets

Baldwin & Lyons, Inc. and Subsidiaries

	December 31	
	2002	2001
	(dollars in thousands)	
Assets		
Investments:		
Fixed maturities	**$ 290,155**	$ 246,632
Equity securities	**105,441**	136,399
Short-term and other	**9,158**	27,584
	404,754	410,615
Cash and cash equivalents	**41,699**	31,840
Accounts receivable--less allowance (2002, $1,047; 2001, $1,143)	**33,646**	25,151
Accrued investment income	**4,060**	3,875
Reinsurance recoverable	**137,870**	111,585
Deferred policy acquisition costs	**4,177**	3,523
Current federal income taxes	**1,701**	2,590
Property and equipment--less accumulated depreciation (2002, $8,718; 2001, $8,354)	**6,658**	7,442
Notes receivable from employees	**7,494**	2,257
Other assets	**2,403**	2,231
	$ 644,462	$ 601,109
Liabilities and Shareholders' Equity		
Reserves:		
Losses and loss expenses	**$ 277,744**	$ 247,143
Unearned premiums	**29,016**	23,914
	306,760	271,057
Reinsurance payable	**1,592**	5,260
Note payable	**7,500**	-
Accounts payable and other liabilities	**38,262**	26,523
Deferred federal income taxes	**5,760**	9,909
	359,874	312,749
Shareholders' equity:		
Common stock, no par value:		
Class A -- authorized 3,000,000 shares; outstanding -- 2002, 2,666,666 shares; 2001, 2,847,382 shares	**114**	121
Class B -- authorized 20,000,000 shares; outstanding -- 2002, 11,882,813 shares; 2001, 12,252,415 shares	**507**	523
Additional paid-in capital	**35,248**	36,272
Unrealized net gains on investments	**29,640**	32,377
Retained earnings	**219,079**	219,067
	284,588	288,360
	$ 644,462	$ 601,109

See notes to consolidated financial statements.

Consolidated Statements of Income

Baldwin & Lyons, Inc. and Subsidiaries

	Year Ended December 31		
	2002	2001	2000
	(dollars in thousands, except per share data)		
Revenue:			
Net premiums earned	**$ 104,392**	$ 83,138	$ 77,439
Net investment income	**14,964**	17,626	19,049
Realized net gains (losses) on investments	**(16,445)**	5,053	12,473
Commissions, service fees and other income	**5,219**	4,063	3,512
	108,130	109,880	112,473
Expenses:			
Losses and loss expenses incurred	**68,107**	81,870	57,470
Other operating expenses	**22,193**	21,572	26,039
	90,300	103,442	83,509
Income before federal income taxes	**17,830**	6,438	28,964
Federal income taxes	**5,464**	1,048	9,214
Net income	**$ 12,366**	$ 5,390	$ 19,750
Per share data:			
Diluted earnings:			
Income before realized net gains (losses)	**$ 1.57**	$ .14	$ .74
Realized net gains (losses) on investments	**(.73)**	.21	.52
Net income	**$ .84**	$ .35	$ 1.26
Basic earnings:			
Income before realized net gains (losses)	**$ 1.58**	$ .14	$ .75
Realized net gains (losses) on investments	**(.73)**	.22	.52
Net income	**$ .85**	$ .36	$ 1.27
Dividends	**$ .32**	$ .32	$ .32

See notes to consolidated financial statements.

Consolidated Statements of Changes in Equity Other Than Capital

Baldwin & Lyons, Inc. and Subsidiaries

	2002	2001	2000
		(dollars in thousands)	
Balances at beginning of year:			
Retained earnings	**$ 219,067**	$ 220,698	$ 219,707
Unrealized gains on investments	**32,377**	36,237	24,711
	251,444	256,935	244,418
Changes arising from income-producing activities:			
Net income	**12,366**	5,390	19,750
Gains (losses) on investments:			
Holding gains (losses) arising during period,			
before federal income taxes	**(20,656)**	(886)	30,205
Federal income taxes	**(7,230)**	(310)	10,572
	(13,426)	(576)	19,633
(Gains) losses realized during period included in net income,			
before federal income taxes	**16,445**	(5,053)	(12,473)
Federal income taxes	**5,756**	(1,769)	(4,366)
	10,689	(3,284)	(8,107)
Change in unrealized gains on investments	**(2,737)**	(3,860)	11,526
Foreign exhange adjustment	**77**	(300)	(193)
Total realized and unrealized income	**9,706**	1,230	31,083
Other changes affecting retained earnings:			
Cash dividends paid to shareholders	**(4,636)**	(4,850)	(4,994)
Cost of treasury shares in excess of original issue proceeds	**(7,795)**	(1,871)	(13,572)
	(12,431)	(6,721)	(18,566)
Total changes	**(2,725)**	(5,491)	12,517
Balances at end of year:			
Retained earnings	**219,079**	219,067	220,698
Unrealized gains on investments	**29,640**	32,377	36,237
	$ 248,719	$ 251,444	$ 256,935

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Baldwin & Lyons, Inc. and Subsidiaries

