

consolidated balance sheets

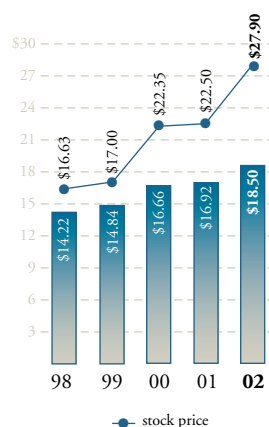
The accompanying notes are an integral part of the consolidated financial statements.

| (in thousands, except share data) | December 31, | |
|---|--------------------|--------------|
| | 2002 | 2001 |
| Assets | | |
| Investments: | | |
| Fixed maturities: | | |
| Available-for-sale, at fair value (amortized cost — \$466,479 in 2002 and \$188,269 in 2001) | \$ 484,819 | \$ 191,676 |
| Held-to-maturity, at amortized cost (fair value — \$249,768 in 2002 and \$273,194 in 2001) | 231,781 | 263,029 |
| Trading, at fair value (amortized cost — \$7,591 in 2002 and \$7,317 in 2001) | 8,196 | 7,568 |
| Equity securities available-for-sale, at fair value (cost — \$136,283 in 2002 and \$137,538 in 2001) | 227,342 | 277,621 |
| Short-term investments, at cost which approximates fair value | 47,889 | 53,648 |
| Total investments | 1,000,027 | 793,542 |
| Cash | — | — |
| Accrued investment income | 9,454 | 7,870 |
| Premiums and reinsurance balances receivable, net of allowances for uncollectible amounts of \$10,930 in 2002 and \$9,891 in 2001 | 122,258 | 105,168 |
| Ceded unearned premiums | 95,406 | 66,626 |
| Reinsurance balances recoverable on unpaid losses and settlement expenses, net of allowances for uncollectible amounts of \$4,280 in 2002 and \$4,173 in 2001 | 340,886 | 277,255 |
| Deferred policy acquisition costs, net | 60,102 | 52,872 |
| Property and equipment, at cost, net of accumulated depreciation of \$31,786 in 2002 and \$29,098 in 2001 | 17,757 | 18,438 |
| Investment in unconsolidated investee | 25,261 | 20,893 |
| Goodwill, net of accumulated amortization of \$4,700 in 2002 and \$5,079 in 2001 | 27,882 | 28,459 |
| Other assets | 20,294 | 19,847 |
| Total assets | \$1,719,327 | \$ 1,390,970 |

| (continued) | December 31, | |
|---|--------------|--------------|
| | 2002 | 2001 |
| Liabilities and shareholders' equity | | |
| Liabilities: | | |
| Unpaid losses and settlement expenses | \$ 732,838 | \$ 604,505 |
| Unearned premiums | 350,803 | 256,450 |
| Reinsurance balances payable | 78,231 | 58,438 |
| Income taxes — current | 1,787 | 1,116 |
| Income taxes — deferred | 26,022 | 43,151 |
| Notes payable, short-term | 54,356 | 77,239 |
| Other liabilities | 18,735 | 14,639 |
| Total liabilities | 1,262,772 | 1,055,538 |
| Shareholders' equity: | | |
| Common stock (\$1 par value, authorized 50,000,000 shares, issued 30,472,864 shares in 2002 and 12,820,727 pre-split shares in 2001) | 30,473 | 12,821 |
| Paid-in capital | 170,205 | 73,181 |
| Accumulated other comprehensive earnings net of tax | 71,297 | 93,476 |
| Retained earnings | 265,573 | 237,006 |
| Deferred compensation | 5,531 | 6,040 |
| Treasury stock, at cost (5,791,689 shares in 2002 and 2,908,131 pre-split shares in 2001) | (86,524) | (87,092) |
| Total shareholders' equity | 456,555 | 335,432 |
| Total liabilities and shareholders' equity | \$1,719,327 | \$ 1,390,970 |

