VESTA INSURANCE GROUP INC
Form 10-K405
March 28, 2002

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2001	Commission file number 1-12338

VESTA INSURANCE GROUP, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

Delaware (STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	63-1097283 (I.R.S. EMPLOYER IDENTIFICATION NO.)
3760 River Run Drive, Birmingham, AL (ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	35243 (ZIP CODE)

Registrant's telephone number, including area code:
(205) 970-7000
Securities registered pursuant to Section 12(b) of the Act:

TITLE OF EACH CLASS	CUSIP NUMBER:	NAME OF EACH EXCHANGE ON WHICH REGISTERED
Common Stock, $.01 Par Value	925391104	Common Stock, $.01 Par Value

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

None

INDICATE BY CHECK MARK WHETHER THE REGISTRANT (1) HAS FILED ALL REPORTS REQUIRED TO BE FILED BY SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 DURING THE PRECEDING 12 MONTHS (OR FOR SUCH SHORTER PERIOD THAT THE REGISTRANT WAS REQUIRED TO FILE SUCH) AND (2) HAS BEEN SUBJECT TO SUCH FILING REQUIREMENTS FOR THE PAST 90 DAYS.

YES [X] NO [ ]

INDICATE BY CHECK MARK IF DISCLOSURE OF DELINQUENT FILERS PURSUANT TO ITEM 405 OF REGULATION S-K (Section 229.405 OF THIS CHAPTER) IS NOT CONTAINED HEREIN, AND WILL NOT BE CONTAINED, TO THE BEST OF REGISTRANT'S KNOWLEDGE, IN DEFINITIVE PROXY OR INFORMATION STATEMENTS INCORPORATED BY REFERENCE IN PART III OF THIS FORM 10-K OR ANY AMENDMENT TO THIS FORM 10-K. [X]

THE AGGREGATE MARKET VALUE OF THE VOTING STOCK HELD BY NON-AFFILIATES OF THE REGISTRANT AS OF MARCH 15, 2002:
$ 210,700,254

THE NUMBER OF SHARES OUTSTANDING OF THE REGISTRANT'S COMMON STOCK, AS OF MARCH 15, 2002 is 36,415,839

DOCUMENTS INCORPORATED BY REFERENCE
PORTIONS OF THE VESTA INSURANCE GROUP, INC. PROXY STATEMENT FOR ITS 2002 ANNUAL MEETING OF STOCKHOLDERS

ARE INCORPORATED BY REFERENCE INTO PART III HEREOF.

Table of Contents

Part I

Item 1 Business Overview
Significant Developments
Business Segments
Standard Property-Casualty
Life and Health Insurance
Non-Standard Auto Agency
Specialty Lines
Corporate and Other
Reserves
Investments
Regulation
A.M. Best
Competition
Employees
Item 2 Properties
Item 3 Legal Proceedings
Item 4 Submission of Matters to a Vote of Security Holders

Part II
Item 5 Market for Registrants' Common Equity and Related Stockholder Matters
Item 6 Selected Financial Data
Item 7 Management's Discussion and Analysis of Results of Operations and Financial Condition
Item 8 Financial Statements and Supplementary Data
Item 9 Changes in and Disagreements with Accountants on Accounting and Financial Disclosures

Part III
Item 10 Directors and Executive Officers of the Registrants
Item 11 Executive Compensation
Item 12 Security Ownership of Certain Beneficial Owners and Management
Item 13 Certain Relationships and Related Transactions

Part IV
Item 14 Exhibits, Financial Statement Schedules, and Reports on Form 8-K

Special Note Regarding Forward-Looking Statements

Any statement contained in this report which is not a historical fact, or which might otherwise be considered an opinion or projection concerning Vesta or its business, whether expressed or implied, is meant as and should be considered a forward-looking statement as that term is defined in the Private Securities Litigation Reform Act of 1996. Forward-looking statements are based on assumptions and opinions concerning a variety of known and unknown risks, including but not necessarily limited to changes in market conditions, natural disasters and other catastrophic events, increased competition, changes in availability and cost of reinsurance, changes in governmental regulations, and general economic conditions, as well as other risks more completely described in Vesta's filings with the Securities and Exchange Commission, including exhibit 99.1 to this Report on Form 10-K. If any of these assumptions or opinions proves incorrect, any forward-looking statements made on the basis of such assumptions or opinions may also prove materially incorrect in one or more respects.

PART I

Item 1. Business

Business Overview

As used in this Annual Report, unless the context otherwise requires, the terms "Vesta," "we," and "our" refer to Vesta Insurance Group, Inc., a Delaware corporation, and its subsidiaries, collectively.

Vesta is an insurance holding company that offers a wide range of insurance products for consumers. Our largest business segment is standard property-casualty insurance, which underwrites and sells personal automobile and residential property products distributed through approximately 1,500 independent sales agencies. Our standard lines business, like that of most of our competitors, experienced increasing loss costs relative to pricing in recent years, resulting in less than anticipated underwriting profits. Recognizing these loss cost trends, we applied for and received approval for 50 rate changes at an average of approximately 8% increase in 2001 in a number of key markets. We believe these rate increases will begin to positively impact our underwriting results in the second half of 2002 after we have earned a full year of increased premiums from policies issued and renewed after the rate increase took effect. In addition to rate increases, we took other actions in 2001 to improve our results in the standard lines segment, including reducing the number of active agencies in the Shelby-Vesta operations by approximately 40% and migrating a substantial portion of our policy processing from an outside vendor to an in house system.

In the standard lines segment, we also acquired Florida Select Insurance Holdings, Inc. in 2001. Florida Select is one of the largest insurers of residential property in the state of Florida. We intend to leverage Florida Select's expertise in selecting and managing risk in catastrophe prone areas to improve our underwriting in our existing business, particularly the northeastern United States which is subject to hurricane risk, as well as to expand into other geographic areas such as Texas, South Carolina and California.

The operating earnings in our standard lines segment are not highly predictable because they are subject to weather related damages and catastrophic events such as hurricanes and tropical storms. Over the last three years, we have executed a strategy to grow and stabilize operating earnings by entering other businesses with lower volatility of earnings. To this end, we have:

- Entered the life and health insurance and annuity business, which is subject to more predictable and extended claim payment (loss) patterns, thereby stabilizing underwriting results and providing greater opportunities to earn investment income;

- Developed an agency operation to earn fee and commission income from the distribution of non-standard automobile insurance policies; and

- Began offering specialty "fronting" products in exchange for fees to agencies and reinsurers who produce and underwrite large programs, particularly non-standard auto programs, but which do not have the state licenses necessary to issue the policies directly.

Vesta, a Delaware corporation, was founded in 1993 as a subsidiary of Torchmark Corporation ("Torchmark") to be the holding company for Torchmark's property and casualty subsidiaries. We completed our initial public offering in 1993, and, at that time, Torchmark retained ownership of approximately 25% of our shares of capital stock and was our largest shareholder. Torchmark divested its remaining shares of our capital stock in 2000.

Significant Developments

The following events have occurred since January 1, 2001 and have had a positive impact on Vesta:

- Settlement of Securities Litigation: In the fourth quarter of 2001, we settled the securities litigation that had been pending against Vesta and certain current and former officers and directors since June 1998.

- Strengthening of the Balance Sheet: During 2001 and in 2002, we continued to engage in transactions to reduce annual interest expense obligations and improve our debt to total capital ratio:

    - On January 26, 2001, we effectively retired 2,950,000 shares of Series A Convertible Preferred Stock, eliminating $2.25 million in annual dividend payments. The preferred stock holders converted the preferred stock pursuant to their original conversion terms, and we then repurchased the 5,900,000 shares of common stock issued upon conversion for $15 million cash and a $32.2 million note. We subsequently resold 5.5 million of these shares in privately negotiated transactions and repaid the $32.2 million note in full on March 14, 2001.

    - Debt Exchanges and Repurchases: During 2001 and through February 2002, we redeemed $10.8 million face amount of our 8.525% Deferrable Capital Securities for approximately 1.03 million shares of Vesta common stock. We also redeemed $11.6 million face amount of our 8.75% Senior Debentures for 1.03 million shares of Vesta common stock.

  As a result of this series of transactions, we reduced our outstanding debt by approximately $22.4 million and have reduced our annual ongoing interest obligations by $1.9 million. These transactions also continued the reduction of our debt to total capital ratio from 48.5% at December 31, 1999 to 33.8% at December 31, 2001.

- Acquisition of Florida Select Insurance Holdings, Inc.: In 2001, we closed on a $64.5 million acquisition of Florida Select Insurance Holdings, Inc. Florida Select is one of the largest insurers of residential property in Florida. To finance the acquisition, we completed a public offering of 8.625 million shares of our common stock in June 2001, resulting in net proceeds of approximately $64 million.

- Formation and Growth of Non-Standard Auto Business: In 2001, we began reporting results in a non-standard automobile business segment due to our acquisition of approximately 52% economic interest of Instant

Insurance Holdings, Inc. In December 2001, we increased our majority ownership in Instant Insurance Holdings to approximately 92%. Instant Insurance Holdings and Vesta affiliates acquired several non-standard auto wholesale and retail agencies in 2001 and in early 2002:

- Instant Insurance Holdings gained control of the Spacecoast agencies in Florida;
- Instant Insurance Holdings acquired A-Affordable Insurance agency in Texas;
- In January 2002, Vesta formed a new agency and acquired certain assets of InsureOne Independent Insurance Agency, Inc., a non-standard insurance agency headquartered in Chicago. In addition, Vesta acquired the renewal rights to the non-standard auto business of InsureOne's insurance company's affiliates, Gallant Insurance Company and Valor Insurance Company;
- In February 2002, Instant Insurance Holdings, Inc. acquired certain assets of the non-standard auto business of Harbor Insurance Group, Inc and purchased the stock of Old American Investments, Inc.

- Increase in Annual Dividend Rate: In May 2001, the Board of Directors doubled the annual dividend rate to $0.10 per share.

- Life and Health Insurance Acquisitions: Our lead life insurance subsidiary, American Founders, continued to execute its growth strategy of acquiring blocks of policies and efficiently integrating them into its operations. In August 2001, American Founders acquired Washington Life Insurance Company. Also, American Founders acquired Teton National Insurance Company and Imperial General Life Insurance Company.

- Increase in Share Repurchase Authority: In November 2001, the Board of Directors authorized company management to repurchase up to an additional 5 million shares of its common stock. During 2001, we repurchased 1,410,210 shares of our common stock at prices ranging from $5.75 to $11.57.

Business Segments

Summary. In 2001, we changed our segment reporting to reflect the start-up of the non-standard automobile agency business. This data should be read in conjunction with our Consolidated Financial Statements and related notes thereto. For additional information on our business segments, see "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Note K to the Consolidated Financial Statements. Each segment is discussed in detail on following pages.

Standard Property-Casualty

General. In our standard property-casualty segment, we write primarily personal auto and residential property insurance, along with other miscellaneous products targeted for particular markets. For the last several years, we have taken a disciplined approach to our standard property-casualty business, maintaining relationships with only our core agencies. Our independent agency force stands at approximately 1,500 agencies. These agents have historically produced our most profitable business. As a result of this approach, our gross written premium in this segment declined in 1999 and 2000, but premium increased in 2001 largely due to the acquisition of Florida Select Insurance Holdings, Inc. Through these actions, we believe we are positioned to achieve an underwriting profit from our standard property-casualty operations and strengthen our relationships with our most profitable independent agencies. The following table shows our combined ratio and surplus leverage in our standard lines segment:

Selected Operational Ratios for Standard Property-Casualty Segment

	2001	2000	1999
Loss and LAE ratio	64.7%	58.6%	66.5%
Underwriting expense ratio	34.9%	37.1%	30.3%
Combined ratio	99.6%	95.7%	96.8%
Net premiums written to Surplus Ratio	1.12x	.76x	.98x

The following table illustrates the source of our gross premium written in our standard property-casualty lines operations. This data should be read in conjunction with our consolidated financial statements and related notes appearing later in this annual report.

Year Ended December 31

	2001		2000		1999	
			(in thousands,except percentages)			
Residential Property	$179,813	63%	$121,483	54%	$107,025	42%
Personal Auto	104,667	36%	98,449	44%	141,868	56%
Other	2,046	1%	3,405	2%	6,098	2%
Total	$286,526	100%	$223,337	100%	$254,991	100%

Residential Property. Our residential property, homeowner and dwelling insurance products cover the full range of homes, starting with lower valued dwellings in the $10,000 to $50,000 range, through middle valued homes in the $50,000 to $150,000 range, and occasionally we insure higher valued homes up to $10 million. The majority of our homeowners business covers properties valued between $40,000 and $250,000.

We write residential property insurance through various insurance subsidiaries, but we generally divide it into four books of business:

- Hawaiian coverage, primarily written by our wholly-owned subsidiary, The Hawaiian Insurance and Guaranty Company, Ltd.;
- The Property Plus business, a large book of homeowners business that we acquired from CIGNA in 1998;
- Shelby homeowners, written through our wholly owned subsidiary, Shelby Insurance Company;
- Florida and Texas residential property business, written through our wholly owned subsidiary, Florida Select Insurance Holdings, Inc., which we acquired in 2001.

Our Hawaiian homeowners business generally covers higher valued dwellings against fire and other catastrophic loss. Until recently, we did not underwrite significant wind, or hurricane, risk of loss in Hawaii, because most policyholders procured that coverage through a state-sponsored insurance pool. In 2000, that state insurance pool disbanded, and many of our policyholders began purchasing wind, or hurricane, coverage from us in Hawaii. Although this increases the total risk in our Hawaiian portfolio, we have effectively managed this risk through reinsurance coverage procured in the capital markets as well as the traditional reinsurance markets. During 2000, Vesta entered into a transaction with NeHi Re, L.P., a special purpose limited syndicate under the INEX Insurance Exchange, to provide $50.0 million of excess-of-loss reinsurance protection to potential losses arising in Hawaii and in the Northeast United States for a period of three years. We paid $3.0 million in annual premiums for this catastrophe reinsurance. In 2001, we wrote approximately $17.4 million in annual premiums in this book of business.

Our Property Plus book of business covers mid-to-high valued homes primarily in the northeastern region of the United States as well as a limited amount across the entire country. We have taken a conservative approach in the northeastern section of the country and minimized our exposure on the coastal regions. This book of homeowners business was acquired from CIGNA in 1998 through a reinsurance arrangement, coupled with CIGNA's commitment to use reasonable efforts to cause the policyholder base to renew their coverage with us. In 2001, we wrote approximately $52.0 million in annual premium in this book of business.

The Shelby homeowners business focuses on the Midwestern and Mid Atlantic sections of the United States covering homes primarily from $100,000 to $250,000 in value. Homes in this book of business have very minimal exposure to hurricanes. This section of our business had a renewal rate of approximately 86% for 2001, and we wrote $32.5 million in annual premium in 2001.

Florida Select utilizes various risk management techniques to underwrite residential property in Florida, Texas and South Carolina. The majority of Florida Select's policyholders are former customers of the Florida Residential Property and Casualty Joint Underwriting Association ("JUA"), a state sponsored insurer created by the Florida Legislature following Hurricane Andrew in 1992. Florida Select was originally organized for the purpose of assuming policies from the JUA, which initiated various incentives programs to encourage carriers to assume the policies from the JUA. Florida Select was one of the first companies to assume policies from the JUA and it has operated profitably since its inception. In addition to renewals of policies assumed from the JUA, Florida Select produces new business through its wholly owned subsidiary, Florida Select Insurance Agency, Inc. Florida Select also owns Select Insurance Services, Inc., the attorney-in-fact for Texas Select Lloyds Insurance Company, which is a Texas unincorporated association.

Personal Auto. Our standard personal auto line targets drivers over age thirty-five with above average driving records. We write policies with liability limits up to $500,000, with personal umbrella liability coverage available up to $5 million. The vast majority of our personal umbrella coverage is written at limits of $1 million or $2 million. We write the majority of our standard auto business in Ohio, Pennsylvania, Tennessee, West Virginia, Illinois, and Wisconsin through The Shelby Insurance Company and its affiliated companies. Our renewal rate for this line of business was approximately 83% for active agents in 2001.

Underwriting. The goal of our underwriting operations is to manage the quality of our book of business. Working in concert with our agency force, our underwriting staff supports our agents on a daily basis. Vesta's agency force understands our underwriting philosophy and goals and, in turn, we rely on our agents to exercise a high degree of underwriting knowledge in the field.

Our target market profile is families with multiple insurance policies, who own more than one automobile and who live in a home valued between $100,000 and $250,000. Our underwriting staff is highly trained and operates in an efficient manner in order to maintain and manage expenses.

Exposure to Catastrophic Events. In our standard lines operations, the greatest risk of loss we face is property damage resulting from catastrophic events, particularly hurricanes and tropical storms affecting Hawaii, the northeastern United States and Florida. Our exposure to loss from other catastrophic events, such as tornadoes and earthquakes, is not as significant, because we do not insure significant levels of property in areas traditionally affected by these events. While we seek to reinsure a significant portion of our risk of catastrophic losses, there can be no assurance that our losses will be within the coverage limits of our reinsurance programs.