	Year Ended December 31		
	2002	2001	2000
	(dollars in thousands)		
Operating activities			
Net income	**$ 12,366**	$ 5,390	$ 19,750
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Change in accounts receivable and unearned premium	**(3,434)**	(365)	(512)
Change in accrued investment income	**(185)**	(151)	(27)
Change in loss and loss expense reserves and reinsurance recoverable	**4,357**	17,788	(10,680)
Change in other assets, other liabilities and current income taxes	**7,046**	(3,732)	(380)
Amortization of net policy acquisition costs	**(5,569)**	(3,141)	1,031
Net policy acquisition costs deferred	**4,915**	3,293	(854)
Provision for deferred income taxes	**(2,675)**	(559)	(1,359)
Bond amortization	**1,482**	578	227
Loss on sale of property	**10**	8	57
Depreciation	**2,601**	2,604	2,318
Net realized loss (gain) on investments	**17,057**	(5,668)	(13,524)
Compensation expense related to discounted stock options	**134**	131	136
Net cash provided by (used in) operating activities	**38,105**	16,177	(3,817)
Investing activities			
Purchases of fixed maturities and equity securities	**(172,806)**	(163,996)	(132,874)
Proceeds from maturities	**51,978**	74,029	44,185
Proceeds from sales of fixed maturities	**32,000**	11,921	35,779
Proceeds from sales of equity securities	**53,112**	61,328	108,063
Net sales (purchases) of short-term investments	**19,814**	4,213	(9,671)
Distributions from limited partnerships	**632**	9,896	1,799
Net increase in principal balance of notes receivable from employees	**(5,036)**	(532)	(1,709)
Purchases of property and equipment	**(1,989)**	(1,727)	(4,121)
Proceeds from disposals of property and equipment	**161**	129	184
Net cash provided by (used in) investing activities	**(22,134)**	(4,739)	41,635
Financing activities			
Dividends paid to shareholders	**(4,636)**	(4,850)	(4,994)
Proceeds from sale of common stock	**2**	3	10
Drawing on line of credit	**10,000**	-	5,411
Repayment on line of credit	**(2,500)**	(5,411)	(8,528)
Cost of treasury shares	**(8,978)**	(2,154)	(17,018)
Net cash used in financing activities	**(6,112)**	(12,412)	(25,119)
Increase (decrease) in cash and cash equivalents	**9,859**	(974)	12,699
Cash and cash equivalents at beginning of year	**31,840**	32,814	20,115
Cash and cash equivalents at end of year	**$ 41,699**	$ 31,840	$ 32,814

See notes to consolidated financial statements.

Note A - Summary of Significant Accounting Policies

***Basis of Presentation*:** The consolidated financial statements include the accounts of Baldwin & Lyons, Inc. and its wholly owned subsidiaries (the Company). All significant intercompany transactions and accounts have been eliminated in consolidation.

***Use of estimates*:** Preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and cash equivalents: The Company considers investments in money market funds to be cash equivalents. Carrying amounts for these instruments approximate their fair values.

***Investments*:** Carrying amounts for fixed maturity securities (bonds, notes and redeemable preferred stocks) represent fair value and are based on quoted market prices, where available, or broker/dealer quotes for specific securities where quoted market prices are not available. Equity securities (nonredeemable preferred stocks and common stocks) are carried at quoted market prices (fair value). Other investments are carried at either market value, cost or cost adjusted for operations of limited partnerships, depending on the nature of the investment. All fixed maturity and equity securities are considered to be available for sale; the related unrealized net gains or losses (net of applicable tax effect) are reflected directly in shareholders' equity unless a decline in value is determined to be other than temporary, in which case, the loss is charged to income. Although the Company has classified fixed maturity investments as available for sale, it has the ability to hold its fixed maturity investments to maturity. Short-term investments are carried at cost which approximates their fair values. Realized gains and losses on disposals of investments are determined by specific identification of cost of investments sold and are included in income.

***Property and Equipment*:** Property and equipment is carried at cost. Depreciation is computed principally by the straight-line method.

***Reserves for Losses and Loss Expenses*:** The reserves for losses and loss expenses, certain of which are discounted, are determined using case basis evaluations and statistical analyses and represent estimates of the ultimate cost of all reported and unreported losses which are unpaid at year end. These reserves include estimates of future trends in claim severity and frequency and other factors which could vary as the losses are ultimately settled. Although it is not possible to measure the degree of variability inherent in such estimates, management believes that the reserves for losses and loss expenses are adequate. The estimates are continually reviewed and as adjustments to these reserves become necessary, such adjustments are reflected in current operations.

***Recognition of Revenue and Costs*:** Premiums are earned over the period for which insurance protection is provided. A reserve for unearned premiums, computed by the daily pro-rata method, is established to reflect amounts applicable to subsequent accounting periods. Commissions to unaffiliated companies and other acquisition costs applicable to unearned premiums are deferred and expensed as the related premiums are earned. If it is determined that deferred expenses will exceed the related unearned premiums, the asset representing deferred policy acquisition costs is reduced and an expense is charged against current operations to reflect any such premium deficiency. If the expected premium deficiency exceeds deferred policy acquisition costs, an additional liability is recorded with a corresponding expense to current operations for the amount of the excess premium deficiency. Anticipated investment income is considered in determining recoverability of deferred acquisition costs.