*book value
per share/
stock price*

Book value shows steady growth and was boosted by 2002's equity offering. Year-end closing stock price set a new year-end record.



consolidated statements of earnings and comprehensive earnings

The accompanying notes are an integral part of the consolidated financial statements.

| (in thousands, except per share data) | Years ended December 31, | | |
|---|--------------------------|-------------|------------|
| | 2002 | 2001 | 2000 |
| Net premiums earned | \$ 348,065 | \$ 273,008 | \$ 231,603 |
| Net investment income | 37,640 | 32,178 | 29,046 |
| Net realized investment gains (losses) | (3,552) | 4,168 | 2,847 |
| Consolidated revenue | 382,153 | 309,354 | 263,496 |
| Losses and settlement expenses | 203,122 | 155,876 | 124,586 |
| Policy acquisition costs | 105,543 | 90,904 | 76,454 |
| Insurance operating expenses | 23,792 | 18,554 | 18,479 |
| Interest expense on debt | 1,860 | 3,211 | 5,275 |
| General corporate expenses | 3,505 | 2,636 | 3,388 |
| Total expenses | 337,822 | 271,181 | 228,182 |
| Equity in earnings of unconsolidated investee | 4,397 | 2,845 | 2,979 |
| Earnings before income taxes and cumulative effect | 48,728 | 41,018 | 38,293 |
| Income tax expense (benefit): | | | |
| Current | 18,494 | 7,728 | 7,748 |
| Deferred | (5,618) | 3,043 | 1,852 |
| Income tax expense | 12,876 | 10,771 | 9,600 |
| Earnings before cumulative effect | 35,852 | 30,247 | 28,693 |
| Cumulative effect of initial application of SFAS 133 | — | 800 | — |
| Net earnings | \$ 35,852 | \$ 31,047 | \$ 28,693 |
| Other comprehensive earnings (loss), net of tax | | | |
| Unrealized gains (losses) on securities: | | | |
| Unrealized holding gains (losses) arising during the period | \$ (24,538) | \$ (17,207) | \$ 15,283 |
| Less: Reclassification adjustment for gains (losses) included in net earnings | 2,359 | (2,467) | (1,934) |
| Other comprehensive earnings (loss) | (22,179) | (19,674) | 13,349 |
| Comprehensive earnings | \$ 13,673 | \$ 11,373 | \$ 42,042 |

| (continued) | Years ended December 31, | | |
|---|--------------------------|---------|---------|
| | 2002 | 2001 | 2000 |
| Earnings per share: | | | |
| Basic | | | |
| Earnings per share before cumulative effect | \$ 1.80 | \$ 1.54 | \$ 1.46 |
| Cumulative effect of SFAS 133 adoption | — | 0.04 | — |
| Net earnings per share | \$ 1.80 | \$ 1.58 | \$ 1.46 |
| Comprehensive earnings per share | \$ 0.69 | \$ 0.58 | \$ 2.14 |
| Diluted | | | |
| Earnings per share before cumulative effect | \$ 1.75 | \$ 1.51 | \$ 1.44 |
| Cumulative effect of SFAS 133 adoption | — | 0.04 | — |
| Net earnings per share | \$ 1.75 | \$ 1.55 | \$ 1.44 |
| Comprehensive earnings per share | \$ 0.67 | \$ 0.57 | \$ 2.11 |
| Weighted average number of common shares outstanding: | | | |
| Basic | 19,937 | 19,630 | 19,634 |
| Diluted | 20,512 | 20,004 | 19,891 |

*annualized
compounded total
return*

*Comparison of five-year cumulative
RLI, S&P 500 and S&P Ins Index*

RLI — 8.53%

S&P 500 — (0.58)%

S&P Ins Index — (2.37)%

Assumes \$100 invested on December 31, 1997,
in RLI, S&P 500 and S&P Ins Index with
reinvestment of dividends.