Exposure to Mold Claims. Our standard lines operations experienced growth in Texas during the latter half of 2001 and we have been diligent in attempting to contain our exposure to mold claims not only in Texas, but also in all of our markets. Effective February 15, 2002, all of the policies written or renewed in Texas will have an endorsement that limits our exposure to mold to $5,000 per policy unless policyholders choose to buy back coverage up to the full amount of the policy limit.

Standard Property-Casualty Lines Reinsurance. We seek to manage our risk exposure on standard property-casualty lines insurance through the purchase of reinsurance. We obtain reinsurance principally to reduce our net liability on individual risks and to provide protection for individual loss occurrences, including catastrophic losses, in order to stabilize our underwriting results. In exchange for reinsurance, we pay to our reinsurers a portion of the premiums received under the reinsured policies.

In addition to our traditional catastrophe reinsurance program, we obtained additional catastrophe coverage for potential hurricane and tropical storm loss in Hawaii and hurricane loss in the northeastern United States through a securitization transaction effected through the INEX insurance exchange.

Although we reinsure a significant portion of potential losses on the policies that we issue, we initially pay all claims and seek to recover the reinsured losses from our reinsurers. Although we report as assets the amount of claims paid which we expect to recover from reinsurers, there is no guarantee that we will be able to collect those amounts. The possibility exists that reinsurers would be unable to pay, or reinsurers may dispute our calculation of the amounts recoverable. In either of these circumstances, we may not have the anticipated liquidity to pay the claims on the reinsured policies. We believe that our procurement of a portion of our reinsurance through the capital markets in the manner described above mitigates these credit and collection risks inherent in the traditional reinsurance market.

Marketing. We have chosen to distribute our standard property-casualty products through Independent Insurance Agents. We strive to develop and maintain relationships with agencies in rural or suburban areas and provide them with above average compensation when policies are issued through our companies. Our product offerings in the standard property-casualty market fit the needs of a wide range of consumers. Vesta supports its agency force through advertising and promotions aimed to create top-of-mind awareness of the agency and our companies as well as creating business to business technology that has the potential to increase agent productivity while decreasing our operating expenses.

We believe that the Independent Agent is best able to sell and service the needs of our target market because of the agent's close relationship with their customers. Consumers who use independent agents typically keep using the services of the same independent agent year after year. This means once Vesta acquires a new customer, the likelihood that particular customer will renew his/her policy with us the following year is very high. This will keep our policy acquisition expenses to a minimum over time. We currently have a marketing force of approximately 1,500 agencies in 24 states that distribute our standard property-casualty products.

Our agency force has a voice in Vesta through the Agency Advisory Council. The Council was created to foster ideas and give the agents the opportunity to suggest new initiatives to improve both our businesses. In 2001, we implemented a stock incentive plan for our agents so that top-performing agents have the opportunity to acquire Vesta common stock at a discount to market prices.

The following table sets forth the principal geographic distribution of our gross premiums written in our standard property-casualty business for the three years indicated. The states listed below comprise the ten states with the largest gross premiums written for the year ending December 31, 2001 and their comparative amounts for prior years.

Standard Property-Casualty
Gross Written Premium
Year Ended December 31

	2001		2000		1999	
Florida	$ 65,585	22.9%	$ 1,815	0.8%	$ 1,029	0.4%
Pennsylvania	43,655	15.2%	40,305	18.0%	48,822	19.1%
West Virginia	28,187	9.8%	25,258	11.3%	26,677	10.5%
Hawaii	20,909	7.3%	17,187	7.7%	18,426	7.2%
Texas	14,550	5.1%	2,607	1.2%	18,992	7.4%
Ohio	13,594	4.7%	15,126	6.8%	19,307	7.6%
North Carolina	11,609	4.1%	9,910	4.4%	10,426	4.1%
New York	11,229	3.9%	9,877	4.4%	1,983	0.8%
Tennessee	10,434	3.6%	14,971	6.7%	20,065	7.9%
Illinois	9,485	3.3%	11,642	5.2%	15,936	6.2%
All Other	57,289	20.1%	74,639	33.5%	73,328	28.8%
Total	$286,526	100.0%	$223,337	100.0%	$254,991	100.0%

Our independent agents have limited authority to bind insurance coverages without prior approval from us, as long as such coverages fit within our established guidelines. However, our underwriting staff reviews all coverages bound by these agents and ultimately decides whether to continue such coverages. Because of the broad base of our independent agency force, the contractual limitation on their authority to bind coverage and our underwriting review procedures, we do not believe that the authority of our agents to bind us presents any material risk to our operations.

Claims. Claim costs represent actual payments made and changes in estimated future payments to be made to or on behalf of policyholders, including expenses required to settle claims and losses. These costs include a loss estimate for future assignments and assessments. Claims arising under our policies are managed by our Claims Department. When we receive notice of a loss, our claims personnel open a claim file and establish a reserve based on specific loss codes with respect to the loss. All claims are reviewed and all payments are made by our employees, with the exception of claims on certain products, which are adjusted by a managing general agency and periodically audited by our claims personnel. Management believes that utilizing our trained employee adjusters permits faster, more efficient service at a lower cost.

Claims settlement authority levels are established for each adjuster or manager based upon each employee's ability and level of experience. Upon loss notification, each claim is reviewed and assigned to an adjuster or manager based upon the type of claim. Home office litigation supervisors monitor claims-related litigation. We emphasize prompt, fair and equitable settlement of meritorious claims, adequate reserving for claims and controlling of claims adjustment and legal expenses.

Systems. In 2001, we completed a conversion of substantially all our Shelby policy management systems to an in-house system. We have been working to upgrade our core infrastructure and expanding the scope of our capabilities in recent years. The policy management systems conversion was the last major expense that we intend to incur as a result of the integration of the Shelby Companies acquisition.

Our efforts in e-commerce and technology have a high priority, and during the year we intensified our resources devoted to Internet-based technology. To assist the marketing and servicing capabilities of our agency force, we maintain an Internet-based programs that give agents the ability to quote, enter new business, perform endorsements and perform inquiries on policies, billing and claims. This information is exchanged through Vesta Internet Access (VIA), which is located on our web site -- www.vesta.com -- and provides Agents fast, convenient access to product, policy and claims information. We are committed to utilizing the latest electronic technology to allow our agency force to securely conduct transactions, access information and communicate with our insurance subsidiaries.

Life and Health Insurance

We diversified our product offering by entering the Life and Health Insurance business through strategic acquisitions in 2000. Similar to the property-casualty industry, life and health insurance is a mature industry experiencing consolidation. One major difference, however, is that as the overall population ages, individuals will focus on efficiently transferring wealth between generations. As a result, we believe that consumers will be attracted to savings-oriented products with tax-advantaged status to both fund their retirement years and protect their accumulated savings.

Even though the demand for life, annuity and health products has increased in recent years, this business remains extremely competitive. Access and retention of distribution channels is a key factor in the success in this business, and we utilize an independent agency force to distribute these products.

Life and health insurance is expected to have a different impact on Vesta's earnings stream as compared to property-casualty business. Losses in the property-casualty business are difficult to predict due to potential catastrophes, such as hurricanes, tornadoes and other weather-related events. In addition, losses in the property-casualty line can take years to ultimately determine due to litigation and other factors. On the other hand, financial results from life and health insurance businesses are easier to predict and the ultimate results are not as volatile. Accordingly, we believe that our earnings from the life and health segment should be more predictable and consistent than our property-casualty segment.

Primary Products. The primary products of our life and health segment consist of traditional life products, universal life products, annuity and pension contracts and related products. Fixed-rate annuities are a substantial portion of our offerings. The critical illness product is designed to bridge the gap between disability insurance and life insurance by paying the face amount of the policy at death or earlier in the event of the occurrence of certain critical illnesses, such as Alzheimer's disease, organ transplants or loss of sight.

Strategy. We believe our life and health insurance business is well positioned for growth. We intend to grow by acquisitions, joint ventures and internal sales. The main drivers of these strategies are an efficient and flexible operating and administrative system and maintaining seasoned management with industry expertise to identify potential targets and successfully integrate blocks of policies efficiently into the current administrative system.

Marketing. We distribute our life and health products through agents recruited and contacted directly by our life and health insurance subsidiaries, American Founders and Aegis Financial.

Reinsurance Ceded. Our life business engages in reinsurance to appropriately spread reinsurance-ceded risks among reinsurers. American Founders maintains excess of loss reinsurance agreements for more than $50,000 on policies issued prior to October 24, 1990 and for more than $250,000 on policies issued subsequently.

Systems. A key criteria in our diversification strategy was to acquire effective information systems to support new products offered. We believe that each of American Founders and Aegis have efficient and flexible administrative systems that have demonstrated the ability to quickly and efficiently assimilate and provide administration for acquired blocks of policies. The result is an ongoing low-cost administration of the insurance and annuity policies.

Non-Standard Auto Agency

Our mission for the non-standard agency segment is to acquire, develop and grow non-standard auto insurance agencies consisting of operations with both "wholesaling" and "retailing" capabilities. Generally, a non-standard auto "wholesaler," or managing general agency ("MGA"), provides marketing, policy issuance, underwriting, policy billings, claims management and other client services on behalf of various insurers. The MGA utilizes independent "retail" agencies or captive "retail agencies" to produce customers (insureds). A "retail" agency advertises to acquire customers and provides points of sale/service to customers and through convenient and sometimes extensive branch store locations. A fully integrated non-standard auto agency operation should include a common "wholesaler" with the technology and resources necessary to support an ever-expanding "retail" branch network. In 2001, we took important steps towards developing such an operation through acquisitions.

Recent Acquisitions. Structurally, we own approximately 92% of the outstanding stock of Instant Insurance Holdings, Inc., which serves as a vehicle to acquire both wholesale and retail insurance agencies. In 2001 and the first quarter of 2002, we acquired five "wholesale" agencies and two "retail" agencies which collectively produced approximately $250 million in premium during the twelve months ended 2001:

- Spacecoast Agencies, of which we own 75%, a "wholesaler" operating primarily in the state of Florida, which produced approximately $28 million in annual premium in 2001;
- A-Affordable, a fully integrated MGA with its own captive "retail" agency network operating through approximately 38 retail

stores in the state of Texas, which produced approximately $26 million in premium in 2001;

- Harbor Insurance Managers, a "wholesaler" utilizing independent retail agencies operating in Texas, Nevada and New Mexico, which produced and administered approximately $29 million in premium in 2001. We anticipate discontinuing the business in Nevada in 2002;

- American Agencies General Agency (formerly affiliated with Old American County Mutual), a "wholesaler" utilizing independent agencies operating in Texas, which produced approximately $38 million in premium in 2001;

- InsureOne, a "wholesale" and "retail" agency utilizing both captive and independent retail agencies operating in the states of Illinois, Missouri, Indiana, Wisconsin and Iowa, which produced and administered approximately $121 million in premium in 2001. InsureOne's captive retail agencies operate through 99 retail stores located primarily in Illinois and Missouri. This agency was initially acquired by subsidiaries other than Instant Insurance Holdings, but we anticipate contributing these assets to Instant Insurance Holdings in 2002.

During 2002, we are focused on integrating the various technological platforms that we have acquired with the "wholesale" and "retail" agencies into a common information system and administration platform capable of providing more cost efficient support for all policies distributed through the operation. The call center which Instant Insurance Holdings had developed prior to implementation of its acquisition strategy has already proven to be an effective and complimentary tool to the retail agencies that we have acquired, even as they continue to operate independently. As the "wholesale" functions of our agency operation are centralized and refined, we believe that we will experience even greater operational synergies and cost saving opportunities.

Financial Summary. The primary sources of revenue in our non-standard auto segment are (i) agent's commissions and fees collected by retailers and (ii) policy fees and commissions collected by wholesalers. These revenue streams are not risk-bearing and are intended to be more stable than the related underwriting income, which is earned by the insurers and reinsurers who bear the underwriting risk on the business produced by our agencies. A typical agency contract provides for a minimum commission or a fixed policy fee on all business produced. However, the level of "profit sharing" commissions that we collect in excess of contractually stated minimums is directly related to the losses incurred on the policies produced in relation to written premium (i.e., loss ratios).

The primary expenses of our retail agency operation are workforce costs, advertising, and rent. In our wholesale operations, the major expense is commissions to independent agencies.

Consolidation Strategy. We believe the consolidation of the production and administration of smaller books of business into a larger book of business subject to common agency contracts and reinsurance will increase marginal revenues and decrease marginal expenses. From a revenue perspective, we believe that such consolidation will generate increased revenue from the overlay of better technological platforms, infrastructure and business approach, as well as stronger leverage based on increased volumes to negotiate more favorable commissions, profit sharing and reinsurance terms. From an expense perspective, we believe that once we have successfully integrated to common and more efficient systems, we should be able to increase the volume of business produced, with proportionately less relative increases in fixed cost.

Fronting Companies and Risk Bearers. In our non-standard auto agency operation, we typically contract with various carriers to issue the policies which we distribute. In turn, those carriers will typically cede substantial amounts of premiums received on those policies to various reinsurers, depending upon the carrier's appetite for underwriting risk, and the availability and pricing of reinsurance. Generally speaking, the issuing carrier retains anywhere from 10% to 100% of the underwriting risk, and cedes the balance to reinsurers. An issuing carrier that cedes more than 80% of the premiums and liabilities arising from its policies to reinsurers is generally known as a "fronting" company. Such a fronting company typically earns in addition to underwriting income, the collection of "front" fees from reinsurers as compensation for the use of its licenses, rate and form filings and other assets necessary to issue insurance policies. From time to time, our affiliated insurance companies may act as a fronting company and bear underwriting risk as an issuing carrier or reinsurer for the non standard business produced by our agency. See, Specialty Lines, below.

Specialty Lines

As a holding company for 14 insurance subsidiaries, we hold certificates of authority to write various types of insurance in 48 states. In many states, we have several insurance company subsidiaries licensed to write the same types of insurance business, and we are licensed to write business in other states where we are not actively underwriting business. We use our authority to write business in these circumstances, which would otherwise go unused, to write certain lines of business and reinsure the risks in exchange for fees. This can be a valuable asset to reinsurance companies desiring to underwrite insurance business in these states but which do not hold certificates of authority to do so. We may also decide to retain some underwriting risk on selected business, at our discretion and any underwriting results that we retain will be reported in this segment.

Non-Standard Auto. Certain of our affiliated insurance companies may issue or reinsure the policies of insurance distributed by our agency operation or unaffiliated agencies. To the extent our insurance companies retain underwriting risks, the results of such risk retention, including premiums received, loss and loss adjustment expenses, policy acquisition expenses, and the resulting underwriting income or loss, is reported separately in the specialty lines segment. In addition, where one of our affiliated insurers acts as an issuing carrier or "fronting" company for the policies distributed by the agency operation, the fronting fee, less the policy fees paid to the "wholesale" agency for administering such policies, will be recorded as revenues in the specialty lines segment.

In 2001, Vesta affiliated insurance carriers, acting as either issuing carrier or an intermediate reinsurer, bore the underwriting risk on approximately $10.2 million of net earned premium of the non-standard auto business. The underwriting results and related fronting fees earned on this non standard auto business is shown in the table below.

Selected Operational Ratios for Specialty Lines Segment

	2001	2000
Loss and LAE ratio	77.4%	60.2%
Underwriting expense ratio	22.8%	22.2%
Combined ratio	100.2%	82.4%

	======	=====
Fronting fees, net of expenses	$3,961	$ 977

For 2002, we generally anticipate that our affiliated insurance carriers will retain anywhere from 10% to 40% of the underwriting risk associated with the policies of the non-standard auto insurance written in this segment, resinsuring the balance to high quality reinsurers. Depending on market conditions, we may increase or decrease the amount of underwriting risk retention that our affiliated insurance companies elect to retain on this business produced by our affiliated agency. While we believe that most of our non-standard auto underwriting activities will be related to the policies produced by our agency operation, we will also continue to issue non-standard auto policies produced by non-affiliated agencies and retain underwriting risks on such policies in the normal course of our specialty lines operations.

Other: In addition, given our certificates of authority and infrastructure, we believe we are well positioned internally to provide specialty insurance for certain additional coverages. Due to external market requirements, however, we believe our opportunities to provide additional types of specialty insurance depends, in large part, on improved ratings from our various rating agencies, including A. M. Best Company.

Corporate & Other

Our corporate and other segment primarily consists of net investment income on capital, interest on all debt, Tait Advisory Services, Mound Agency, and certain overhead expenses not directly associated with a particular segment. Vesta acquired Tait Advisory Services in 2000 and has grown with offices in Birmingham, New York, Chicago, Kansas City and Louisville. Tait Advisory Services is a specialized consulting firm with experienced professionals who devise solutions to complex business problems and disputes. Founded in 1996, the firm specializes in providing financial, economic and strategic counsel to companies involved in litigation, financial challenges and management performance issues. The Mound Agency is a distributor of life insurance, annuities, long term care insurance, and other financial products. With more than 25 years of service, Mound Agency operates in 22 states.

Reserves

Our insurance subsidiaries maintain reserves to cover their estimated ultimate liability for losses with respect to reported and unreported claims incurred. To the extent that current reserves prove to be inadequate in the future, we would have to increase such reserves and incur a charge to earnings in the period such reserves are increased, which could have a material adverse effect on our results of operations and financial condition. The establishment of appropriate reserves is an inherently uncertain process, and there can be no assurance that ultimate losses will not materially exceed our estimates. Reserves are estimates involving actuarial and statistical projections at a given point in time of what we expect to be the cost of the ultimate settlement and administration of claims based on facts and circumstances then known, estimates of future trends in claims severity and other variable factors such as inflation.