Reinsurance premiums, commissions, expense reimbursements and reserves related to reinsured business are accounted for on bases consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts. Premiums ceded to other insurers have been reported as a reduction of premium income. Amounts applicable to reinsurance ceded for unearned premium and claim loss reserves have been reported as reinsurance recoverable assets. Certain reinsurance contracts provide for additional or return premiums and commissions based upon profits or losses to the reinsurer over prescribed periods. Estimates of additional or return premiums and commissions are adjusted quarterly to recognize actual loss experience to date as well as projected loss experience applicable to the various contract periods. Reinstatement premiums on reinsurance assumed contracts covering catastrophic events are recorded concurrently with the related loss.

***Stock-based Compensation*:** Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations are used in accounting for stock options, stock purchases and equity appreciation rights which are, from time to time, granted to employees and outside directors.

***Federal Income Taxes*:** A consolidated federal income tax return is filed by the Company and includes all wholly owned subsidiaries.

Note A - Significant Accounting Policies (continued)

Earnings Per Share: Diluted earnings per share of common stock are based on the average number of shares of Class A and Class B common stock outstanding during the year, adjusted for the effect, if any, of options outstanding. Basic earnings per share are presented exclusive of the effect of options outstanding. See note I.

Comprehensive Income: The Company records accumulated other comprehensive income from unrealized gains and losses on available-for-sale securities as a separate component of shareholders' equity. Foreign exchange adjustments are not material and the Company has no defined benefit pension plan.

The enclosed *Statement of Changes in Equity Other Than Capital* refers to comprehensive income as *Total realized and unrealized income*. Items of other comprehensive income included in this statement are referred to as *Change in unrealized gains (losses) on investments* and *Foreign exchange adjustment*. A reclassification adjustment to other comprehensive income is made for *Gains realized during period included in net income*.

***Reclassification*:** Certain prior year balances have been reclassified to conform to the current year presentation. All share amounts have been restated for the five-for-four stock split declared in February, 2003 - see Note O.

Note B - Investments

The following is a summary of available-for-sale securities at December 31:

	Fair Value	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Net Unrealized Gains
2002:					
U. S. government obligations	**$ 120,785**	**$ 117,687**	**$ 3,098**	**$ -**	**$ 3,098**
Mortgage-backed securities	**12,817**	**12,240**	**578**	**(1)**	**577**
Obligations of states and political subdivisions	**68,837**	**67,299**	**1,538**	**-**	**1,538**
Corporate securities	**87,716**	**84,101**	**4,084**	**(469)**	**3,615**
Total fixed maturities	**290,155**	**281,327**	**9,298**	**(470)**	**8,828**
Equity securities	**105,441**	**68,669**	**40,036**	**(3,264)**	**36,772**
Short-term and other	**9,158**	**9,158**	**-**	**-**	**-**
Total available-for-sale securities	**$ 404,754**	**$ 359,154**	**$ 49,334**	**$ (3,734)**	**45,600**
			Applicable federal income taxes		**(15,960)**
			Net unrealized gains - net of tax		**$ 29,640**
2001:					
U. S. government obligations	$ 85,459	$ 84,181	$ 1,289	$ (11)	$ 1,278
Mortgage-backed securities	15,075	14,644	431	-	431
Obligations of states and political subdivisions	46,503	45,708	851	(56)	795
Corporate securities	99,595	97,428	2,972	(805)	2,167
Total fixed maturities	246,632	241,961	5,543	(872)	4,671
Equity securities	136,399	91,030	54,214	(8,845)	45,369
Short-term and other	27,584	27,813	-	(229)	(229)
Total available-for-sale securities	$ 410,615	$ 360,804	$ 59,757	$ (9,946)	49,811
			Applicable federal income taxes		(17,434)
			Net unrealized gains - net of tax		$ 32,377

Note B - Investments (continued)

Gross realized gains and losses on investments for the years ended December 31 are summarized below:

	2002	2001	2000
Fixed maturities:			
Gains	**$ 1,396**	$ 82	$ 666
Losses	**(3,278)**	(2,218)	(1,209)
Net losses	**(1,882)**	(2,136)	(543)
Equity securities:			
Gains	**5,774**	15,591	22,861
Losses	**(19,520)**	(8,305)	(6,866)
Net gains (losses)	**(13,746)**	7,286	15,995
Short-term and other - net loss	**(817)**	(97)	(2,979)
Total net gains (losses)	**$ (16,445)**	$ 5,053	$ 12,473

The Company recorded other than temporary writedowns of $7,726, $2,081 and $5,000 in 2002, 2001 and 2000, respectively.

The fair value and the cost or amortized cost of fixed maturity investments at December 31, 2002, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because borrowers have, in some cases, the right to call or prepay obligations with or without call or prepayment penalties.

	Fair Value	Cost or Amortized Cost
One year or less	$ 76,841	$ 76,137
Excess of one year to five years	181,559	173,834
Excess of five years to ten years	3,178	3,102
Excess of ten years	13,214	13,078
Total maturities	274,792	266,151
Mortgage-backed securities	12,817	12,240
Redeemable preferred stock	2,546	2,936
	$ 290,155	$ 281,327

Major categories of investment income for the years ended December 31 are summarized as follows:

	2002	2001	2000
Fixed maturities	**$ 12,744**	$ 13,287	$ 13,951
Equity securities	**2,813**	2,739	3,327
Money market funds	**663**	1,522	1,778
Short-term and other	**207**	1,785	1,674
	16,427	19,333	20,730
Investment expenses	**(1,463)**	(1,707)	(1,681)
Net investment income	**$ 14,964**	$ 17,626	$ 19,049

Approximately 31% of purchases and 47% of sales of investments during the three years ended December 31, 2002 were made through securities broker-dealers in which certain directors of the Company were officers, directors or owners. Fees earned by affiliated investment advisors were $482, $1,110 and $1,499 in 2002, 2001 and 2000, respectively.