consolidated statements of shareholders' equity

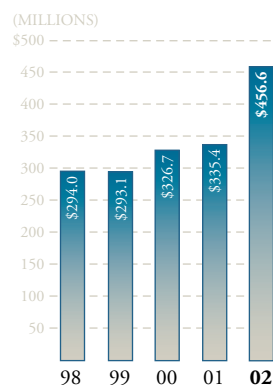
The accompanying notes are an integral part of the consolidated financial statements.

| (in thousands, except per share data) | Total Shareholders' Equity | Common Stock | Paid-in Capital |
|--|----------------------------------|-----------------|--------------------|
| Balance, January 1, 2000 | \$293,069 | \$12,804 | \$ 70,531 |
| Net earnings | 28,693 | | |
| Other comprehensive earnings, net of tax | 13,349 | | |
| Treasury shares purchased (142,544 shares) | (2,086) | | |
| Adjustment to accounting for deferred compensation plans | — | | |
| Shares issued from exercise of stock options | 37 | 2 | 35 |
| Other capital items, including CatEPuts amortization | (624) | | (624) |
| Dividends declared (\$.30 per share) | (5,784) | | |
| Balance, December 31, 2000 | \$326,654 | \$12,806 | \$ 69,942 |
| Net earnings | 31,047 | | |
| Other comprehensive loss, net of tax | (19,674) | | |
| Treasury shares reissued (194,250 shares) | 4,343 | | 3,869 |
| Treasury shares purchased (5,544 shares) | (123) | | |
| Adjustment to accounting for deferred compensation plans | — | | |
| Shares issued from exercise of stock options | 335 | 15 | 320 |
| Other capital items, including CatEPuts amortization | (950) | | (950) |
| Dividends declared (\$.32 per share) | (6,200) | | |
| Balance, December 31, 2001 | \$335,432 | \$12,821 | \$ 73,181 |
| Net earnings | 35,852 | | |
| Other comprehensive loss, net of tax | (22,179) | | |
| 2-for-1 stock split | — | 12,835 | (12,835) |
| Shares issued from public offering, less costs | 114,620 | 4,800 | 109,820 |
| Treasury shares reissued (24,573 shares) | 634 | | 575 |
| Adjustment to accounting for deferred compensation plans | — | | |
| Shares issued from exercise of stock options | 431 | 17 | 414 |
| Other capital items, including CatEPuts amortization | (950) | | (950) |
| Dividends declared (\$.35 per share) | (7,285) | | |
| Balance, December 31, 2002 | \$456,555 | \$30,473 | \$170,205 |

| Accumulated Other Comprehensive Earnings (Loss) | Retained Earnings | Deferred Compensation | Treasury Stock at Cost |
|--|----------------------|--------------------------|---------------------------|
| \$99,801 | \$189,250 | \$4,705 | \$(84,022) |
| | 28,693 | | |
| 13,349 | | | (2,086) |
| | | 684 | (684) |
| | (5,784) | | |
| \$113,150 | \$212,159 | \$5,389 | \$(86,792) |
| | 31,047 | | |
| (19,674) | | | 474 |
| | | | (123) |
| | | 651 | (651) |
| | (6,200) | | |
| \$93,476 | \$237,006 | \$6,040 | \$(87,092) |
| | 35,852 | | |
| (22,179) | | | |
| | | | 59 |
| | | (509) | 509 |
| | (7,285) | | |
| \$71,297 | \$265,573 | \$5,531 | \$(86,524) |

shareholders' equity

Shareholders' equity has
shown regular growth.