Reserves are established to insure that adequate funds are available to pay all expected losses. To insure that an insurance company's investments are sufficiently liquid to pay these losses, the Illinois Department of Insurance imposes a "reserve reconciliation test" which generally requires an insurance company to maintain a certain amount of liquid, high quality assets. At December

31, 2001, Vesta Fire's qualifying assets exceeded the minimum required amount by approximately $8.8 million. See, "Investments" and "Management's Discussion and Analysis - Liquidity and Capital Resources."

Reserves for Property-Casualty Business

With respect to reported claims, reserves are established on a case-by-case basis. The reserve amounts on each reported claim are determined by taking into account the circumstances surrounding each claim and policy provision relating to the type of loss. Loss reserves are reviewed on a regular basis, and as new data becomes available, appropriate adjustments are made to reserves.

For incurred but not reported ("IBNR") losses, a variety of methods have been developed in the insurance industry for determining estimates of loss reserves. One common method of actuarial evaluation, which we use, is the loss development method. This method uses the pattern by which losses have been reported over time and assumes that each accident year's experience will develop in the same pattern as the historical loss development. We also rely on industry data to provide the basis for reserve analysis on newer lines of business (lines written less than three years).

Provisions for inflation are implicitly considered in the reserving process. Our reserves are carried at the total estimate for ultimate expected loss without any discount to reflect the time value of money.

Reserves are computed based upon actuarial principles and procedures applicable to the lines of business written by us. These reserve calculations are reviewed regularly by management, and, as required by state law, we engage an independent actuary to render opinions as to the adequacy of statutory reserves established by management. The actuarial opinions are filed with the various jurisdictions in which we are licensed. Based on our practices and procedures, management believes that reserves were adequate as of the valuation date.

The following table provides a reconciliation of beginning and ending property-casualty liability balances on a GAAP basis for the periods indicated:

	Year Ended December 31,		
	2001	2000	1999
	(in thousands)		
Gross Losses and LAE reserves at beginning of year	$ 263,689	$ 354,709	$ 504,911
Reinsurance Receivable	(170,050)	(186,559)	(206,139)
Net Losses and LAE reserves at beginning of year	93,639	168,150	298,772
Acquisitions	22,019	--	--
Increases (decreases) in provisions for losses and LAE for claims incurred:			
Current year	162,984	169,333	268,931
Prior year (1)	34,355	(5,862)	(22,167)
Losses and LAE payments for claims incurred:			
Current year	(119,668)	(120,888)	(198,503)
Prior year	(79,613)	(117,094)	(178,883)
Net Losses and LAE reserves at end of year	113,716	93,639	168,150
Reinsurance Receivable	167,281	170,050	186,559

Gross loss and LAE Reserves	$ 280,997	$ 263,689	$ 354,709
	=========	=========	=========

(1) The adverse development of $34.4 million is primarily attributable to a $30.0 million pre-tax charge taken in our discontinued lines. See Note Q to the Consolidated Financial Statements for further discussion.

9

The reconciliation between statutory basis and GAAP basis reserves for each of the three years in the period ended December 31, 2000, is shown below:

	Year Ended December 31,		
	2001	2000	1999
	(in thousands)		
Statutory reserves	$156,659	$142,116	$207,351
Retroactive Reinsurance and other amounts	(42,943)	(48,477)	(39,201)
Gross-up of amounts netted against Reinsurance recoverable	167,281	170,050	186,559
Reserves on a GAAP basis	$280,997	$263,689	$354,709

The following table shows the development of the reserves for unpaid losses and LAE from 1991 through 2001 for our insurance subsidiaries on a GAAP basis net of Reinsurance recoveries. The top line of the table shows the liabilities at the balance sheet date for each of the indicated years. This reflects the estimated amounts of losses and LAE for claims arising in that year and all prior years that are unpaid at the balance sheet date, including losses incurred but not yet reported to us. The upper portion of the table shows the cumulative amounts subsequently paid as of successive years with respect to the liability. The lower portion of the table shows the reestimated amount of the previously recorded liability based on experience as of the end of each succeeding year. The estimates change as more information becomes known about the frequency and severity of claims for individual years. A redundancy (deficiency) exists when the reestimated liability at each December 31 is less (greater) than the prior liability estimate. The "cumulative redundancy (deficiency)" depicted in the table, for any particular calendar year, represents the aggregate change in the initial estimates over all subsequent calendar years.

				Year Ended December 31,			
	1991	1992	1993	1994	1995	1996	
				(in thousands)			
Liability for unpaid losses							
and LAE	$21,919	$ 21,976	$ 29,688	$ 66,648	$118,733	$112,932	$3
Paid (cumulative) as of							
One year later	13,166	20,517	20,761	51,527	88,377	86,978	1
Two years later	17,054	20,272	28,766	65,360	116,388	114,704	2
Three years later	16,810	20,281	34,776	66,490	125,299	131,342	2

Four years later	16,622	23,272	33,139	72,273	137,081	137,926	2
Five years later	18,140	20,994	38,222	81,156	139,485	141,234	
Six years later	16,218	22,964	46,298	82,336	142,180		
Seven years later	17,922	31,006	47,185	84,953			
Eight years later	25,941	31,776	49,801				
Nine years later	26,417	33,811					
Ten years later	28,467						
Liability reestimated as of							
End of year	21,919	21,976	29,688	66,648	118,733	112,932	3
One year later	21,853	28,530	28,930	61,033	127,790	99,708	3
Two years later	19,009	27,914	34,219	66,582	110,437	144,986	3
Three years later	19,817	26,120	38,940	66,713	118,657	132,761	3
Four years later	16,470	30,435	41,517	76,863	146,090	140,775	3
Five years later	19,862	33,845	50,993	88,770	144,256	147,405	
Six years later	23,760	40,317	53,330	86,357	152,941		
Seven years later	29,574	37,953	51,482	95,278			
Eight years later	33,388	35,850	60,230				
Nine years later	30,973	44,057					
Ten years later	38,653						
Cumulative redundancy/ (deficiency)	(16,734)	(22,081)	(30,542)	(28,630)	(34,208)	(34,473)	

	2000	2001
Liability for unpaid losses and LAE	$ 93,639	$113,716
Paid (cumulative) as of		
One year later	79,613	
Two years later		
Three years later		
Four years later		
Five years later		
Six years later		
Seven years later		
Eight years later		
Nine years later		
Ten years later		
Liability reestimated as of		
End of year	93,639	113,716
One year later	127,994	
Two years later		
Three years later		
Four years later		
Five years later		
Six years later		
Seven years later		
Eight years later		
Nine years later		
Ten years later		
Cumulative redundancy/ (deficiency)	(34,355)	

We reinsured a number of casualty risks in the early 1980's which could result in claims for coverage of asbestos related and other environmental impairment liabilities to the extent that such liabilities were not excluded from the underlying policies. Our exposure to a significant loss from an asbestos or environmental claim is mitigated due to the fact that our participation in the reinsurance treaties relating to these risks is only at the higher levels and our percentage participation in those layers is relatively low. In addition, we carry reinsurance which would mitigate the effect of any losses under these treaties. While there exists a possibility that we could suffer material loss in the event of a high number of large losses under these treaties, this is unlikely in management's judgment.

Life Insurance Reserves

Policy liabilities: Reserves for traditional life contracts are generally calculated using the net level premium method, based on assumptions as to mortality, withdrawals, dividends, and investment yields ranging from 2.5% to 6.5%. These assumptions are generally made at the time the contract is issued or at the purchase date. These assumptions are based on projections from past experience, making allowance for possible unfavorable deviation.

Our reserves for investment-type contracts are based either on the contract account balance (if future benefit payments in excess of the account balance are not guaranteed) or on the present value of future benefit payments (if such payments are guaranteed).

Investments

Our consolidated investment portfolio consists primarily of investment grade fixed income securities. Our portfolio is managed subject to investment policies and guidelines established by management and the Board of Directors. Our cash and investments at December 31, 2001, totaled approximately $1.1 billion:

Type of Investment	Amount at which Shown on Balance Sheet	% of Portfolio
	(in thousands)	
Cash and short-term investments	$ 64,777	6.1%
Fixed maturity portfolio	807,197	76.2%
Equity securities	31,431	3.0%
Mortgage and collateral loans	43,978	4.2%
Policy loans	63,949	6.0%
Other invested assets	47,996	4.5%
Total	$1,059,328	100.0%

The value of the fixed maturities portfolio, classified by category, as of December 31, 2001, was as follows:

	Amortized Cost	Fair Value
	(in thousands)	
United States Government	$ 76,161	$ 79,561
Asset-backed securities	372,396	382,982
Corporate	305,820	312,346
Municipals	30,672	32,308
Total	$785,049	$807,197

The National Association of Insurance Commissioners ("NAIC") has a bond rating system that assigns securities to classes called "NAIC designations" that are used by insurers when preparing their annual statutory financial statements. The NAIC assigns designations to publicly-traded as well as privately-placed securities. The designations assigned by the NAIC range from class 1 to class 6, with a rating in class 1 being of the highest quality. We invest our fixed maturities portfolio primarily in class 1 or 2 securities as rated by the NAIC, which are considered investment grade. The maturity and duration of our portfolio are managed to match the maturity and duration of the underlying life insurance and property-casualty reserves.

Regulation

General. Our insurance companies are subject to regulation by governmental agencies in the states in which they do business. The nature and extent of such regulation varies by jurisdiction, but typically involves prior approval of the acquisition of control of an insurance company or of any company controlling an insurance company, regulation of certain transactions entered into by an insurance company with any of its affiliates, approval of premium rates for many lines of insurance, standards of solvency and minimum amounts of capital and surplus which must be maintained, limitations on types and amounts of investments, restrictions on the size of risks which may be insured by a single company, licensing of insurers and agents, deposits of securities for the benefit of policyholders, and reports with respect to financial condition and other matters. In addition, state regulatory examiners perform periodic examinations of insurance companies. Such regulation is generally intended for the protection of policyholders rather than security holders.

In addition to the regulatory supervision of our insurance subsidiaries, we are also subject to regulation under the Illinois, Hawaii and Texas Insurance Holding Company System Regulatory Acts. These Holding Company Acts contain certain reporting requirements including those requiring us (or Vesta), as the ultimate parent company, to file information relating to our capital structure, ownership, and financial condition and general business operations of our insurance subsidiaries. These Holding Company Acts contain special reporting and prior approval requirements with respect to transactions among affiliates. The Illinois Holding Company Act is generally the most significant to us since it governs our relationship with Vesta Fire, our principal insurance subsidiary.

The federal government does not directly regulate the insurance business. However, federal legislation and administrative policies in several areas, including pension regulation, privacy regulation, age and sex discrimination, financial services regulation and federal taxation, do affect the insurance business. Legislation has been introduced from time to time in recent years which, if enacted, could result in the federal government assuming a more direct role in the regulation of the insurance industry.

State insurance regulators and the NAIC periodically re-examine existing laws and regulations and their application to insurance companies. In recent years, the NAIC has approved and recommended to the states for adoption and implementation, several regulatory initiatives designed to decrease the risk of insolvency of insurance companies. These initiatives include risk-based capital requirements for determining the levels of capital and surplus an insurer must maintain in relation to its insurance and investment risks. Other NAIC regulatory initiatives impose restrictions on an insurance company's ability to pay dividends to its stockholders. These initiatives may be adopted by the various states in which our subsidiaries are licensed; the ultimate content and timing of any statutes and regulations adopted by the states cannot be determined at this time. It is not possible to predict the future impact of changing state and federal regulation on our operations, and there can be no assurance that existing insurance related laws and regulations will not become more restrictive in the future or that laws and regulations enacted in the future will not be more restrictive.

Risk-based Capital: The NAIC's risk-based capital requirements are intended to be used as an early warning tool to help insurance regulators identify deteriorating or weakly capitalized companies in order to initiate regulatory action. Such requirements are not intended as a mechanism for ranking adequately capitalized companies. The formula defines a minimum capital standard which supplements the low, fixed minimum capital and surplus requirements previously implemented on a state-by-state basis.

The NAIC risk-based capital requirements require insurance companies to calculate and report information under a risk-based formula which attempts to measure statutory capital and surplus needs based on the risks in a company's mix of products and investment portfolio. The formula is designed to allow state insurance regulators to identify potential weakly capitalized companies. Under the formula, a company determines its "risk-based capital" by taking into account certain risks related to the insurer's assets (including risks related to its investment portfolio and ceded Reinsurance) and the insurer's liabilities (including underwriting risks related to the nature and experience of its insurance business). Risk-based capital rules provide for different levels of regulatory attention depending on the ratio of a company's total adjusted capital to its "authorized control level" of risk-based capital.

At December 31, 2001, the total adjusted risk-based capital as a percentage of authorized control level were as follows for our principal insurance subsidiaries:

Vesta Fire Insurance Corporation	550%
American Founders Life Insurance Company	561%

Restrictions on Dividends to Stockholders and Transactions between Affiliates: Transactions between Vesta and its insurance subsidiaries, including the payment of dividends and management fees to Vesta by such subsidiaries, are subject to certain limitations under the insurance laws of those subsidiaries' domiciliary states. The insurance laws of the state of Illinois, where Vesta Fire is domiciled, permit the payment of dividends out of earned surplus in any year which, together with other dividends or distributions made within the preceding 12 months, do not exceed the greater of 10% of statutory surplus as of the end of the preceding year or the net income for the preceding year, with larger dividends payable only after receipt of prior regulatory approval. On October 29, 2001, the Illinois Insurance Department published a Company Bulletin that indicates that the Department interprets these dividend limitations to prohibit the payment of dividends if the insurer has negative or zero "unassigned funds" at the end of the prior year, as reported on its statutorily required annual statement. Our lead insurance subsidiary, Vesta Fire, reported negative "unassigned funds" on its annual statement for 2001. Accordingly, we may not be able to declare and pay a dividend from our lead insurance company subsidiary for the foreseeable future without prior approval.

IRIS Ratios. The NAIC has developed its Insurance Regulatory Information System ("IRIS") to assist state insurance departments in identifying significant changes in the operations of an insurance company, such as changes in its product mix, large Reinsurance transactions, increases or decreases in premiums received and certain other changes in operations. Such changes may not result from any problems with an insurance company but merely indicate changes in certain ratios outside ranges defined as normal by the NAIC. When an insurance company has four or more ratios falling outside "normal ranges," state regulators may investigate to determine the reasons for the variance and whether corrective action is warranted. In 2001, Vesta Fire had 4 ratios which varied unfavorably from the "usual value" range and American Founders had 1 ratio which varied unfavorably from the "usual value" range.

A.M. Best Rating

A.M. Best, which rates insurance companies based upon factors of concern to policyholders, rates our property-casualty insurance subsidiaries a "B+" (Very Good, in the Secure Rating Category). In addition, A.M. Best also rates our lead life insurance subsidiary, American Founders Life, "B+".

Our standard property-casualty business is sensitive to A.M. Best ratings, which is subject to a host of uncertainties and risk factors more fully discussed in Exhibit 99.1 to this report.

Competition

Direct writers are making a strong push in the personal lines arena. These companies compete almost exclusively based on price. While there is a segment of the population that is driven exclusively by price, we believe that many consumers desire the advice and counsel of a professional agent. We have developed a business strategy which focuses on this segment of the market. Accordingly, our relationships with our independent agents is perhaps the most important component of our current competitive profile. In order to develop and retain the independent agents loyalty, we have reaffirmed our commitment to the independent agency distribution by providing innovative solutions to their daily business issues, as well as, responding to the agency's needs as quickly as possible.

The property and casualty insurance industry is highly competitive on the basis of both price and service. We compete for direct business with other stock companies, specialty insurance organizations, mutual insurance companies and other underwriting organizations, some of which are substantially larger and have greater financial resources than we have. In recent years, there has been a trend in the property and casualty industry toward consolidation which could result in even more competitive pricing. In the future, the industry, including us, may face increasing insurance underwriting competition from banks and other financial institutions.

Employees

As of March 5, 2002, we employed 1,650 persons. Our employees are neither represented by labor unions nor are they subject to any collective bargaining agreements. Management knows of no current efforts to establish labor unions or collective bargaining agreements.

Item 2. Properties

Properties

We lease approximately 115,000 square feet for our home office at 3760 River Run Drive, Birmingham, Alabama under a long-term operating lease. For our life and health insurance businesses, we lease approximately 25,000 square feet for our life insurance operations in Phoenix, Arizona, and approximately 13,000 square feet in Dallas, Texas under long-term operating leases.

We consider the office facilities to be suitable and adequate for our current and anticipated level of operations.