The Company has holdings in money-market accounts which were managed by or purchased through companies affiliated with certain directors of the Company.

Note C - Loss and Loss Expense Reserves

Activity in the reserves for losses and loss expenses is summarized as follows. All amounts are shown net of reinsurance recoverable.

	Year Ended December 31,		
	2002	2001	2000
Reserves at the beginning of the year	**$137,733**	$120,206	$130,702
Provision for losses and loss expenses:			
Claims occurring during the current year	**78,115**	82,757	65,577
Claims occurring during prior years	**(10,008)**	(887)	(8,107)
Total incurred	**68,107**	81,870	57,470
Loss and loss expense payments:			
Claims occurring during the current year	**30,997**	33,237	37,671
Claims occurring during prior years	**30,249**	31,132	30,238
Total paid	**61,246**	64,369	67,909
Change in allowance for uncollectible amounts due from reinsurers	**108**	26	(57)
Reserves at the end of the year	**144,702**	137,733	120,206
Reinsurance recoverable on reserves at the end of the year	**133,042**	109,410	62,219
Reserves, gross of reinsurance recoverables, at the end of the year	**$277,744**	$247,143	$182,425

The reserves for losses and loss expenses, net of related reinsurance recoverables, at December 31, 2001, 2000 and 1999 were decreased by $10,008, $887 and $8,107, respectively, for claims that had occurred on or prior to those dates. These decreases are the result of the settlement of claims at amounts lower than previously reserved and changes in estimates of losses incurred but not reported as part of the normal reserving process. Included in the above development during 2002, is a decrease of $1,539 in reserves outstanding at December 31, 2001 for losses and loss expenses related to environmental damage claims. The development during 2001 and 2000 was insignificant for environmental claims. Reserves for incurred but not reported environmental losses were $3,900 at December 31, 2002 and 2001. Development during 2002 also included a decrease in reinsurance assumed loss and loss expense reserves at December 31, 2001 of $1,305. Development during 2001 included $2,100 of incurred losses and loss expenses on reinsurance assumed reserves outstanding at December 31, 2000 which was partially offset by reinstatement premiums of $1,000. Favorable loss development is influenced by the Company's long-standing policy of reserving for losses realistically and a willingness to settle claims based upon a seasoned evaluation of its exposures. Under terms of reinsurance agreements effective June 1, 1998, the Company's exposure on large fleet trucking losses dropped from $1,000 to $100 per occurrence. Effective June 1, 2001 and June 1, 2002, terms of replacement reinsurance agreements increased the Company's maximum exposure on large fleet trucking losses to $1,020 and $1,400, respectively, per occurrence. The increased net retention per occurrence is reflected in the increase in favorable development during 2002. These trends were considered in the establishment of the Company's reserves at December 31, 2002.

The Company participates in mandatory residual market pools in various states. The Company records the results from participation in these pools as reported and records an additional provision in the financial statements for operating periods unreported by the pools.

Loss reserves on certain permanent total disability workers’ compensation reserves have been discounted to present value at pre-tax rates not exceeding 3.5%. At December 31, 2002 and 2001, loss reserves have been reduced by approximately $6,396 and $4,724, respectively. Discounting is applied to these claims since the amount of periodic payments to be made during the lifetime of claimants is fixed and determinable.

Loss reserves have been reduced by estimated salvage and subrogation recoverable of approximately $2,810 and $2,717 at December 31, 2002 and 2001, respectively.

Note D - Employee Benefit Plans

The Company maintains a defined contribution 401(k) Employee Savings and Profit Sharing Plan ("the Plan") which covers all employees who have completed one year of service. The Company's contributions to the Plan for 2002, 2001 and 2000 were $864, $736 and $657, respectively.

Note E - Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets and liabilities as of December 31 are as follows:

	2002	2001
Deferred tax liabilities:		
Unrealized gain on investments	**$ 15,960**	$ 17,434
Deferred acquisition costs	**1,486**	1,255
Salvage and subrogation	**621**	560
Other	**247**	468
Total deferred tax liabilities	**18,314**	19,717
Deferred tax assets:		
Discounts of loss and loss expense reserves	**4,554**	4,298
Other than temporary investment declines	**2,532**	728
Deferred compensation	**2,418**	2,391
Unearned premiums	**2,011**	1,657
Other	**1,039**	734
Total deferred tax assets	**12,554**	9,808
Net deferred tax liabilities	**$ 5,760**	$ 9,909

A summary of the difference between federal income tax expense computed at the statutory rate and that reported in the consolidated financial statements is as follows:

	2002	2001	2000
Statutory federal income rate applied to pretax income	**$ 6,240**	$ 2,253	$ 10,137
Tax effect of (deduction):			
Tax-exempt investment income	**(1,081)**	(1,241)	(1,390)
Other	**305**	36	467
Federal income tax expense	**$ 5,464**	$ 1,048	$ 9,214

Federal income tax expense consists of the following:

	2002	2001	2000
Taxes (credits) on pre-tax income:			
Current	**$ 8,139**	$ 1,607	$ 10,573
Deferred	**(2,675)**	(559)	(1,359)
	$ 5,464	$ 1,048	$ 9,214

Included in current taxes for 2002 is approximately $3,584 of federal tax credits which will be recovered through net capital loss carryback to prior years.