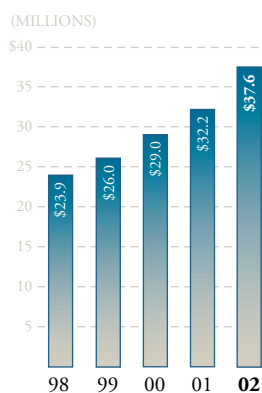
consolidated statements of cash flows

The accompanying notes are an integral part of the consolidated financial statements.

| (in thousands) | Years ended December 31, | | |
|--|--------------------------|-----------|-----------|
| | 2002 | 2001 | 2000 |
| Cash flows from operating activities | | | |
| Net earnings | \$ 35,852 | \$ 31,047 | \$ 28,693 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | | |
| Net realized investment gains (losses) | 3,552 | (4,168) | (2,847) |
| Depreciation | 3,546 | 3,277 | 3,092 |
| Other items, net | (884) | (6,164) | 1,411 |
| Change in: | | | |
| Accrued investment income | (3,392) | (2,894) | (768) |
| Premiums and reinsurance balances receivable (net of direct write-offs and commutations) | (17,090) | (10,407) | (29,284) |
| Reinsurance balances payable | 19,793 | 7,271 | 6,888 |
| Ceded unearned premium | (28,780) | (2,442) | (15,507) |
| Reinsurance balances recoverable on unpaid losses | (63,631) | (37,559) | 5,884 |
| Deferred policy acquisition costs | (7,230) | (9,585) | (8,929) |
| Accounts payable and accrued expenses | 6,801 | (2,475) | 119 |
| Unpaid losses and settlement expenses | 128,333 | 64,755 | 19,255 |
| Unearned premiums | 94,353 | 44,648 | 44,758 |
| Income taxes: | | | |
| Current | 1,102 | 1,469 | 1,708 |
| Deferred | (5,618) | 3,043 | 1,852 |
| Changes in investment in unconsolidated investee: | | | |
| Undistributed earnings | (4,397) | (2,845) | (2,979) |
| Net proceeds from trading portfolio activity | (339) | 903 | (228) |
| Net cash provided by operating activities | \$ 161,971 | \$ 77,874 | \$ 53,118 |

investment income

Investment income reached a record \$37.6 million in 2002, aided by strong cash flow from operations.



| (continued) | Years ended December 31, | | |
|---|--------------------------|------------|-------------|
| | 2002 | 2001 | 2000 |
| Cash flows from investing activities | | | |
| Purchase of: | | | |
| Fixed maturities, held-to-maturity | \$ (7,568) | \$ (9,288) | \$ (41,173) |
| Fixed maturities, available-for-sale | (354,137) | (147,868) | (61,642) |
| Equity securities, available-for-sale | (47,867) | (30,536) | (36,797) |
| Short-term investments, net | — | (10,964) | — |
| Property and equipment | (3,397) | (8,403) | (2,642) |
| Note receivable | — | (6,000) | — |
| Proceeds from sale of: | | | |
| Fixed maturities, available-for-sale | 57,085 | 37,577 | — |
| Equity securities, available-for-sale | 46,008 | 32,995 | 35,145 |
| Short-term investments, net | 1,305 | — | 13,315 |
| Property and equipment | 533 | 495 | 1,183 |
| Proceeds from call or maturity of: | | | |
| Fixed maturities, held-to-maturity | 38,657 | 42,506 | 38,250 |
| Fixed maturities, available-for-sale | 19,758 | 18,165 | 8,622 |
| Note receivable | 1,500 | 6,500 | — |
| Net cash used in investing activities | (248,123) | (74,821) | (45,739) |
| Cash flows from financing activities | | | |
| Proceeds from stock offering | 114,620 | — | — |
| Proceeds from issuance of debt | 11,380 | 10,855 | 366 |
| Payment on debt | (34,263) | (12,379) | — |
| Shares issued under stock option plan | 431 | 335 | 37 |
| Treasury shares purchased | — | (123) | (2,086) |
| Treasury shares reissued | 634 | 4,343 | — |
| Cash dividends paid | (6,650) | (6,084) | (5,696) |
| Net cash provided by (used in) financing activities | 86,152 | (3,053) | (7,379) |
| Net decrease in cash | — | — | — |
| Cash at beginning of year | — | — | — |
| Cash at end of year | \$ — | \$ — | \$ — |