Item 3. Legal Proceedings

Securities Litigation

On October 26, 2001, Vesta executed a definitive agreement to settle the securities litigation that had been pending since June 1998 against Vesta and certain current and former officers and directors. On December 10, 2001, the Court approved settlement of the consolidated class action securities litigation in U.S. District Court in Alabama as to Vesta and its officers and directors for a total of $61 million in cash. A related derivative action lawsuit in the Circuit Court of Jefferson County, Alabama was also dismissed with prejudice. Vesta funded $21.0 million towards the settlement and the Company's excess directors and officers liability carriers funded the remaining $40.0 million. Vesta used its line of credit to finance its portion of the settlement and recorded a pre-tax one-time charge of approximately $25 million against earnings to cover Vesta's contribution to the settlement and other expenses incurred. We have now filed a claim with two of our upper level excess D & O insurers for their part of the settlement and related expenses. We have recorded a receivable of $5.4 million, which represents the amount currently due from those two excess D&O insurers

Vesta determined to participate in the funding of the settlement and to take the related one-time charge against earnings as a result of the Cincinnati Insurance Company's attempted rescission of their $25 million directors and officers liability policy and denial of coverage. Vesta has sued Cincinnati in Alabama state court alleging that its actions were taken in bad faith and is vigorously pursuing that claim. The Cincinnati case is scheduled for trial in August 2002.

Indemnification Agreements and Liability Insurance

Pursuant to Delaware law and our by-laws, we are obligated to indemnify our current and former officers and directors for certain liabilities arising from their employment with or services to Vesta, provided that their conduct complied with certain requirements. Pursuant to these obligations, we have been advancing costs of defense and other expenses on behalf of certain current and former officers and directors, subject to an undertaking from such individuals to repay any amounts advanced in the event a court determines that they are not entitled to indemnification.

Arbitration

As discussed in previous SEC filings, we corrected our accounting for assumed reinsurance business through restatement of our previously issued financial statements. Similar corrections were made on a statutory accounting basis through recording cumulative adjustments in Vesta Fire's 1997 statutory financial statements. The impact of this correction has been reflected in amounts ceded under our 20 percent whole account quota share treaty which was terminated on June 30, 1998 on a run-off basis. We believe such treatment is appropriate under the terms of this treaty and have calculated the quarterly reinsurance billings presented to the three treaty participants accordingly. The aggregate amount included herein as recoverable from such reinsurers totaled $55.9 million at December 31, 2001. Additionally we have previously collected approximately $48.5 million from the drawdown of collateral on hand.

NRMA Insurance Ltd. ("NRMA"), one of the participants in the 20% whole account quota share treaty, filed a lawsuit in the United States District Court for the Northern District of Alabama contesting our billings. NRMA sought recession of the treaty and a temporary restraining order preventing us from drawing down approximately $34.5 of collateral. We filed a demand for arbitration as provided for in the treaty and also filed a motion to compel arbitration which was granted in the United States District action. Vesta reached an agreement with NRMA to collect the $34.5 million of collateral in exchange for posting a $25 million letter of credit in favor of NRMA to fund any amounts NRMA may recover as a result of the arbitration. We filed for arbitration against the other two participants on the treaty and all those arbitrations are in their document discovery stages. While management believes its interpretation of the treaty's terms and computations based thereon are correct, these matters are in arbitration and their ultimate outcome cannot be determined at this time.

During 1999, F&G Re (on behalf of USF&G), filed for arbitration under two aggregate stop loss reinsurance treaties whereby F&G Re assumed certain risk from the Vesta. F&G Re is seeking to cancel the treaties and avoid its obligation. Based on the terms of the two treaties, Vesta will be entitled to recoveries of approximately $30.0 million as losses from prior accident years mature. Vesta has recorded a reinsurance recoverable of $30.0 million at December 31, 2001 related to these two treaties. The hearing in this arbitration began on February 11, 2002. The hearing was adjourned on February 15, 2002 and rescheduled to resume on June 11, 2002. While management believes that USF&G is not entitled to recession, the ultimate outcome cannot be determined at this time.

We are in arbitration with CIGNA Property and Casualty Insurance Company (now ACE USA) under a personal lines insurance quota share reinsurance agreement, whereby we assumed certain risks from CIGNA. During September 2000, CIGNA filed for arbitration under the reinsurance agreement, seeking payment of the balances that CIGNA claims are due under the terms of the treaty. In addition, during the fourth quarter, the treaty was terminated on a cut-off basis. Vesta is seeking recoupment of all improper claims payments and excessive expense allocations and charges from CIGNA. The arbitration was bifurcated into two phases with phase one concentrating on the interpretation of the intent of the parties related to the expense reimbursement provisions of the treaty at the time it was entered and phase two related to any issues between the parties after the Company conducts an audit of expenses related to the treaty. The phase one hearing was held in February 2002 and the panel ruled that (i) the Company is responsible for the payment of ceding commissions provided for in the treaty and should pay any outstanding billings for commissions, and paid claims plus interest; and (ii) the Company may proceed with an audit of expenses ceded to the treaty and (iii) the parties should identify any further issues to be brought before the arbitration panel for phase two of the hearing.

If the amounts recoverable under the relevant treaties are ultimately determined to be materially less than the amounts that we have reported as recoverable, we may incur a significant, material, and adverse impact on our financial condition and results of operations.

Other Litigation

On January 14, 2002, the Company's subsidiary, American Founders, was notified of a lawsuit naming it as a defendant and brought by a creditor of the former parent of the subsidiary. This lawsuit (subsequently identified as the Blitz lawsuit) alleges, among other things, that American Founders redeemed its Series A and Series C preferred stock issues at less than "reasonably equivalent value". American Founders believes that the allegations brought against it in this lawsuit are without merit and intends to mount a vigorous defense in this action. In the opinion of management, resolution of the Blitz lawsuit is not expected to have a material adverse effect on the financial position of the Company. However, depending on the amount and timing, an unfavorable resolution of this matter could materially affect American Founders' future operations or cash flows in a particular period.

Vesta, through its subsidiaries, is routinely a party to pending or threatened legal proceedings and arbitration relating to the regular conduct of its insurance business. These proceedings involve alleged breaches of contract, torts, including bad faith and fraud claims and miscellaneous other specified relief. Based upon information presently available, and in light of legal and other defenses available to Vesta and its subsidiaries, management does not consider liability from any threatened or pending litigation regarding routine matters to be material.

Item 4. Submission of Matters to a Vote of Security Holders

None.

14

PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matter

Price Range of Common Stock and Dividend Policy

Market Prices. Our common stock trades on the New York Stock Exchange under the symbol "VTA."

Quarterly high and low market prices of our common stock in 2001 and 2000 were as follows:

Quarter Ended	High	Low
2001		
March 31	$ 8.39	$ 4.50
June 30	10.95	6.00
September 30	13.40	9.00
December 31	13.05	5.72
2000		
March 31	$ 6.81	$ 3.88
June 30	7.06	4.56
September 30	6.75	4.56
December 31	5.56	4.50

Dividend Policy and History. The declaration and payment of dividends will be at the discretion of our Board of Directors and will depend upon many factors, including our financial condition and earnings, the capital requirements of our operating subsidiaries, legal requirements and regulatory constraints.

The dividends we paid on our common stock for the past three years were as follows (in thousands):

Quarter Ended	2001	2000	1999
March 31	$ 239	$ 235	$ 698
June 30	617	235	-0-
September 30	872	235	-0-
December 31	879	235	-0-

Illinois, Hawaii and Texas impose restrictions on the payment of dividends to us by our insurance subsidiaries under their regulatory authority in excess of certain amounts without prior regulatory approval. See, "Business--Regulation--Restrictions on Dividends to Stockholders."

Item 6. Selected Financial Data

The following information should be read in conjunction with Vesta's Consolidated Financial Statements and related notes reported elsewhere in this Form 10-K.

		Year Ende	
	2001	2000	19
		(in thousands, exc	
Statement of Operations Data *			
Net premiums written	$ 306,323	$ 210,742	$ 22
Net premiums earned	286,804	216,999	24
Net Investment Income	63,918	45,903	2
Policy fees	7,674	4,386	
Realized gains (losses)	(1,172)	(2,061)	1
Other	16,420	903	
Total revenues	373,644	266,130	29
Policyholder benefits, losses and LAE incurred	205,546	135,042	16
Policy acquisition and other operating expenses	134,441	96,798	8
Litigation settlement charge	25,000	--	
Loss on asset impairment	--	--	
Goodwill and other intangible amortization	3,394	1,591	
Interest on debt	17,565	15,105	1
Total expenses	385,946	248,536	26
Income (loss) from continuing operations before taxes, minority interest,and deferrable capital securities	(12,302)	17,594	2
Income taxes (benefit)	(4,490)	5,664	
Minority interest, net of tax	1,076	1,595	
Deferrable capital securities distributions, net of tax	1,394	1,986	
Income (loss) from continuing operations	$ (10,282)	$ 8,349	$ 1
Income(loss)from discontinued operations, net of tax	(19,958)	(2,397)	1
Extraordinary gain on debt extinguishments, net of tax	910	5,250	
Preferred stock dividend	(163)	(3,670)	
Gain on redemption of preferred securities, net of tax	7,068	9,190	
Net income (loss) available to common stockholders	$ (22,425)	$ 16,722	$ 3
Diluted net income (loss) from continuing operations per share	(.46)	0.34	
Diluted net income (loss) from discontinued operations per share	(0.75)	(0.10)	
Diluted net income (loss) available to common shareholders per share	(0.84)	0.78	
Shares used in per share calculation	26,652	24,255	2
Cash dividends per share	0.09	0.05	

Balance Sheet Data (at end of period)			
Total investments and cash	$1,059,328	$1,019,266	$ 48
Total assets	1,830,882	1,621,999	91
Reserves for losses, LAE & future policy benefits	976,167	923,973	35
Long term debt	79,432	86,419	14
Federal Home Loan Bank advances	168,614	150,691	
Total liabilities	1,548,325	1,373,663	67
Deferrable capital securities	23,250	33,225	4
Stockholders' equity	259,307	215,111	20
Other Data			
SAP (1)			
Surplus	$ 235,935	$ 275,270	$ 27
	==========	==========	====

* As a result of Vesta's decision in 2000 to discontinue its reinsurance assumed business, and its decision in 1999 to discontinue its commercial lines segment, all periods presented have been reclassified to present operations on a continuing and discontinued basis.

(1) Statutory data have been derived from the financial statements of Vesta Fire Insurance Corporation, prepared in accordance with statutory accounting principles and filed with insurance regulatory authorities.

16

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

Vesta writes insurance on selected personal lines risks only. Our standard property-casualty writings are balanced between risks of property damage (faster determination of ultimate loss but is highly unpredictable) and casualty exposure (more predictable but takes longer to determine the ultimate loss). We also write life and annuity business, and accident and health insurance business. Additionally, we are actively involved in the writing of insurance on our polices for the benefit of non-affiliated reinsurance companies, commonly referred to as servicing carrier or fronting, which generates fee-for-service income.

Our revenues from operations are derived primarily from net premiums earned on risks written by our insurance subsidiaries, investment income and investment gains or losses. Our expenses consist primarily of payments for claims and underwriting expenses, including agents' commissions and operating expenses.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Vesta's accounting policies are critical to understanding the results of operations as reported in the consolidated financial statements. Significant accounting policies utilized by Vesta are discussed in more detail in the notes to the consolidated financial statements beginning on page 28.

Certain of these policies are considered to be important to the analysis of the Company's financial condition, since they require management to make difficult, complex or subjective judgments, some of which may relate to matters that are inherently uncertain. The following describes the more complex policies involving a significant amount of management judgments about the valuation and the application of complex accounting standards and interpretations.

Loss and loss adjustment expenses: Vesta has recorded liabilities for loss and loss adjustment expenses of $281.0 million at December 31, 2001. Vesta maintains property-casualty loss reserves to cover the estimated ultimate unpaid liability for losses and loss adjustment expenses with respect to reported and unreported claims incurred. Reserves do not represent an exact calculation of the ultimate liability, but instead represent estimates, generally utilizing actuarial projection techniques. These reserve estimates are expectations of what the ultimate settlement and administration of claims will cost based on an assessment of facts and circumstances then known, review of historical settlement patterns, estimates of trends in claims severity and frequency, estimates of reinsurance recoverables, estimates of salvage and subrogation and other factors. Vesta believes its liability for loss and loss adjustment expenses is adequate, however given the inherent uncertainty in reserve estimates, there can be no assurance that the ultimate amount of actual losses will not exceed the related amounts currently estimated. Furthermore, any such differences, either positive or negative, could have a material effect on our results of operations and could be material to our financial position.

Policy Liabilities: Vesta has recorded liabilities for life and accident and health reserves of $695.2 million at December 31, 2001. The reserves have been computed based upon mortality, morbidity, persistency and interest rate assumptions applicable to these coverages, including provisions for adverse deviation. These assumptions consider past experience and industry standards and may be revised if it is determined that future experience will differ substantially from that previously assumed.

Collectibility of reinsurance recoverables: Vesta has recorded amounts recoverable from reinsurers on paid losses of $76.7 million at December 31, 2001. These recoverables are based on management's interpretation of reinsurance ceded contracts and the financial viability of the reinsurer. If the amounts recoverable under the reinsurance contracts are determined to be materially less than the amounts recorded, we may incur a material, adverse impact on our financial condition and results of operations. For further discussion of reinsurance recoverables and other amounts subject to estimation due to arbitrations with our reinsurers, see Note F to the Consolidated Financial Statements.

Recoverability of other assets: Vesta has recorded amounts recoverable from other assets of $208.5 million at December 31, 2001, including deferred acquisition costs, deferred tax assets, and goodwill and other intangible assets. The methodologies and assumptions for determining the carrying value of these assets involve significant judgments made by management.

Deferred acquisition costs represent the costs of acquiring new business, principally commissions, certain underwriting and agency expenses, and the cost of issuing policies. These costs are generally amortized over the life of the insurance contract or at a constant rate based upon the present value of estimated gross profits. Management periodically reviews these costs to determine their recoverability.

Deferred tax assets are recorded for the future tax consequences of events that have been recognized in the financial statements or tax returns, based upon enacted tax laws and rates. The deferred tax asset recorded at December 31, 2001 of $38.6 million primarily consists of net operating loss carryforwards. Deferred tax assets are recognized subject to management's judgment that realization is more likely than not. The recoverability of the recorded deferred tax asset is contingent upon the generation of enough future taxable income to provide use of the net operating loss carryforward.

Goodwill and other intangible assets are recorded on business combinations to the extent the purchase price exceeds the fair value of tangible assets acquired and liabilities assumed. Fair values of assets and liabilities assumed in a business combination are generally based on quoted market prices, however if such prices are not available, management utilizes other methods such as pricing models. The recoverability of the goodwill and other intangible assets recorded at December 31, 2001 is contingent upon the future performance of the related acquisitions and segments in which it is assigned.

Fair value estimates: A significant amount of our recorded assets and liabilities are reported at fair value (and to a lesser extent at the lower of historical cost or fair value) including available for sale securities, equity securities, mortgage loans and collateral loans. Fair value is generally based on quoted market prices, however if such prices are not available, management utilizes other methods such as pricing models. The fair value estimate derived from pricing models may be different from the actual realized amount. Our valuation process is subjected to continuous management oversight and review. This review includes monitoring the credit quality of our invested assets and the adequacy of any underlying collateral.

Comparison of Fiscal Year 2001 to Fiscal Year 2000

Income available to common shareholders decreased by $39.1 million, to a loss of $22.4 million for the year ended December 31, 2001, from income of $16.7 million for the year ended December 31, 2000. On a diluted per share basis, income available to common shareholders for 2001 was a loss of $0.84 per share versus income of $.78 per share for 2000. The decrease in income available to common shareholders is primarily attributable to an after-tax discontinued operations charge of $20.0 million in 2001 versus an after-tax discontinued operations expense of $2.4 million in 2000 and the recognition of a $16.3 million after-tax charge for the settlement of our securities class action lawsuit in 2001.

Standard Property-Casualty

Net premiums written for standard property-casualty lines increased by $58.5 million, or 28.5%, to $264.0 million for the year ended December 31, 2001, from $205.5 million for the year ended December 31, 2000. Net premiums earned for standard property-casualty lines increased $33.3 million, or 15.6% to $246.1 million for the year ended December 31, 2001, from $212.8 million for the year ended December 31, 2000. The increase in net premiums written and net premiums earned is primarily attributable to the acquisition of Florida Select Insurance Holdings, Inc. on April 1, 2001.

Loss and loss adjustment expenses ("LAE") for standard property-casualty lines increased by $36.8 million, or 29.5%, to $161.6 million for the year ended December 31, 2001, from $124.8 million for the year ended December 31, 2000. The loss and LAE ratio for property-casualty lines for the year ended December 31, 2001 was 64.7% as compared to 58.6% at December 31, 2000. The increase in loss and LAE incurred is primarily attributable to the increase in earned premium. The increase in the loss and LAE ratio is primarily attributable to deterioration in our Homeowners book, uninsured motorist coverage in Pennsylvania and a $1.4 million net loss on Tropical Storm Gabrielle.

Policy acquisition expenses increased by $2.4 million, or 4.6% to $54.8 million for the year ended December 31, 2001, from $52.4 million for the year ended December 31, 2000 primarily due to an increase in earned premium, partially offset by a decrease in contingent commissions owed on profitable business. Operating expenses increased by $5.8 million or 21.8% to $32.4 million primarily due to increased costs incurred by Florida Select after our acquisition.