The components of the provision for deferred federal income taxes (credits) are as follows:

	2002	2001	2000
Other than temporary investment declines	**$ (1,804)**	$ (725)	$ -
Discounts of loss and loss expense reserves	**(256)**	(144)	895
Limited partnerships	**(351)**	(153)	(1,750)
Unearned premium disallowance	**(354)**	35	15
Deferred compensation	**(28)**	537	(495)
Other	**118**	(109)	(24)
Provision for deferred federal income tax	**$ (2,675)**	$ (559)	$ (1,359)

Cash flows related to federal income taxes paid, net of refunds received, for 2002, 2001 and 2000 were $7,250, $5,200 and $8,807, respectively, including Section 847 special tax deposits. Future tax benefits on approximately $4,554 of deferred tax assets at December 31, 2002 arising from loss reserve discounting are assured based on Section 847 of the Internal Revenue Code.

Note F - Reinsurance

The insurance subsidiaries cede portions of their gross premiums written to certain other insurers under excess and quota share treaties and by facultative placements. Risks are reinsured with other companies to permit the recovery of a portion of related direct losses. The Company also serves as an assuming reinsurer under retrocessions from certain other reinsurers. These retrocessions include individual risks as well as aggregate catastrophe treaties. Accordingly, the occurrence of a major catastrophic event can have a significant impact on the Company's operating income. In addition, the insurance subsidiaries participate in certain involuntary reinsurance pools which require insurance companies to provide coverages on assigned risks. The assigned risk pools allocate participation to all insurers based upon each insurer’s portion of premium writings on a state or national level.

Net premiums earned for 2002, 2001 and 2000 have been reduced by reinsurance ceded premiums of approximately $63,790, $37,706 and $23,943, respectively. Net losses and loss expenses incurred for 2002, 2001 and 2000 have been reduced by ceded reinsurance recoveries of approximately $60,055, $72,701 and $40,586, respectively. Ceded reinsurance premiums and loss recoveries for catastrophe reinsurance contracts were not material. The Company remains liable to the extent the reinsuring companies are unable to meet their obligations under reinsurance contracts.

Net premiums earned for 2002, 2001 and 2000 include approximately $8,147, $5,931 and $4,678, respectively, relating to the assumption of reinsurance from other companies and from reinsurance pools. Losses and loss expenses incurred for 2001 included an estimated $20,000 for the Company's exposure from reinsurance assumed treaties related to the events of September 11, 2001.

Components of reinsurance recoverable at December 31 are as follows:

	2002	2001
Unpaid losses and loss expenses	**$ 133,042**	$ 109,410
Paid losses and loss expenses	**4,547**	1,935
Unearned premiums	**281**	240
	$ 137,870	$ 111,585

Note G - Shareholders' Equity

Changes in common stock outstanding and additional paid-in capital are as follows

	Class A		Class B		Additional Paid-in
	Shares	Amount	Shares	Amount	Capital
Balance at January 1, 2000	2,906,943	$ 124	13,546,742	$ 578	$ 39,663
Discounted stock options issued	-	-	-	-	136
Discounted stock options exercised	-	-	22,361	1	9
Treasury shares purchased	(30,961)	(1)	(1,231,500)	(53)	(3,392)
Balance at December 31, 2000	2,875,982	123	12,337,603	526	36,416
Discounted stock options issued	-	-	-	-	130
Discounted stock options exercised	-	-	8,312	1	3
Treasury shares purchased	(28,600)	(2)	(93,500)	(4)	(277)
Balance at December 31, 2001	2,847,382	121	12,252,415	523	36,272
Discounted stock options issued	-	-	-	-	134
Discounted stock options exercised	-	-	7,110	-	2
Fractional share adjustment from stock split	(37)	-	(48)	-	-
Treasury shares purchased	(180,679)	(7)	(376,664)	(16)	(1,160)
Balance at December 31, 2002	2,666,666	$ 114	11,882,813	$ 507	$ 35,248

The Company's Class A and Class B common stock has a stated value of approximately $.04 per share.

Shareholders’ equity at December 31, 2002 includes $277,583 representing GAAP shareholder’s equity of insurance subsidiaries, of which $40,347 may be transferred by dividend or loan to the parent company without approval by, or notification to, regulatory authorities. An additional $181,544 of shareholder’s equity of such insurance subsidiaries may be advanced or loaned to the Company with prior notification to and approval from regulatory authorities.

Net income of the insurance subsidiaries, as determined in accordance with statutory accounting practices, was $10,318, $5,660 and $24,309 for 2002, 2001 and 2000, respectively. Consolidated statutory shareholder’s equity for these subsidiaries was $269,005 and $273,072 at December 31, 2002 and 2001, respectively. Minimum statutory surplus necessary for the insurance subsidiaries to satisfy statutory risk based capital requirements was $45,606 at December 31, 2002.

Note H - Other Operating Expenses

Details of other operating expenses for the years ended December 31:

	2002	2001	2000
Amortization of deferred policy acquisition costs	**$ 12,072**	$ 9,692	$ 9,740
Other underwriting expenses	**14,158**	12,878	13,103
Expense allowances from reinsurers	**(17,641)**	(12,833)	(8,709)
Net other underwriting expenses	**(3,483)**	45	4,394
Total underwriting expenses	**8,589**	9,737	14,134
Operating expenses of non-insurance companies	**13,604**	11,835	11,905
Total other operating expenses	**$ 22,193**	$ 21,572	$ 26,039

Note I - Earnings Per Share

The following is a reconciliation of the denominators used in the calculations of basic and diluted earnings per share for the years ended December 31:

	2002	2001	2000
Average shares outstanding for basic earnings per share	**14,609,727**	15,153,577	15,583,138
Dilutive effect of options	**104,168**	105,104	110,765
Average shares outstanding for diluted earnings per share	**14,713,895**	15,258,681	15,693,903

No effect on net income was considered to result from the presumed exercise of the options used in calculating diluted earnings per share. The market value options, discussed in Note K, were not included in the computation of diluted earnings per share because the exercise price was greater than the average market price of the Company's stock.

Note J - Reportable Segments

The Company and its consolidated subsidiaries market and underwrite casualty insurance in five major speciality areas (reportable segments): (1) fleet trucking, (2) nonstandard private passenger automobile, (3) small fleet trucking, (4) the assumption of reinsurance and (5) small business workers' compensation. The fleet trucking segment provides multiple line insurance coverage to large trucking fleets which generally retain substantial amounts of self-insurance and to medium-sized trucking fleets on a first dollar or small deductible basis. The nonstandard private passenger automobile segment provides motor vehicle liability and physical damage coverages to individuals. The small fleet trucking segment provides commercial automobile coverages to small trucking fleets and owner/operators. The reinsurance assumed segment accepts retrocessions from selected reinsurance companies, principally reinsuring against catastrophes. The small business workers' compensation segment provides workers' compensation coverages to small businesses and other entities.

The Company's reportable segments are business units that operate in the property/casualty insurance industry and each offers products to different classes of customers. The reportable segments are managed separately due to the differences in underwriting criteria used to market products to each class of customer and the methods of distribution of the products each reportable segment provides. Segment information shown in the table below as "all other" includes products provided by the Company to assigned risks and residual markets as well as the runoff of discontinued product lines.

The Company evaluates performance and allocates resources based on gain or loss from insurance underwriting operations before income taxes. Underwriting gain or loss does not include net investment income nor does it include realized gains or losses on the Company's investment portfolio. All investment-related revenues are managed at the corporate level. Underwriting gain or loss for the fleet trucking segment includes revenue and expense from the Company's agency operations since the agency operations serve as an exclusive direct marketing facility for this segment. Underwriting gain or loss also includes fee income generated by each segment in the course of its underwriting operations. Management does not identify or allocate assets to reportable segments when evaluating segment performance and depreciation expense is not material for any of the reportable segments. The accounting policies of each reportable segment are the same as those described in the summary of significant accounting policies.

Note J - Reportable Segments (continued)

The following table provides certain profit and loss information for each reportable segment for the years ended December 31:

	2002	2001	2000
Direct and assumed premium written:			
Fleet trucking	$ 112,355	$ 68,154	$ 49,258
Non-standard private passenger automobile	35,466	30,094	35,713
Small fleet trucking	10,514	11,722	9,934
Voluntary reinsurance assumed	8,128	5,668	4,203
Small business workers' compensation	6,321	4,332	2,180
All Other	510	338	102
Totals	$ 173,294	$ 120,308	$ 101,390
Net premium earned and fee income:			
Fleet trucking	$ 55,145	$ 34,824	$ 27,842
Non-standard private passenger automobile	33,754	33,800	39,476
Small fleet trucking	8,316	9,600	7,797
Voluntary reinsurance assumed	7,739	5,636	4,521
Small business workers' compensation	3,535	2,791	1,114
All Other	414	295	156
Totals	$ 108,903	$ 86,946	$ 80,906
Underwriting gain (loss)			
Fleet trucking	$ 22,718	$ 11,116	$ 12,582
Non-standard private passenger automobile	2,527	436	(9,498)
Small fleet trucking	1,340	-	(373)
Voluntary reinsurance assumed	1,586	(19,429)	2,083
Small business workers' compensation	157	(337)	(160)
All Other	(619)	(392)	795
Totals	$ 27,709	$ (8,606)	$ 5,429

The following tables are reconciliations of reportable segment revenues and profits to the Company's consolidated revenue and income before federal income taxes, respectively.

	2002	2001	2000
Revenue:			
Net premium earned and fee income	$ 108,903	$ 86,946	$ 80,906
Net investment income	14,964	17,626	19,049
Realized net gains (losses) on investments	(16,445)	5,053	12,473
Other income	708	255	45
Total consolidated revenue	$ 108,130	$ 109,880	$ 112,473
Profit:			
Underwriting gain (loss)	$ 27,709	$ (8,606)	$ 5,429
Net investment income	14,964	17,626	19,049
Realized net gains (losses) on investments	(16,445)	5,053	12,473
Corporate expenses	(8,398)	(7,635)	(7,987)
Income before federal income taxes	$ 17,830	$ 6,438	$ 28,964

The Company, through its subsidiaries, is licensed to do business in all 50 states of the United States, all Canadian provinces and Bermuda. Canadian and Bermuda operations are currently not significant.