Life and Health Insurance

In June, 2000, we entered the life and annuity business through a 71% investment in American Founders Financial Corporation, a holding company for two life insurance companies domiciled in Texas and we entered the health insurance business through the acquisition of Aegis Financial Corporation, a holding company for two life and health insurance companies domiciled in Texas, in December, 2000. American Founders and Aegis have approximately $2.5 billion (face value) of life and annuity products in force and $22.9 million of health insurance premiums in force at December 31, 2001. Life insurance premiums and policy fees were $14.1 million for the year ended December 31, 2001 compared to $5.3 million for the comparable prior period primarily due to the acquisition of Aegis in December 2000 and Washington Life in August 2001 and the inclusion of American Founders for a full year in 2001 versus six months in 2000. Health insurance premiums totaled $20.5 million for the year ended December 31, 2001 versus zero for the comparable prior period. Health insurance benefits incurred totaled $14.0 million for the year ended December 31, 2001 and health insurance commission expense was $6.3 million.

Specialty Lines

Net premiums written for specialty lines increased by $9.6 million, to $11.8 million for the year ended December 31, 2001, from $2.2 million for the year ended December 31, 2000. Net premiums earned for specialty lines increased $9.1 million to $10.2 million for the year ended December 31, 2001, from $1.1 million for the year ended December 31, 2000. The increase in net premiums written and net premiums earned is primarily attributable a full year's worth of activity in this segment versus four months of activity in 2000 and an increase in retained risk in certain programs.

Loss and loss adjustment expenses ("LAE") for specialty lines increased by $7.3 million to $8.0 million for the year ended December 31, 2001, from $.7 million for the year ended December 31, 2000. The loss and LAE ratio for specialty lines for the year ended December 31, 2001 was 77.4% as compared to 60.2% at December 31, 2000. The increase in loss and LAE incurred is primarily attributable to the increase in earned premium. The increase in the loss and LAE ratio is primarily attributable to increased losses from our California program.

Policy acquisition expenses increased by $2.1 million consistent with the increase in earned premium. For the year ended December 31, 2001, we earned approximately $4.2 million of fronting fees compared to $1.0 million for the year ended December 31, 2000 primarily attributable to a full year's worth of activity in this segment versus four months of activity in 2000.

Non Standard Auto Agency

The principal operating subsidiary of our non standard auto agency segment is Instant Auto. Its principal revenue stream is agents' fees and commissions. In the 4th quarter of 2001, Instant Auto completed the acquisition of A-Affordable Insurance Agency and Spacecoast Agency in Florida. In the 4th quarter, A-Affordable added $2.3 million of fees and commissions and Spacecoast recognized $2.4 million of fees and commissions. These acquisitions helped Instant Auto increase their fees and commissions for the year to $5.9 million and helped the non standard auto agency segment improve is pre-tax income to approximately breakeven in the 4th quarter from an approximate $1.0 million quarterly pre-tax loss in prior quarters. We expect continued improvement in revenue and profitability in 2002 as we integrate and consolidate these two acquisitions and the additional acquisitions that we have completed in the 1st quarter of 2002.

Discontinued Operations

We discontinued our reinsurance assumed business and our commercial lines business in 2000 and 1999, respectively. Each was discontinued by non-renewal, however we remain obligated to settle claims on coverages provided prior to such non-renewal. We estimated the reserves required to fulfill these obligations at the dates of discontinuance and we continue to monitor these estimates with respect to ultimate settlement. As a result of an unexpected increase in the severity and volume of reported claims associated with both our commercial and assumed reinsurance lines and an increase in payments on claim reserves during 2001, we increased our expected losses from discontinued operations by approximately $19.5 million, net of tax. The increase in our expected losses with respect to our commercial business related to a variety of underlying coverages including general liability. These types of claims may take many years to fully develop and we must continue to monitor trends in their ultmate developments. Similarly, we experienced negative development in some of our assumed reinsurance contracts, principally related to certain homeowner coverages. These types of claims should fully develop over a comparatively shorter period of time. While we believe that the recorded reserves for discontinued operations at December 31, 2001 are adequate, further adjustments to our estimates could be necessary as we continue to run off the remaining outstanding claims.

Net Investment Income

Net investment income increased by $18.0 million, or 39.2%, to $63.9 million for the year ended December 31, 2001, from $45.9 million for the year ended December 31, 2000. The weighted average yield on invested assets (excluding realized and unrealized gains) was 6.25% for the year ended December 31, 2001, compared with 6.7% for the year ended December 31, 2000. The increase in investment income is primarily attributable to an increase in average invested assets from the American Founders acquisition and a decrease in investment yield resulting from a overall decrease in interest rates.

Income Taxes

Income taxes decreased by $10.2 million, to a $4.5 million benefit for the year ended December 31, 2001. The effective rate on pre-tax income increased to 35% for the year ended December 31, 2001 versus 32.2% for the year ended December 31, 2000 due to lower tax exempt investment income and increased state income taxes in 2001 versus 2000.

Other

There were a number of additional items that materially affected our results for 2001. In October, we settled our securities class action litigation for $61.0 million in cash plus expenses. In conjunction with this, the Company recorded a $25.0 million pre-tax charge. This charge is included in operating expenses in the Corporate and other segment.

Comparison of Fiscal Year 2000 to Fiscal Year 1999

Income available to common shareholders decreased by $15.7 million, or 48.4% to $16.7 million for the year ended December 31, 2000, from $32.4 million for the year ended December 31, 1999. On a diluted per share basis, income available to common shareholders for 2000 was $0.78 per share versus income of $1.63 per share for 1999. The decrease in income available to common shareholder is primarily attributable to $8.3 million of after tax realized gains recognized during 1999 and the recognition of a $1.1 million after tax loss from the sale of a building in Shelby, Ohio in 2000. Also, in the fourth quarter of 2000, our last active reinsurance assumed contract was cancelled and we are presenting its reinsurance assumed segment as a discontinued operation. In 1999, our discontinued operations, which include the former commercial and reinsurance assumed segments, reported net income of $12.7 million compared to a loss of $2.4 million in 2000. The 1999 results for our discontinued operations included a $15 million pre-tax gain related to the sale of the bulk of our reinsurance assumed operations.

Standard Property-Casualty

Net premiums written for standard property-casualty lines decreased by $22.4 million, or 9.8%, to $205.4 million for the year ended December 31, 2000, from $227.8 million for the year ended December 31, 1999. Net premiums earned for standard property-casualty lines decreased $35.3 million, or 14.2% to $ 212.8 million for the year ended December 31, 2000, from $248.1 million for the year ended December 31, 1999. The decrease in net premiums written and net premiums earned are primarily attributable to the decrease in new policy applications that occurred when we were temporarily downgraded by A.M. Best to a B (good) and to our strategy of only maintaining relationships with our core agencies, partially offset by the continued rollover of the Property Plus homeowners policies acquired in 1998. In February 2000, A.M. Best upgraded Vesta to B+ (secure).

Loss and loss adjustment expenses ("LAE") for standard property-casualty lines decreased by $40.2 million, or 24.4%, to $124.8 million for the year ended December 31, 2000, from $165.0 million for the year ended December 31, 1999. The loss and LAE ratio for property-casualty lines for the year ended December 31, 2000 was 58.6% as compared to 66.5% at December 31, 1999. The decrease in loss and LAE incurred is primarily attributable to the decline in earned premium. The decrease in the loss and LAE ratio is primarily attributable to a decrease in catastrophe losses in the current versus the prior year and to the recognition of increased estimated salvage and subrogation from prior years.

Policy acquisition expenses increased by $6.1 million, or 13.2 % to $52.4 million for the year ended December 31, 2000, from $46.3 million for the year ended December 31, 1999 primarily due to an increase in contingent commissions owed on profitable business and the additional premium earned on our Property Plus book of business, which pays a higher commission than our other books of business. Operating expenses decreased by $2.2 million or 7.6% to $26.6 million as we continued our efforts to control costs.

Life Insurance

On June 30, 2000, we entered the life and annuity business through an investment in American Founders Financial Corporation, a holding company for two life insurance companies domiciled in Texas. American Founders has approximately $1.8 billion (face value) of life products in force and approximately $339 million of annuity deposits as of December 31, 2000. Premiums and policy fees were $5.3 million for the year ended December 31, 2000 compared to zero for the comparable prior period due to the acquisition of American Founders on June 30, 2000. American Founders has approximately $2.1 billion face amount of life insurance and annuities in force at December 31, 2000.

Specialty Lines

Net premiums written for specialty lines were $2.2 million for the year ended December 31, 2000. Net premiums earned for specialty lines were $1.1million for the year ended December 31, 2000. For the year ended December 31, 2000, we earned approximately $1.0 million of fronting fees.

Net Investment Income

Net investment income increased by $20.0 million, or 77.2%, to $45.9 million for the year ended December 31, 2000, from $25.9 million for the year ended December 31, 1999. The weighted average yield on invested assets (excluding realized and unrealized gains) was 6.7% for the year ended December 31, 2000, compared with 6.5% for the year ended December 31, 1999. The increase in investment income is primarily attributable to an increase in average invested assets from the American Founders acquisition and an increased investment yield resulting from a lower percentage of tax-exempt securities in the current portfolio.

Income Taxes

Income taxes decreased by $1.4 million, or 19.7%, to $5.7 million for the year ended December 31, 2000. The effective rate on pre-tax income increased to 32.2% for the year ended December 31, 2000 versus 30.3% for the year ended December 31, 1999 due to lower tax exempt investment income in 2000 versus 1999.

Liquidity and Capital Resources

Vesta is a holding company whose principal asset is its investment in the capital stock of the companies constituting the Vesta Insurance Group, a group of wholly owned insurance companies including Vesta Fire Insurance Corporation and a majority ownership in a life insurance holding company which includes American Founders Life Insurance Company and a majority ownership in Instant Insurance Holdings, Inc. The insurance subsidiaries comprising the Vesta Group are individually supervised by various state insurance regulators, but given our organizational structure, Vesta Fire is our only operating subsidiary that can pay dividends directly to our holding company. Vesta Fire is an Illinois domestic insurance company.

Dividends and Management Fees

The principal uses of funds at the holding company level are to pay operating expenses, principal and interest on outstanding indebtedness and deferrable capital securities and dividends to stockholders if declared by the Board of Directors. During the last three years, our insurance subsidiaries have produced operating results and paid management fees and dividends sufficient to fund our needs. As a holding company with no other business operations, we rely primarily on fees generated by our management agreement with our insurance subsidiaries and dividend payments from Vesta Fire to meet our cash requirements (including our debt service) and to pay dividends to our stockholders.

Transactions between Vesta and its insurance subsidiaries, including the payment of dividends and management fees to Vesta by such subsidiaries, are subject to certain limitations under the insurance laws of those subsidiaries' domiciliary states. The insurance laws of the state of Illinois, where Vesta Fire is domiciled, permit the payment of dividends out of earned surplus in any year which, together with other dividends or distributions made within the preceding 12 months, do not exceed the greater of 10% of statutory surplus as of the end of the preceding year or the net income for the preceding year, with larger dividends payable only after receipt of prior regulatory approval. On October 29, 2001, the Illinois Insurance Department published a Company Bulletin that indicates that the Department interprets these dividend limitations to prohibit the payment of dividends if the insurer has negative or zero "unassigned funds" at the end of the prior year, as reported on its statutorily required annual statement. Our lead insurance subsidiary, Vesta Fire, reported negative "unassigned funds" on its annual statement for 2001. Accordingly, we may not be able to declare and pay a dividend from our lead insurance company subsidiary for the foreseeable future without prior approval.

We believe that the Illinois Insurance Department's willingness to approve the payment of a dividend by Vesta Fire to our holding company will depend on a variety of factors, such as the impact to the holding company if the dividend is not paid and the impact to Vesta Fire if the dividend is paid. For example,the payment of a dividend may cause non-compliance with the Illinois Department of Insurance's "reserve reconciliation test," which requires Vesta Fire to maintain a minimum amount of liquid, high quality assets. At December 31, 2001, Vesta Fire's qualifying assets exceeded its minimum by approximately $8.8 million. If the payment of a dividend would jeopardize Vesta Fire's ability to comply with this reserve reconciliation test, then the Illinois Department of Insurance may not approve it. Accordingly, there can be no assurance that Vesta Fire will be able to obtain the requisite regulatory approval for the payment of dividends.

We rely primarily on fees earned under our management agreement with our insurance company subsidiaries to meet our cash requirements (including debt service) and to pay dividends to our stockholders. This management agreement, which provided approximately $25 million to our holding company in 2001, is subject to certain regulatory standards which generally require its terms and fees to be fair and reasonable. The Illinois Department of Insurance may review this agreement from time to time to insure the reasonableness of its terms and fees, and it is possible that such terms and fees could be modified to reduce the amounts available to our holding company. Assuming the management agreement is not modified in a material respect, we believe that this management agreement will provide us with funds sufficient to meet our anticipated needs (including debt service) for at least the next twelve months.

Credit Facilities

On March 3, 2000, we established a revolving credit facility with First Commercial Bank, Birmingham, Alabama ("First Commercial"). In May, 2001 we increased the amounts available and increased the term of the credit facility to the following:

- a $15 million unsecured line which bears interest at First Commercial's prime rate +1/4%;

- an additional $15 million line which bears interest at First Commercial's prime rate, secured by a pledge of the revenues received under the management contract between our wholly owned management company, J. Gordon Gaines, Inc., and our operating insurance subsidiaries.

Each of these credit facilities mature on April 30, 2003. These credit agreements contain covenants which require us to maintain minimum (i) statutory consolidated net income, (ii) GAAP consolidated net income, (iii) statutory surplus and (iv) risk based capital. For the year ending December 31, 2001, our GAAP consolidated net income and statutory surplus did not meet the minimum requirements as set forth in our credit agreements. First Commercial has agreed that any such non-compliance will not be deemed an event of default under the credit agreement.

Contractual Obligations

The following table sets forth the principal maturities of all contractual obligations at December 31, 2001:

	Total	Less than 1 year	2-3 years	4-5 years	After 5 years
8.75% Senior Debentures	$ 79,820	$ -	-	-	$ 79,820
8.525% Deferrable Capital Securities	23,250	-	-	-	23,250
Federal Home Loan Bank advances	168,614	88,401	20,586	5,872	53,755
Line of credit	29,964	-	29,964	-	-
	$ 301,648	$ 88,401	$ 50,550	5,872	$ 156,825

As part of the Federal Home Loan Bank program, as more fully described in Note M, we have pledged securities with a market value of $176.8 million to secure our obligation of $168.6 million. We intend to renew all Federal Home Loan Bank advances maturing in the current year, however in the unlikely event we elect not to renew all maturing advances, we could liquidate the pledged investments to satisfy the obligation.

Future payments for interest and operating lease obligations at December 31, 2001 are as follows:

	Total	Less than 1 year	2-3 years	4-5 years	After 5 years
8.75% Senior Debentures	$ 160,638	$ 6,984	$ 13,969	$ 13,969	$ 125,717
8.525% Deferrable Capital Securities	49,552	1,982	3,964	3,964	39,641
Federal Home Loan Bank advances	66,811	5,739	9,859	9,131	42,082
Line of credit	1,951	1,463	488	-	-
Operating leases	18,447	4,535	7,158	4,914	1,840
	$ 297,398	$ 20,703	$ 35,438	$ 31,978	$ 209,280

Contingent Obligations:

As part of its ongoing reinsurance recoverable arbitrations, we have obtained letters of credit for the benefit of certain parties. Our principal operating subsidiary, Vesta Fire is contingently liable under the terms of these letters of credit. For our reinsurance arbitrations, we have obtained letters of credit totaling $33.7 million for which we are contingently liable.

Additionally, as part of our specialty lines underwriting retained, we have obtained letters of credit or other pledges of securities totaling $29.2 million securing our obligations under the various reinsurance agreements.

Cash Flows

The principal sources of funds for our insurance subsidiaries are premiums, investment income and proceeds from the sale or maturity of invested assets. Such funds are used principally for the payment of claims, operating expenses, commissions and the purchase of investments. As is typical in the insurance industry, we collect cash in the form of premiums and invest that cash until claims are paid. Cash collected from premiums and cash paid for claims is included in cash flow from operations, while the cash impact from our investing activities is included in cash flow from investing activities. In periods such as 2001 and 2000, where we are exiting certain lines of business such as commercial lines and reinsurance assumed lines we are funding the payout of commercial and reinsurance assumed claims through the liquidation of invested assets, consistent with the historical insurance business model. However, this generates cash outflows from operations that can be misleading.

On a consolidated basis, net cash used in operations for the year ended December 31, 2001 and 2000, was $11.1 million and $59.0 million, respectively. Cash flow from operations was negative for the current period primarily due to the continued payout of claims from our discontinued operations, the payout of standard-property casualty claims incurred in prior periods, and the timing of payment of certain payables and other operational items. Net cash (used in) provided by investing activities was $(45.0) million and $128.6 million for the year ended December 31, 2001 and 2000, respectively as we used cash to purchase Florida Select in April, 2001, and funded the discontinuance of the reinsurance assumed and commercial lines of business in 2000 through the liquidation of our investment portfolio. Net cash provided by (used in) financing activities was $66.3 million and $(73.9) million for the year ending December 31, 2001 and 2000, respectively as we engaged in a number of stock transactions in the year ended December 31, 2001 including the issuance of 8.625 million shares of stock in a follow-on offering for approximately $64.0 million, net of underwriting discount and expenses and repurchased outstanding debt in the year ending December 31, 2000.

New Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board issued SFAS No. 141, "Business Combinations." SFAS No. 141 address financial accounting and reporting for business combinations and supersedes Accounting Principles Board Opinion No. 16, "Business Combinations," and SFAS No. 38 "Accounting for Preacquisition Contingencies of Purchased Enterprises." The standard eliminates the pooling of interests method of accounting for business combinations except for qualifying business combinations initiated prior to July 1, 2001 and requires that all intangible assets be accounted for separately from goodwill, for acquisitions after July 1, 2001. Vesta has applied the requirements of SFAS No. 141 to all acquisitions after July 1, 2001 and will account for future acquisitions in accordance with the new guidance.

In June of 2001, the Financial Accounting Standards Board issued SFAS No. 142, "Goodwill and Other Intangible Assets." This statement addresses how intangible assets that are acquired individually or with a group of other assets (but not those acquired in a business combination) should be accounted for in financial statements upon their acquisition. This statement also addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements.

Except for goodwill and intangible assets acquired after June 30, 2001, which are immediately subject to its provisions, SFAS No. 142 is effective starting with fiscal years beginning after December 15, 2001.

The provisions of SFAS No. 142 no longer allow the amortization of goodwill, and certain intangible assets that have indefinite useful lives, and requires that impairment of goodwill on those assets be tested annually. In addition, SFAS No. 142 requires the following additional disclosures for goodwill and other intangible assets:

- Changes in the carrying amount of goodwill from period-to-period;
- The carrying amount of intangible assets by major category; and
- The estimated intangible amortization for the next five years.

Vesta will adopt the provisions of SFAS No. 142 effective January 1, 2002. Vesta is currently in the process of preparing for its adoption of SFAS No. 142 and is making the determinations as to what its reporting units are and what amounts of goodwill, intangible assets, other assets, and liabilities should be allocated to those reporting units. SFAS No. 142 requires that goodwill be tested annually for impairment and the initial goodwill impairment test is required to be completed within six months of adoption. Vesta has not completed its initial goodwill impairment test and has net yet determined what effect the impairment tests will have on its financial position or results of operations. Vesta expects that the elimination of goodwill amortization will positively impact pretax net income by approximately $2.6 million in fiscal year 2002.

In October of 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 is effective for fiscal years beginning after December 15, 2001 and was written to provide a single model for the disposal of long-lived assets. SFAS No. 144 supersedes SFAS No. 121 "Accounting for Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of" and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30, "Reporting the results of Operations--Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." Vesta will adopt the provision of SFAS No. 144 effective January 1, 2002. Adoption of SFAS No. 144 is not expected to have a material impact on Vesta's financial position, results of operations or cash flows.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

Market Risk of Financial Instruments

Vesta's principal assets are financial instruments, which are subject to the market risk of potential losses from adverse changes in market rates and prices. Our primary risk exposures on assets are interest rate risk on fixed maturity investments, and mortgage and collateral loans and equity price risk for domestic stocks. In addition, our outstanding annuity liabilities are subject to interest rate risk, although, many of our products contain surrender charges and other features that reward persistency and penalize early withdrawal of funds.

Vesta manages its exposure to market risk by selecting investment assets with characteristics such as duration, yield and liquidity to reflect the underlying characteristics of the related insurance reserves.

The following table sets forth the estimated market values of our fixed maturity investments, mortgage and collateral loans, annuities, and equity investments resulting from a hypothetical immediate 100 basis point adverse change in interest rates and a 10% decline in market prices for equity exposures, respectively from levels prevailing at December 31, 2001.

	Amount (in thousands)
Fixed Maturity Investments	$ 775,623
Equity Investments	28,288
Mortgage and collateral loans	42,885

Annuity liabilities	359,554

The decrease in fair values based on an adverse change in interest rates for fixed maturity investments, mortgage and collateral loans, and annuity liabilities, was determined by estimating the present value of future cash flows using various models, primarily duration modeling.

The decrease in fair value of equity securities based on a decrease in the market prices of all equity securities was estimated as 10% of the fair value.

Item 8. Financial Statements and Supplementary Data

	Page
Report of Independent Accountants	24
Consolidated Balance Sheets at December 31, 2001 and 2000	25
Consolidated Statements of Operations and Comprehensive Income (loss) for each of the years in the three-year period ended December 31, 2001	26
Consolidated Statements of Stockholders' Equity for each of the years in the three-year period ended December 31, 2001	27
Consolidated Statements of Cash Flows for each of the years in the three-year period ended December 31, 2001	28
Notes to Consolidated Financial Statements	29 - 48

Report of Independent Accountants

To the Stockholders of
Vesta Insurance Group, Inc.

In our opinion, the consolidated financial statements listed in the index appearing under Item 14(a)(1) present fairly, in all material respects, the financial position of Vesta Insurance Group, Inc. and its subsidiaries at December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedules listed in the index appearing under Item 14(a)(2) present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedules are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements and financial statement schedules based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PRICEWATERHOUSECOOPERS LLP

Birmingham, Alabama
February 28, 2002

23

Vesta Insurance Group, Inc
Consolidated Balance Sheets
(amounts in thousands, except share data)

	December 2001
Assets:	
Investments:	
Fixed maturities available for sale - at fair value (cost: 2001 - $785,049; 2000 - $795,118)	$ 807,197
Equity securities--at fair value (cost: 2001 - $32,298; 2000 - $30,221)	31,431
Mortgage and collateral loans	43,978
Policy loans	63,949
Short-term investments	41,198
Other invested assets	47,996
Total investments	1,035,749
Cash	23,579
Accrued investment income	23,090
Premiums in course of collection (net of allowances for losses of $2,684 in 2001 and $3,937 in 2000)	47,589
Reinsurance balances receivable	357,827
Reinsurance recoverable on paid losses	76,757
Deferred policy acquisition costs	58,832
Property and equipment	18,368
Deferred income taxes	38,591
Goodwill and other intangible assets	109,260
Other assets	41,240
Total assets	$ 1,830,882
Liabilities:	
Policy liabilities	$ 695,170
Losses and loss adjustment expenses	280,997
Unearned premiums	179,879
Federal Home Loan Bank advances	168,614
Short term debt	29,964
Long term debt	79,432
Other liabilities	114,269
Total liabilities	1,548,325
Commitments and contingencies: See Note F	
Deferrable Capital Securities	23,250

Stockholders' equity:	
Preferred stock, $.01 par value, 5,000,000 shares authorized, issued: 2001 - 0 and 2000 - 2,950,000	--
Common stock, $.01 par value, 100,000,000 shares authorized, issued: 2001 - 36,994,464 and 2000 - 18,964,322	370
Additional paid-in capital	244,640
Accumulated other comprehensive income, net of tax expense of $4,191 and $1,453 in 2001 and 2000, respectively	7,784
Retained earnings	32,611
Treasury stock (923,972 shares and 166,294 shares at cost) at December 31, 2001 and 2000, respectively	(6,591)
Unearned stock	(19,507)
Total stockholders' equity	259,307
Total liabilities, deferrable capital securities and stockholders' equity	$ 1,830,882

See accompanying Notes to Consolidated Financial Statements

Vesta Insurance Group, Inc.
Consolidated Statements of Operations and Comprehensive
Income (Loss) (amounts in thousands, except
share data) Statements of Operations

	For the Decem	
	2001	20
Revenues:		
Net premiums written	$ 306,323	$ 21
Decrease (increase) in unearned premium	(19,519)	
Net premiums earned	286,804	21
Policy fees	7,674	
Net investment income	63,918	4
Realized (losses) gains	(1,172)	(
Other	16,420	
Total revenues	373,644	26
Expenses:		
Policyholder benefits	35,950	
Losses and loss adjustment expenses incurred	169,596	12
Policy acquisition expenses	64,833	5
Operating expenses	69,608	4
Litigation settlement charge	25,000	
Interest on debt	17,565	1
Goodwill and other intangible amortization	3,394	
Total expenses	385,946	24
Income (loss) from continuing operations before taxes, minority interest, and deferrable capital securities	(12,302)	1
Income tax expense (benefit)	(4,490)	

Minority interest, net of tax	1,076	
Deferrable capital security distributions, net of tax	1,394	
Income (loss) from continuing operations	(10,282)	
Income (loss) from discontinued operations, net of tax	(19,958)	(
Extraordinary gain on debt extinguishments, net of tax	910	
Net income (loss)	(29,330)	1
Preferred stock dividend	(163)	(
Gain on redemption of preferred securities, net of tax	7,068	
Net income (loss) available to common stockholders	$ (22,425)	$ 1
Basic net income (loss) from continuing operations per share	$ (0.46)	$
Basic net income (loss) available to common stockholders per share	$ (0.84)	$
Diluted net income (loss) from continuing operations per share	$ (0.46)	$
Diluted net income (loss) available to common stockholders per share	$ (0.84)	$

Statements of Comprehensive Income (Loss)

Net income (loss)	$ (29,330)	$ 1
Other comprehensive income, net of tax:		
Unrealized holding gains (losses) on available-for-sale securities net of tax expense (benefit) of $4,997, $4,475 and $(5,347) in 2001, 2000 and 1999, respectivel	9,282	
Less realized gains (losses) on available-for-sale securities net of tax expense (benefit) of $2,259, $(323) and $2,784 in 2001, 2000, and 1999, respectively	4,196	
	5,086	
Gain on extinguishments of preferred securities net of tax expense of $1,060, $700 and $5,141 in 2001, 2000 and 1999 respectively	7,068	
Comprehensive income (loss)	$ (17,176)	$ 2

See accompanying Notes to Consolidated Financial Statements

Vesta Insurance Group, Inc
Consolidated Statements of Stockholders' Equity
(amounts in thousands, except share data)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Other Comprehensive Income (Loss)
Balance, December 31, 1998	--	$ 190	$ 156,465	$ 8,889
Net income	--	--	--	--
Preferred stock dividend	--	--	--	--
Change in restricted stock receivable	--	--	--	--

Treasury stock issued for restricted stock	--	--	(9,238)	--
Common dividends declared (0.04 per share)	--	--	--	--
Net change in unrealized gains net of tax of $(8,133)	--	--	--	(15,102)
Issuance of preferred stock	$ 30	--	25,045	--
Extinguishment of preferred securities, net of tax of $5,141	--	--	--	--
Balance, December 31, 1999	30	190	172,272	(6,213)
Net income				
Preferred stock dividend	--	--	--	--
Issuance of restricted stock	--	--	(1,426)	--
Treasury stock acquisitions	--	--	--	--
Issuance of treasury stock	--	--	(1,904)	--
Common dividends declared (0.05 per share)	--	--	--	--
Net change in unrealized gains net of tax expense of $4,798	--	--	--	8,911
Issuance of stock for Agent's Trust	--	--	--	--
Extinguishment of preferred securities, net of tax of $700	--	--	(1,560)	--
Balance, December 31, 2000	30	190	167,382	2,698
Net income	--	--	--	--
Preferred stock dividend	--	--	--	--
Issuance of restricted stock	--	8	7,285	--
Amortization of restricted stock awards	--	--	--	--
Treasury stock acquisitions	--	--	--	--
Issuance of treasury stock	--	--	(14,229)	--
Issuance of common stock	(30)	172	84,202	--
Common dividends declared (0.0875 per share)	--	--	--	--
Net change in unrealized gains net of tax expense of $2,738	--	--	--	5,086
Issuance of stock from Agent's Trust	--	--	--	--
Extinguishment of preferred securities, net of tax of $1,060	--	--	--	--
Balance, December 31, 2001	$ --	$ 370	$ 244,640	$ 7,784

	Retained Earnings	Treasury Stock	Unearned Stock	Total
Balance, December 31, 1998	$ 10,120	$(15,592)	$ (2,045)	$ 158,027
Net income	23,455	--	--	23,455
Preferred stock dividend	(563)	--	--	(563)
Change in restricted stock receivable	--	--	243	243
Treasury stock issued for restricted stock	--	9,318	--	80
Common dividends declared (0.04 per share)	(698)	--	--	(698)
Net change in unrealized gains net of tax of $(8,133)	--	--	--	(15,102)
Issuance of preferred stock	--	--	--	25,075
Extinguishment of preferred securities, net of tax of $5,141	9,548	--	--	9,548
Balance, December 31, 1999	41,862	(6,274)	(1,802)	200,065
Net income	11,202			11,202

Preferred stock dividend	(3,670)	--	--	(3,670)
Issuance of restricted stock	--	2,249	(440)	383
Treasury stock acquisitions	--	(56,304)	--	(56,304)
Issuance of treasury stock	--	42,179	--	40,275
Common dividends declared (0.05 per share)	(941)	--	--	(941)
Net change in unrealized gains net of tax expense of $4,798	--	--	--	8,911
Issuance of stock for Agent's Trust	--	4,725	(4,725)	--
Extinguishment of preferred securities, net of tax of $700	9,190	7,560	--	15,190
Balance, December 31, 2000	57,643	(5,865)	(6,967)	215,111
Net income	(29,330)	--	--	(29,330)
Preferred stock dividend	(163)	--	--	(163)
Issuance of restricted stock	--	7,357	(14,650)	--
Amortization of restricted stock awards	--	--	2,076	2,076
Treasury stock acquisitions	--	(57,218)	--	(57,218)
Issuance of treasury stock	--	49,135	--	34,906
Issuance of common stock	--	--	--	84,344
Common dividends declared (0.0875 per share)	(2,607)	--	--	(2,607)
Net change in unrealized gains net of tax expense of $2,738	--	--	--	5,086
Issuance of stock from Agent's Trust	--	--	34	34
Extinguishment of preferred securities, net of tax of $1,060	7,068	--	--	7,068
Balance, December 31, 2001	$ 32,611	$ (6,591)	$(19,507)	$ 259,307

See accompanying Notes to Consolidated Financial Statements

Vesta Insurance Group, Inc
Consolidated Statements of Cash Flows
(amounts in thousands)

	For the Year Ended 2001	2000
Operating Activities:		
Net income (loss)	$ (29,330)	$ 11,20
Adjustments to reconcile net income (loss) to cash used in operations		
Changes in:		
Loss and LAE reserves	(6,317)	(91,02
Unearned premium reserves	39,309	(28,27
Reinsurance balances receivable	10,262	6,04
Premiums in course of collection	(20,734)	17,32
Reinsurance recoverable on paid losses	(19,432)	20,60
Policy liabilities of traditional life insurance products	7,633	2,30
Other assets and liabilities	(8,004)	(13,75
Policy acquisition costs deferred	(56,871)	(39,42
Policy acquisition costs amortized	64,833	52,36
Realized (gains) losses	1,172	2,06

Amortization and depreciation	7,282	6,77
Extraordinary gain	(910)	(5,25
Net cash used in operations	(11,107)	(59,04
Investing Activities:		
Investments sold, matured, and called:		
Fixed maturities available for sale	319,457	157,64
Equity securities	3,338	49
Investments acquired:		
Fixed maturities available for sale	(276,166)	(90,88
Equity securities	(16,555)	(13,38
Other invested assets	(275)	(21,56
Net cash paid for acquisition	(56,942)	(13,56
Net (increase) decrease in short-term investments	(11,744)	112,90
Disposition of Vesta County Mutual	--	-
Additions to property and equipment	(6,336)	(6,73
Dispositions of property and equipment	232	3,75
Net cash (used in) provided from investing activities	(44,991)	128,65
Financing Activities:		
Net change in short term debt	24,964	-
Net change in FHLB borrowings	14,651	11,68
Net deposits and withdrawals from insurance liabilities	(9,705)	(5,64
Issuance of long term debt	--	-
Retirement of long term debt and preferred securities	--	(51,71
Issuance of common stock	96,381	32,67
Acquisition of common stock	(57,218)	(56,30
Dividends paid	(2,770)	(4,61
Preferred stock issuance	--	-
Capital contributions from exercising stock options	--	-
Net cash (used in) provided from financing activities	66,303	(73,91
Increase (decrease) in cash	10,205	(4,30
Cash at beginning year	13,374	17,67
Cash at end of year	$ 23,579	$ 13,37

See accompanying Notes to Consolidated Financial Statements

Vesta Insurance Group, Inc
Notes to Consolidated Financial Statements

Note A - Significant Accounting Policies

Nature of Operations: Vesta Insurance Group, Inc. and subsidiaries is a holding company for a group of insurance companies that offers financial services through the production, distribution, and administration of property-casualty and life and health insurance products. The lead insurers in the Vesta Group are Vesta Fire Insurance Corporation and American Founders Life Insurance Company. In 1999 and 2000, we discontinued commercial line of business and our reinsurance assumed line of business, respectively. See Note Q.

Principles of Consolidation: The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States and include the accounts of Vesta Insurance Group, Inc. and its operating subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

Use of Estimates in the Preparation of the Financial Statements: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates. These estimates and assumptions are particularly important in determining the premiums in course of collection, reserves for losses and loss adjustment expenses, deferred policy acquisition costs and reinsurance recoverables.

Investments: Investment securities are classified as available for sale and reported at fair value, with unrealized gains and losses excluded from earnings and reported in a separate component of stockholders' equity. Mortgage loans, policy loans, and collateral loans are stated at the aggregate unpaid principal balances, less any unamortized discount and less allowance for possible losses, if required.