One customer of the fleet trucking segment represents approximately $39,359, $28,864 and $23,739 of the Company's consolidated direct and assumed premium written in 2002, 2001 and 2000, respectively.

Note K - Stock Purchase and Option Plans

In accordance with the terms of the 1981 Stock Purchase Plan (1981 Plan), the Company is obligated to repurchase shares issued under the 1981 Plan, at a price equal to 90% of the book value of the shares at the end of the quarter immediately preceding the date of repurchase. No shares were repurchased during 2002, 2001 or 2000. At December 31, 2002 there were 170,224 shares (Class A) and 469,708 shares (Class B) outstanding which are eligible for repurchase by the Company.

The Company maintains stock option plans and has reserved an aggregate of 1,312,500 shares of Class B common stock for the granting of stock options to employees and directors. Discounted options granted to employees are generally exercisable immediately while discounted options granted to directors are generally not exercisable for one year from the date of grant. All options expire ten years after the date of grant. All of the Company's option plans have received shareholder approval. Approximately 333,000 of such options are available for future grants.

A summary of the Company's stock option activity and related information for the years ended December 31 follows:

	2002		2001		2000	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding at beginning of year	**689,822**	**$ 17.479**	689,711	$ 17.477	716,019	$ 17.233
Granted at exercise prices below market	**7,496**	**.800**	8,423	.800	9,803	.800
Exercised	**7,110**	**.305**	8,312	.418	22,361	.438
Forfeited	**-**	**-**	-	-	13,750	20.600
Outstanding at end of year	**690,208**	**17.474**	689,822	17.479	689,711	17.477
Exercisable at end of year	**682,712**	**17.657**	681,399	17.685	679,908	17.717
Weighted average fair value of options granted during the year at exercise prices below market	**7,496**	**17.931**	8,423	15.509	9,803	13.929

The fair value of market value options granted during 1997 was determined using a Black Scholes option pricing model with the following assumptions: risk-free interest rate of 5.8%; dividend yield of 1.8%; volatility factor of the expected market price of the Company's common stock of .21; and an expected life of the option of 10 years. If the Company had followed Financial Accounting Standards Board Statement No. 123, *Accounting for Stock-Based Compensation,* 2000 net income and earnings per share would have been reduced by $918 and $.06, respectively, related to the issuance of 1997 market value options. There would have been no impact on net income or earnings per share related to these options for the years 2002 or 2001.

Exercise prices for options outstanding as of December 31, 2002 were $.80 or $20.60. The weighted-average remaining contractual life of options exercisable at $.80 is 4.5 years. The remaining contractual life of options exercisable at $20.60 is 5 years. The compensation cost that has been charged against income for all stock-based compensation plans, consisting of directors' fees only, was $134, $130 and $136 for 2002, 2001 and 2000, respectively.

During 2002, 2001 and 2000, the Company offered loans to certain key employees for the sole purpose of purchasing the Company's Class B common stock in the open market. $7,494 and $2,257 of such full-recourse loans were issued and outstanding at December 31, 2002 and 2001, respectively, and carry interest rates ranging from 4.75% to 6%, payable annually on the loan anniversary date. The underlying securities serve as collateral for these loans, which must be repaid no later than 10 years from the date of issue.

Note L - Note Payable

At December 31, 2002, the Company carried a note payable to bank in the amount of $7.5 million, payable in May, 2003 at an annual interest rate of 3.22%. The carrying amount of this note payable approximates fair value.

Note M - Concentrations of Credit Risk

The Company writes policies of excess insurance attaching above a self-insured retention, ("SIR") and also writes policies that contain large, per-claim deductibles. Those losses and claims that fall within the SIR or deductible are obligations of the insured. The company also writes surety bonds in favor of various regulatory agencies guaranteeing the insured's payment of claims within the SIR. Losses and claims under a large deductible policy are payable by the Company with reimbursement due the Company from the insured. The Company requires collateral from its insureds to serve as a source of reimbursement if the Company's guarantee requires it to pay claims within the SIR by reason of an insured's default or if the insured fails to reimburse the Company for deductible amounts paid by the Company.

Acceptable collateral may be provided in the form of letters of credit on Company approved banks, Company approved marketable securities or cash. At December 31, 2002, the Company held collateral in the aggregate amount of $154,292. The amount of collateral required of an insured is determined by the financial condition of the insured, the type of obligations guaranteed by the Company, estimated reserves for incurred losses within the SIR or deductible that have been reported to the insured or the Company, estimated incurred but not reported losses, and estimates for losses that have not yet occurred that will be within the SIR or deductible. In general, the Company attempts to hold collateral equal to 100% of the ultimate losses that would be paid by or due the Company in the event of the insured's default. Periodic audits are conducted by the Company to evaluate its exposure and the collateral required. If a deficiency in collateral is noted as the result of an audit, additional collateral is requested immediately. Because collateral amounts contain numerous estimates of the Company's exposure, are adjusted only periodically and are sometimes adjusted based on the financial condition of the insured, the amount of collateral held by the Company at a given point in time may not be sufficient to fully reimburse the Company for all of its guarantees or amounts due in the event of an insured's default. Further, the Company is not fully collateralized for the guarantees made for, or the deductible amounts that may be due from, the company's largest customer, and in the event of that customer's default, such default may have a material adverse impact on the Company.