Short-term investments are carried at cost and include investments in certificates of deposit and other interest-bearing time deposits with original maturities of one year or less.

Gains and losses realized on the disposition of investments are recognized as revenues and are determined on a specific identification basis. Unrealized gains and losses on equity securities and fixed maturities available for sale, net of deferred income taxes, are reflected directly in stockholders' equity. If an investment becomes other than temporarily impaired, such impairment is treated as a realized loss and the investment is adjusted to net realizable value.

Determination of Fair Values of Financial Instruments: Fair values for cash, short-term investments, short-term debt, receivables and payables approximate their carrying value. Fair values for investment securities and long-term debt are based on quoted market prices where available. Otherwise, fair values are based on quoted market prices of comparable instruments.

Cash: Cash consists of balances on hand and on deposit in banks and financial institutions.

Recognition of Revenue: Revenue is recognized as follows:

- Earned premiums on property-casualty business are generally recognized as revenue on a pro rata basis over the policy term. Reinsurance premiums ceded are similarly pro-rated with the prepaid portion recorded as an asset in the Consolidated Balance Sheet.
- Agency commission income is recognized at the later of the billing or effective date of the related insurance policies, net of an allowance for estimated policy cancellations.
- Premiums on traditional life contracts are recognized as income when due.
- Premiums for accident and health policies are recognized in proportion to the insurance protection provided over the period covered by the policies.

Losses and Loss Adjustment Expenses: The liability for losses and loss adjustment expenses ("LAE") includes an amount determined from loss reports and individual cases. It also includes an amount for losses incurred but not reported ("IBNR") which is based on historical experience. Such liabilities are necessarily based on estimates and, while management believes that the amount is adequate, the ultimate liability may be in excess of or less than the amounts provided. The methods for making such estimates and for establishing the resulting liabilities are continually reviewed, and any adjustments are reflected in earnings currently. These reserves are established on an undiscounted basis and are reduced for estimates of salvage and subrogation.

Policy Liabilities: Reserves for investment-type contracts are based either on the contract account balance (if future benefit payments in excess of the account balance are not guaranteed) or on the present value of future benefit payments (if such payments are guaranteed). Additions to insurance liabilities are made if it is determined that future cash flows (including investment income) are insufficient to cover future benefits and expenses.

For investment contracts without mortality risk (such as deferred annuities and immediate annuities with benefits paid for a certain period), premium deposits and benefit payments are recorded as increases or decreases in a liability account, rather than as revenue and expense. We record as revenue any amounts charged against the liability account for the cost of insurance, policy administration, and surrender penalties. Any interest credited to the liability account and any benefit payments which exceed the contract liability account balance are recorded as expenses. As of December 31, 2001 and 2000, approximately $95.7 million and $72.5 million, respectively, of Vesta's annuity reserves are subject to discretionary withdrawal without surrender charges or other adjustments.

Reserves for traditional life contracts are generally calculated using the net level premium method, based on assumptions as to mortality, withdrawals, dividends, and investment yields ranging from 2.5% to 6.5%. These assumptions are generally made at the time the contract is issued or at the purchase date. These assumptions are based on projections from past experience, making allowance for possible unfavorable deviation.

Deferred Acquisition Costs: Commissions and other costs that vary with and are primarily related to the production of new and renewal business are deferred and amortized over the terms of the policies to which they relate. Anticipated investment income is considered in determining recoverability of deferred acquisition costs.

The costs to acquire blocks of life insurance representing the present value of future profits from such blocks of insurance is also included in deferred acquisition costs. We amortize the present value of future profits over the premium payment period. The unamortized present value of future profits was approximately $20.9 and $17.9 million at December 31, 2001 and 2000, respectively. During 2001 and 2000, $4.5 million and $19.2 million, respectively, of present value of future profits was capitalized (relating to acquisitions made during the year) and $1.5 million and $2.5 million was amortized.

Reinsurance: We report assets and liabilities related to insurance contracts before the effects of reinsurance. Reinsurance receivables and prepaid reinsurance premiums (including amounts related to insurance liabilities) are reported as assets. Estimated reinsurance receivables are recognized in a manner consistent with the liabilities related to the underlying reinsured contracts. Reinsurance recoverables represent amounts due from reinsurers for paid losses.

Minority Interest: Minority interest in consolidated subsidiaries totaled $16.1 million and $20.5 million at December 31, 2001 and 2000, respectively. $7.6 million of this amount at December 31, 2000 represents mandatorily redeemable preferred stocks.

Income Taxes: Vesta accounts for income taxes using the asset and liability method under which deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases.

Property and Equipment: Property and equipment is reported at cost less allowances for depreciation. Depreciation is recorded primarily on the straight line method over the estimated useful lives of these assets which range from 1 to 15 years. Ordinary maintenance and repairs are charged to income as incurred.

A summary of property and equipment used in the business is as follows (in thousands):

	December 31,		Estimated Useful Lives
	2001	2000	Lives
Building and real estate	$ 5,570	$ 5,065	3-9 yrs
Data processing equipment	24,616	18,341	3-15 yrs
Furniture and office equipment	7,721	7,893	1-5 yrs
Other	3,622	1,639	1-5 yrs
	41,529	32,938	
Accumulated depreciation	(23,161)	(18,928)	
	$ 18,368	$ 14,010	

Depreciation expense on property and equipment used in the business was $3.9 million, $3.3 million, and $4.3 million for the years ended December 31, 2001, 2000, and 1999, respectively.

Goodwill: Goodwill at December 31 is as follows (in thousands):

	2001	2000
Goodwill and other intangible assets	$115,373	$20,516
Accumulated amortization	(6,113)	(2,719)
	$109,260	$17,797

Reclassification: Certain amounts in the financial statements presented have been reclassified from amounts previously reported in order to be comparable between years. These reclassifications have no effect on previously reported total assets, total liabilities, stockholders' equity or net income during the period involved.

Vesta Insurance Group, Inc
Notes to Consolidated Financial Statements

Income Per Share: Basic EPS is computed by dividing net income available to common stockholders by the weighted average common shares outstanding for the period. Diluted EPS is calculated by adding to shares outstanding the additional net effect of potentially dilutive securities or contracts which could be exercised or converted into common shares. Reconciliation of net income available to common shareholders and average shares outstanding for years ending December 31 are as follows:

	Year Ended December 31, 2001	2000	1999
	(in thousands)		
Net income (loss) available to common shareholders	$(22,425)	$16,722	$32,440
Preferred stock dividends on convertible preferred stock	163	2,252	563
Adjusted net income (loss) available to common shareholders	$(22,262)	$18,974	$33,003
Average shares outstanding - basic	26,652	18,240	18,699
Stock options and restricted stock *	--	115	--
Convertible preferred stock *	--	5,900	1,503
Average shares outstanding - diluted	26,652	24,255	20,202

* In 2001, the shares had an anti-dilutive effect and were excluded in accordance with SFAS No. 128

Long Lived Assets: We evaluate long-lived assets and certain identifiable intangibles held and used by an entity for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. This evaluation is based on undiscounted future projected cash flows of the asset or asset group. If an impairment exists, the amount of such impairment is calculated based on the estimated fair value of the assets. Fair value is generally determined by discounting future projected cash flows of the asset or asset group under review.

In accordance with Accounting Principles Board Opinion (APB) No. 17, "Intangible Assets," the recoverability of goodwill not identified with assets subject to an impairment loss is reviewed for impairment, on an acquisition by acquisition basis, whenever events or changes in circumstances indicate that it may not be recoverable. If such an event occurred, we would prepare projections of future discounted cash flows for the applicable acquisition. The projections are for the remaining term of the goodwill using a discount rate and terminal value that would be customary for evaluating insurance company transactions. We believe that this discounted cash flow approach approximates fair market value.

New Accounting Standards: Effective January 1, 2001, Vesta adopted SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," which provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. Those standards are based on consistent application of a financial-components approach that focuses on control. Under that approach, after a transfer of financial assets, an entity recognizes the financial and servicing assets it controls and the liabilities it has incurred, and derecognizes financial assets when control has been surrendered, and derecognizes liabilities when extinguished. SFAS No. 140 also provides consistent standards for distinguishing transfers of financial assets that are sales from transfers that are secured borrowings.

In June 2001, the Financial Accounting Standards Board issued SFAS No. 141, "Business Combinations." SFAS No. 141 address financial accounting and reporting for business combinations and supersedes Accounting Principles Board Opinion No. 16, "Business Combinations," and SFAS No. 38 "Accounting for Preacquisition Contingencies of Purchased Enterprises." The standard eliminates the pooling of interests method of accounting for business combinations except for qualifying business combinations initiated prior to July 1, 2001 and requires that all intangible assets be accounted for separately from goodwill, for acquisitions after July 1, 2001. Vesta has applied the requirements of SFAS No. 141 to all acquisitions after July 1, 2001 and will account for future acquisitions in accordance with the new guidance.

In June of 2001, the Financial Accounting Standards Board issued SFAS No. 142, "Goodwill and Other Intangible Assets." This statement addresses how intangible assets that are acquired individually or with a group of other assets (but not those acquired in a business combination) should be accounted for in financial statements upon their acquisition. This statement also addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements.

Except for goodwill and intangible assets acquired after June 30, 2001, which are immediately subject to its provisions, SFAS No. 142 is effective starting with fiscal years beginning after December 15, 2001.

The provisions of SFAS No. 142 no longer allow the amortization of goodwill, and certain intangible assets that have indefinite useful lives, and requires that impairment of goodwill on those assets be tested annually. In addition, SFAS No. 142 requires the following additional disclosures for goodwill and other intangible assets:

- Changes in the carrying amount of goodwill from period-to-period;
- The carrying amount of intangible assets by major category; and
- The estimated intangible amortization for the next five years.

Vesta will adopt SFAS No. 142 effective January 1, 2002. Upon initial application of SFAS No. 142, Vesta does not anticipate impairment losses for goodwill resulting from a transitional impairment test. However, Vesta has not yet fully determined the impact that the adoption of other elements of SFAS No. 142, including the possible future impairment charges on goodwill, may have on its financial position or results of operations. Vesta expects that the elimination of goodwill amortization will positively impact pretax net income by approximately $2.6 million in fiscal year 2002.

In October of 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 is effective for fiscal years beginning after December 15, 2001 and was written to provide a single model for the disposal of long-lived assets. SFAS No. 144 supersedes SFAS No. 121 "Accounting for Impairment of Long-Lived Assets and for Long-Lived

Assets to be Disposed of" and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30, "Reporting the results of Operations--Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." Vesta will adopt the provision of SFAS No. 144 effective January 1, 2002. Adoption of SFAS No. 144 is not expected to have a material impact on Vesta's financial position, results of operations or cash flows.

Effective January 1, 2001, Vesta adopted Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 and subsequent amendments standardize the accounting for derivative instruments, including certain derivative instruments embedded in other contracts, by requiring that an entity recognize those items as assets or liabilities in the financial statements and measure them at fair value. Management has evaluated our activities and determined that Vesta does not have any material derivative exposures and that the adoption of the SFAS No. 133 did not have a material impact on the financial statements.

Note B - Acquisitions

Effective April 1, 2001, we acquired Florida Select Insurance Holdings Inc., the parent company of Florida Select Insurance Company for cash of approximately $66.4 million. Florida Select is the 8th largest residential homeowners insurer in the State of Florida with approximately $137.7 million of assets and $60.0 million of annual gross written premium. The transaction has been accounted for as a purchase. Summarized below is an allocation of assets and liabilities acquired and the consolidated results of operations for the years ended December 31, 2001 and 2000 on an unaudited pro forma basis as if the acquisition had occurred as of the beginning of each period presented.

Assets and liabilities acquired (in thousands except per share amounts and unaudited):

Assets acquired:	
Invested assets	$ 56,707
Cash	24,895
Other assets	14,109
Intangible assets	7,756
Goodwill	34,215
Total assets	$137,682
Liabilities acquired:	
Loss and LAE reserves	$ 22,019
Unearned premiums	36,582
Other liabilities	12,668
Total liabilities	$ 71,269

On October 1, 2001, our subsidiary Instant Insurance Holdings, Inc. ("Instant") acquired a 75% interest in Spacecoast Agencies of Florida for $3.7 million. On October 31, Instant acquired A-Affordable Insurance Agency of Texas for approximately $8.5 million. These transactions have been accounted for as a purchase. Summarized below is an allocation of assets and liabilities acquired (in thousands):

Assets acquired:	
Cash	$ 3,211
Other assets	1,746
Goodwill and other intangibles	11,874
Total assets	$16,831

Liabilities acquired:	
Payables and other liabilities	$ 4,590
Total liabilities	$ 4,590

31

Vesta Insurance Group, Inc
Notes to Consolidated Financial Statements

On June 30, 2000, we completed the acquisition of a 71% controlling interest in American Founders Financial Corporation for $25 million. American Founders is a life insurance holding company with approximately $1.8 billion (face value) of life products in force and approximately $339 million of annuity deposits as of December 31, 2000. American Founders is currently rated B+ by A.M. Best and operates in 40 states and the District of Columbia. The transaction has been accounted for as a purchase. Summarized below is an allocation of assets and liabilities acquired (in thousands):

Assets acquired:	
Invested assets	$682,906
Value of business acquired	20,290
Reinsurance receivables	187,473
Other assets	20,156
Total assets	$910,825
Liabilities acquired:	
Future policy benefits	$690,206
FHLB notes payable	143,123
Other liabilities	52,496
Total liabilities	$885,825

Summarized below are the consolidated results of operations for the years ended December 31, 2001 and 2000 on an unaudited pro forma basis as if the acquisitions had occurred as of the beginning of each period presented. The pro forma information is based on our consolidated results of operations for the year ended December 30, 2001 and 2000 and on data provided by the acquired companies, after giving effect to certain proforma adjustments, including the issuance of 8.625 million shares of common stock. The pro forma financial information does not purport to be indicative of results of operations that would have occurred had the transactions occurred on the basis assumed above nor are they indicative of results of the future operations of the combined enterprises (in thousands except per share amounts and unaudited):

	Year ended December 31, 2001	2000
Total revenues	$ 408,748	$ 372,618
Income (loss) available to common shareholders	$ (16,555)	$ 30,732
Income (loss) available to common shareholders per share - basic	$ (0.53)	$ 1.19
Income (loss) available to common shareholders per share - diluted	$ (0.53)	$ 1.04

Note C - Statutory Accounting and Regulation

Insurance subsidiaries of Vesta are required to file statutory financial statements with state insurance regulatory authorities. Accounting principles used to prepare these statutory financial statements differ from accounting principles generally accepted in the United States of America. The most significant differences between GAAP and statutory accounting principles are as follows: (a) acquisition costs of obtaining new business are deferred and amortized over the policy period rather than charged to operations as incurred; (b) deferred income taxes are provided for temporary differences between financial and currently taxable earnings; (c) certain items are reported as assets (property and equipment, agents' balances, prepaid expenses) rather than being charged directly to surplus as nonadmitted items; (d) statutory accounting disallows reserve credits for reinsurance in certain circumstances; (e) bonds are recorded at their market values instead of amortized costs; (f) benefit liabilities are computed using a net level method and are based on realistic estimates of expected mortality, interest, and withdrawals as adjusted to provide for possible unfavorable deviation from such assumptions; (g) the Asset Valuation Reserve and Interest Maintenance Reserve are restored to shareholders' equity.

The following is a summary of selected statutory financial information for our primary insurance subsidiaries at December 31, 2001 and 2000 (in thousands):

	2001	2000
Statutory Capital and Surplus:		
Vesta Fire Insurance Corporation	$235,935	$275,270
American Founders Life	$ 35,030	$ 32,995
Statutory net income:		
Vesta Fire Insurance Corporation	$ 68,544	$ 41,611
American Founders Life	$ 8,761	$ 12,444

32

Vesta Insurance Group, Inc
Notes to Consolidated Financial Statements

Restrictions on Dividends to Stockholder and Transactions between Affiliates: Transactions between Vesta and its insurance subsidiaries, including the payment of dividends and management fees to Vesta by such subsidiaries, are subject to certain limitations under the insurance laws of those subsidiaries' domiciliary states. The insurance laws of the state of Illinois, where Vesta Fire is domiciled, permit the payment of dividends out of earned surplus in any year which, together with other dividends or distributions made within the preceding 12 months, do not exceed the greater of 10% of statutory surplus as of the end of the preceding year or the net income for the preceding year, with larger dividends payable only after receipt of prior regulatory approval. On October 29, 2001, the Illinois Insurance Department published a Company Bulletin that indicates that the Department interprets these dividend limitations to prohibit the payment of dividends if the insurer has negative or zero "unassigned funds" at the end of the prior year, as reported on its statutorily required annual statement. Our lead insurance subsidiary, Vesta Fire, reported negative "unassigned funds" on its annual statement for 2001. Accordingly, we may not be able to declare and pay a dividend from our lead insurance company subsidiary for the foreseeable future without prior approval.