Note N - Quarterly Results of Operations (Unaudited)

Quarterly results of operations are as follows:

	Results by Quarter							
	2002				2001			
	1st	**2nd**	**3rd**	**4th**	1st	2nd	3rd	4th
Net premiums earned	**$21,664**	**$25,865**	**$27,040**	**$29,823**	$19,037	$21,531	$20,657	$21,913
Net investment income	**3,883**	**3,793**	**3,524**	**3,764**	4,566	4,413	4,144	4,503
Realized net gains (losses) on investments	**835**	**(735)**	**(4,972)**	**(11,573)**	6,538	(1,557)	2,728	(2,656)
Losses and loss expenses incurred	**13,764**	**17,137**	**17,388**	**19,817**	14,360	16,181	35,435 [1]	15,894
Net income (loss)	**5,459**	**4,922**	**2,831**	**(846)**	7,176	2,644	(7,173) [1]	2,743
Per share - diluted:								
Income (loss) before realized net gains (losses) on investments	**$ .33**	**$ .37**	**$ .41**	**$ .46**	$ .19	$ .24	$ (.59) [1]	$ .29
Realized net gains (losses) on investments	**.04**	**(.03)**	**(.22)**	**(.52)**	.28	(.07)	.12	(.11)
Net income (loss)	**$ .37**	**$ .34**	**$ .19**	**$ (.06)**	$ .47	$ .17	$ (.47) [1]	$ .18

[1] Third quarter, 2001 results were impacted by the Company's exposure, under certain reinsurance assumed treaties, to the events of September 11, 2001. Losses and loss expenses incurred were increased by $20,000, net loss was increased by $13,000 and earnings per share were reduced by $.86 as the result of this event.

Note O - Subsequent Event

At its regular meeting in February, 2003, the Company's Board of Directors declared a 25% stock dividend in the form of a five-for-four stock split on the Company's Class A and Class B Common Stock. The additional shares were distributed on March 3, 2003 to shareholders of record on February 17, 2003. Fractional shares were settled in cash using the closing market value on February 17, 2003. All share and per share references within this report have been restated to reflect the stock split.

Directors

Stuart D. Bilton
President and CEO
ABN Amro Asset
Management (US), Inc.
Chicago, Illinois

Joseph J. DeVito
Executive Vice President
Baldwin & Lyons, Inc.
President
Sagamore Insurance Co.

Otto N. Frenzel III
Chairman of the Executive Committee
National City Bank, Indiana
Indianapolis, Indiana

James W. Good
Executive Vice President
Baldwin & Lyons, Inc.
President
Protective Insurance Co.

Gary W. Miller
Chairman & CEO
Baldwin & Lyons, Inc.

John M. O'Mara
Business Consultant & Private Investor
Greenwich, Connecticut

Thomas H. Patrick
Executive Vice Chairman, Finance and Administration
Merrill Lynch Co., Inc.
New York, New York

John A. Pigott
Former President
Anixter, Inc.
Winnetka, Illinois

Nathan Shapiro
President
S F Investments, Inc.
Chicago, Illinois

Norton Shapiro
Personal Investments
Chicago, Illinois

Robert Shapiro
President & CEO
Emlin Cosmetics
Chicago, Illinois

John D. Weil
President
Clayton Management Co.
St. Louis, Missouri

Officers

Gary W. Miller
Chairman & CEO

Joseph J. DeVito
Executive Vice President

James W. Good
Executive Vice President

G. Patrick Corydon
Senior Vice President & CFO

James E. Kirschner
Senior Vice President & Secretary

Mark L. Bonini
Vice President (Sales)

James D. Isham
Vice President (Administration)

Walter D. Osborne
Treasurer

Corporate Data

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Indianapolis, Indiana 46204

Sagamore Insurance Company
1099 N. Meridian Street
Indianapolis, Indiana 46204
Internet
www.sagamoreinsurance.com

B & L Insurance, Ltd.
Windsor Place
18 Queen Street
Hamilton, Bermuda

Availability of Form 10-K
The Company's 2002 annual report filed with the Securities and Exchange Commission on Form 10-K will be sent to shareholders without charge upon written request to the Investor Contact at the corporate address. This document, along with all other financial statements filed with the Securities and Exchange Commission are available for review, download or printing from the Company's web site.

Notice of Annual Meeting
10:00 a.m. May 6, 2003
Landmark Center
Lower Level
1099 N. Meridian Street
Indianapolis, Indiana 46204

Transfer Agent and Registrar
National City Bank
Cleveland, Ohio

Investor Contact
G. Patrick Corydon
corydon@baldwinandlyons.com
Fax (317) 715-9610

Common Stock Structure
The Class A and Class B common shares have identical rights and privileges except that Class B shares have no voting rights other than on matters for which Indiana law requires class voting.

Dividends
Cash dividends have been paid quarterly since 1974. The two classes of common stock have identical dividend rights. The effective quarterly dividend rate was increased to $.10 per share effective March 4, 2003.

Independent Auditors
Ernst & Young LLP
Indianapolis, Indiana