Risk-Based Capital Requirements: The NAIC adopted risk-based capital requirements that require insurance companies to calculate and report information under a risk-based formula which attempts to measure statutory capital and surplus needs based on the risks in a company's mix of products and investment portfolio. The formula is designed to allow state insurance regulators to identify potential weakly capitalized companies. Under the formula, a company determines its "risk-based capital" ("RBC") by taking into account certain risks related to the insurer's assets (including risks related to its investment portfolio and ceded reinsurance) and the insurer's liabilities (including underwriting risks related to the nature and experience of its insurance business). Risk-based capital rules provide for different levels of regulatory attention depending on the ratio of a company's total adjusted capital to its "authorized control level" ("ACL") of RBC. Based on calculations made by Vesta, the RBC levels for each of our insurance subsidiaries did not trigger regulatory attention.

Note D - Investment Operations

Investment income is summarized as follows (in thousands):

	Year Ended December 31,		
	2001	2000	1999
Fixed maturities	$ 49,093	$ 39,264	$ 18,059
Equity securities	1,295	1,047	135
Short-term investments	11,593	5,093	9,885
Other	2,686	2,132	--
	64,667	47,536	28,079
Less investment expense	(749)	(1,633)	(2,130)
Net investment income from continuing operations	$ 63,918	$ 45,903	$ 25,949

An analysis of gains (losses) from investments is as follows (in thousands):

	Year Ended December 31,		
	2001	2000	1999
Realized investment gains (losses) from:			
Fixed maturities	$ 3,516	$ (342)	$ (250)
Equity securities	680	(581)	8,206
Other (1)	(5,368)	--	--
	$(1,172)	$ (923)	$ 7,956
Net change in unrealized investment gains (losses) on:			
Fixed maturities available for sale	$ 7,950	$ 13,032	$(15,634)
Equity securities available for sale	(126)	677	(3,199)
Less: Applicable tax expense (benefit)	2,738	4,798	(3,731)
Net change in unrealized gains (losses)	$ 5,086	$ 8,911	$(15,102)

(1) The realized loss from other assets is primarily attributable to a realized loss recorded on certain collateral loans held by Vesta's life insurance subsidiary, American Founders.

A summary of fixed maturities and equity securities by amortized cost and estimated fair value at December 31, 2001 and 2000 is as follows (in thousands):

2001	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
United States Government	$ 76,161	$ 3,530	$ 130	$ 79,56
States, municipalities and political subdivisions	29,922	1,778	142	31,55
Foreign	750	-	-	75
Corporate	305,820	11,570	5,044	312,34
Mortgage-backed securities, GNMA collateral	372,396	12,298	1,712	382,98
Total Fixed Maturities	785,049	29,176	7,028	807,19
Equity securities	32,298	545	1,412	31,43
Total portfolio	$817,347	$ 29,721	$ 8,440	$838,62
2000				
United States Government	$ 80,235	$ 2,582	$ 128	$ 82,68
States, municipalities and political subdivisions	21,372	1,228	-	22,60
Corporate	312,412	8,226	5,105	315,53
Mortgage-backed securities, GNMA collateral	381,099	3,671	7,387	377,38
Total Fixed Maturities	795,118	15,707	12,620	798,20
Equity securities	30,221	1,339	275	31,28
Total portfolio	$825,339	$ 17,046	$12,895	$829,49

A schedule of fixed maturities by contractual maturity at December 31, 2001 is shown below on an amortized cost basis and on a fair value basis. Actual maturities could differ from contractual maturities due to call or prepayment provisions.

	Amortized Cost	Fair Value
	(in thousands)	
Due in one year or less	$ 22,074	$ 22,436
Due from one to five years	154,606	159,769
Due from five to ten years	139,739	143,479
Due in ten years or more	96,234	98,531
Mortgage backed securities	372,396	382,982

Total	$785,049	$807,197
	========	========

Proceeds from the sale of equity securities were $3.3 million, $.5 million, and $22 million in 2001, 2000, and 1999, respectively. Gross gains (losses) realized on those sales were $.4 million, $(.6) million and $8.2 million in 2001, 2000 and 1999, respectively. Proceeds from sales, maturities and calls of fixed maturities were $319.5 million in 2001, $157.7 million in 2000 and $294 million in 1999. Gross gains realized on those sales were $3 million in 2001, $1.4 million in 2000 and $1.7 million in 1999. Gross losses on those sales were $.5 million in 2001, $1.8 million in 2000 and $2.0 million in 1999.

We maintain a mortgage loan portfolio consisting of first-lien residential and commercial mortgages. At December 31, 2001, our residential mortgages had carrying values of approximately $12.7 million and commercial mortgages had carrying values of approximately $4.2 million. Collateral loans totaled $27.1 million and were collateralized by the stock of 5 separate Mexican companies, whose only underlying assets supporting the loans consisted of real estate properties located in Mexico. The collateral loans were non-performing as of December 31, 2001, and we are taking the steps necessary to collect the amounts due on these loans from the borrowers. Although the loans are past due in terms of principal and interest payments, the Company does not believe them to be impaired and has not established an allowance against their carrying values due to the estimated value of the collateral being in excess of the combined carrying value of the principal and accrued interest at December 31, 2001.

Vesta Insurance Group, Inc
Notes to Consolidated Financial Statements

Note E - Reserves for Losses and Loss Adjustment Expenses

The table below presents a reconciliation of beginning and ending loss and LAE reserves for the last three years (in thousands):

	Year Ended December 31,		
	2001	2000	1999
Gross Losses and LAE reserves at beginning of year	$ 263,689	$ 354,709	$ 504,911
Reinsurance Recoverable	(170,050)	(186,559)	(206,139)
Net Losses and LAE reserves at beginning of year	93,639	168,150	298,772
Increases (decreases) in provisions for losses and			
Acquisition of Florida Select	22,019	--	--
LAE for claims incurred:			
Current year	162,984	169,333	268,931
Prior year (1)	34,355	(5,862)	(22,167)
Losses and LAE payments for claims incurred:			
Current year	(119,668)	(120,888)	(198,503)
Prior year	(79,613)	(117,094)	(178,883)
Net Losses and LAE reserves at end of year	113,716	93,639	168,150
Reinsurance Recoverable	167,281	170,050	186,559

Gross loss and LAE Reserves	$ 280,997	$ 263,689	$ 354,709
	=========	=========	=========

(1) The adverse development of $34.4 million is primarily attributable to a $30.0 million pre-tax charge taken in our discontinued lines. See Note Q for further discussion.

Note F - Commitments and Contingencies

Securities Litigation

On October 26, 2001, Vesta executed a definitive agreement to settle the securities litigation that had been pending since June 1998 against Vesta and certain current and former officers and directors. On December 10, 2001, the Court approved settlement of the consolidated class action securities litigation in U.S. District Court in Alabama as to Vesta and its officers and directors for a total of $61 million in cash. A related derivative action lawsuit in the Circuit Court of Jefferson County, Alabama was also dismissed with prejudice. Vesta funded $21.0 million towards the settlement and the Company's excess directors and officers liability carriers funded the remaining $40.0 million. Vesta used its line of credit to finance its portion of the settlement and recorded a pre-tax one-time charge of approximately $25 million against earnings to cover Vesta's contribution to the settlement and other expenses incurred. We have now filed a claim with two of our upper level excess D & O insurers for their part of the settlement and related expenses. We have recorded a receivable of $5.4 million, which represents the amount currently due from those two excess D&O insurers

Vesta determined to participate in the funding of the settlement and to take the related one-time charge against earnings as a result of the Cincinnati Insurance Company's attempted rescission of their $25 million directors and officers liability policy and denial of coverage. Vesta has sued Cincinnati in Alabama state court alleging that its actions were taken in bad faith and is vigorously pursuing that claim. The Cincinnati case is scheduled for trial in August 2002.

Indemnification Agreements and Liability Insurance

Pursuant to Delaware law and our by-laws, we are obligated to indemnify our current and former officers and directors for certain liabilities arising from their employment with or services to Vesta, provided that their conduct complied with certain requirements. Pursuant to these obligations, we have been advancing costs of defense and other expenses on behalf of certain current and former officers and directors, subject to an undertaking from such individuals to repay any amounts advanced in the event a court determines that they are not entitled to indemnification.

Arbitration

As discussed in previous SEC filings, in 1998 we corrected our accounting for assumed reinsurance business through restatement of our previously issued financial statements. Similar corrections were made on a statutory accounting basis through recording cumulative adjustments in Vesta Fire's 1997 statutory financial statements. The impact of this correction has been reflected in amounts ceded under our 20 percent whole account quota share treaty which was terminated on June 30, 1998 on a run-off basis. We believe such treatment is appropriate under the terms of this treaty and have calculated the quarterly reinsurance billings presented to the three treaty participants accordingly. The aggregate amount included herein as recoverable from such reinsurers totaled $55.9 million at December 31, 2001. Additionally we have previously collected approximately $48.5 million from the drawdown of collateral on hand.

NRMA Insurance Ltd. ("NRMA"), one of the participants in the 20% whole account quota share treaty, filed a lawsuit in the United States District Court for the Northern District of Alabama contesting our billings. NRMA sought recession of the treaty and a temporary restraining order preventing us from drawing down approximately $34.5 of collateral. We filed a demand for arbitration as provided for in the treaty and also filed a motion to compel arbitration which was granted in the United States District action. Vesta reached an agreement with NRMA to collect the $34.5 million of collateral in exchange for posting a $25 million letter of credit in favor of NRMA to fund any amounts NRMA may recover as a result of the arbitration. We filed for arbitration against the other two participants on the treaty and all those arbitrations are in their document discovery stages. While management believes its interpretation of the treaty's terms and computations based thereon are correct, these matters are in arbitration and their ultimate outcome cannot be determined at this time.

During 1999, F&G Re (on behalf of USF&G), filed for arbitration under two aggregate stop loss reinsurance treaties whereby F&G Re assumed certain risk from the Vesta. F&G Re is seeking to cancel the treaties and avoid its obligation. Based on the terms of the two treaties, Vesta will be entitled to recoveries of approximately $30.0 million as losses from prior accident years mature. Vesta has recorded a reinsurance recoverable of $30.0 million at December 31, 2001 related to these two treaties. The hearing in this arbitration began on February 11, 2002. The hearing was adjourned on February 15, 2002 and rescheduled to resume on June 11, 2002. While management believes that USF&G is not entitled to recession, the ultimate outcome cannot be determined at this time.

We are in arbitration with CIGNA Property and Casualty Insurance Company (now ACE USA) under a personal lines insurance quota share reinsurance agreement, whereby we assumed certain risks from CIGNA. During September 2000, CIGNA filed for arbitration under the reinsurance agreement, seeking payment of the balances that CIGNA claims are due under the terms of the treaty. In addition, during the fourth quarter, the treaty was terminated on a cut-off basis. Vesta is seeking recoupment of all improper claims payments and excessive expense allocations and charges from CIGNA. The arbitration was bifurcated into two phases with phase one concentrating on the interpretation of the intent of the parties related to the expense reimbursement provisions of the treaty at the time it was entered and phase two related to any issues between the parties after the Company conducts an audit of expenses related to the treaty. The phase one hearing was held in February 2002 and the panel ruled that (i) the Company is responsible for the payment of ceding commissions provided for in the treaty and should pay any outstanding billings for commissions, and paid claims plus interest; and (ii) the Company may proceed with an audit of expenses ceded to the treaty and (iii) the parties should identify any further issues to be brought before the arbitration panel for phase two of the hearing.

If the amounts recoverable under the relevant treaties are ultimately determined to be materially less than the amounts that we have reported as recoverable, we may incur a significant, material, and adverse impact on our financial condition and results of operations.

Other Litigation

On January 14, 2002, the Company's subsidiary, American Founders, was notified of a lawsuit naming it as a defendant and brought by a creditor of the former parent of the subsidiary. This lawsuit (subsequently identified as the Blitz lawsuit) alleges, among other things, that American Founders redeemed its Series A and Series C preferred stock issues at less than "reasonably equivalent value". American Founders believes that the allegations brought against it in this lawsuit are without merit and intends to mount a vigorous defense in this action. In the opinion of management, resolution of the Blitz lawsuit is not expected to have a material adverse effect on the financial position of the Company. However, depending on the amount and timing, an unfavorable resolution of this matter could materially affect American Founders' future operations or cash flows in a particular period.

Vesta, through its subsidiaries, is routinely a party to pending or threatened legal proceedings and arbitration relating to the regular conduct of its insurance business. These proceedings involve alleged breaches of contract, torts, including bad faith and fraud claims and miscellaneous other specified relief. Based upon information presently available, and in light of legal and other defenses available to Vesta and its subsidiaries, management does not consider liability from any threatened or pending litigation regarding routine matters to be material.

Contingent liabilities

As part of its ongoing reinsurance recoverable arbitrations, we have obtained letters of credit for the benefit of certain parties. Our principal operating subsidiary, Vesta Fire is contingently liable under the terms of these letters of credit. For our reinsurance arbitrations, we have obtained letters of credit totaling $33.7 million for which we are contingently liable. Additionally, as part of our specialty lines underwriting retained, we have obtained letters of credit or other pledges of securities totaling $29.2 million securing our obligations under the various reinsurance agreements. As part of our Federal Home Loan Bank Program, as more fully described in Note M, we have pledged securities with a market value of $176.8 million securing our obligation thereunder.

Leases

We lease office space for our home office and subsidiary offices under operating lease arrangements. Rental expense for operating leases was $6.2 million, $3.0 million, and $2.1 million for the years ending December 31, 2001, 2000 and 1999 respectively. Future minimum rental commitments required under these leases are approximately $3.2 million per year.

Note G - Supplemental Disclosures for Cash Flow Statement

The following table summarizes amounts recorded for interest and income taxes paid (in thousands).

	Year Ended December 31, 2001	2000	1999
Cash paid for interest	$19,642	$23,275	$10,174
Cash paid for income taxes	7,605	1,901	--

In 2001, we redeemed $10.0 million face amount of Deferrable Capital Securities in exchange for approximately 965 thousand shares of common stock. The resulting after-tax gain from these transactions of $1.9 million was recorded directly to equity in accordance with EITF 86-32 "Early Extinguishment of a Subsidiary's Mandatorily Redeemable Preferred Stock." Also, we redeemed

$7.0 million face amount of our Senior Debentures in exchange for approximately 568 thousand shares of common stock. In December 2001, we issued 1.5 million shares of common stock in exchange for 9.2 million shares of Instant Insurance Holdings, Inc. held by a minority shareholder.

In December 2000, we issued 952,381 shares of common stock in exchange for 693 shares of non-voting stock of Aegis Financial Corporation. In December 2000, we issued 555,738 shares of common stock in exchange for 3,000,000 shares of Instant Auto Insurance Holdings, Inc. In December 2000, we issued 1,200,066 shares of common stock in exchange for $8 million face amount of our Deferrable Capital Securities, resulting in a pre-tax gain of $2.0 million.

36

Vesta Insurance Group, Inc
Notes to Consolidated Financial Statements

Note H - Reinsurance

Vesta engages in reinsurance ceded transactions as part of its overall underwriting and risk management strategy. Vesta's reinsurance ceded programs include coverages which limit the amount of individual claims to a fixed amount or percentage and which limit the amount of claims related to catastrophes.

The effect on premiums earned and losses and loss adjustment expenses of all assumed reinsurance transactions are as follows:

	Year Ended December 31, 2001	2000	1999
		(in thousands)	
Premiums assumed	$11,698	$38,240	$116,678
Losses, policy benefits, and LAE assumed	37,453	31,746	69,348

The effect on premiums earned and losses and loss adjustment expenses incurred of reinsurance ceded transactions are as follows:

	Year Ended December 31, 2001	2000	1999
		(in thousands)	
Reinsurance ceded:			
Premiums ceded	$130,473	$43,413	$91,759
Losses, policy benefits, and loss adjustment expenses	110,321	40,316	97,758

The amount of reserves for unpaid losses and loss adjustment expenses, policy benefits and unearned premiums that Vesta would remain liable for should reinsuring companies be unable to meet their obligations are as follows:

	Year Ended December 31, 2001	2000

	(in thousands)	
Losses and loss adjustment expense	$167,281	$170,050
Policy benefits	152,235	170,766
Retroactive Reinsurance Receivable	599	599
Unearned premiums	37,712	12,534
	$357,827	$353,949

During 2000, Vesta entered into a transaction with NeHi Re, L.P., a special purpose limited syndicate under the INEX Insurance Exchange, to provide $50.0 million of excess-of-loss reinsurance protection to potential losses arising in Hawaii and in the Northeast United States for a period of three years. We paid $3.0 million in annual premiums for this catastrophe reinsurance.

Note I - Income Taxes

Income tax expense (benefit) consists of:

	Year Ended December 31,		
	2001	2000	19
	(in thousands)		
Current tax expense (benefit)	$ 531	$ 709	$ 1,
Deferred tax expense (benefit)	(14,877)	6,805	16,
Less:			
Tax (benefit) expense from discontinued operations	(11,406)	(1,418)	5,
Tax expense on extraordinary gain on extinguishment of debt	490	2,568	5,
Tax expense on gain on redemption of preferred securites	1,060	700	
Total tax expense (benefit) from continuing operations	$ (4,490)	$ 5,664	$7,

Vesta's effective income tax rate differed from the statutory income tax rate as follows:

	Year Ended December 31,		
	2001	2000	1999
Statutory federal income tax rate	35.0%	35.0%	35.0%
Increases (reductions) in tax resulting from:			
Tax exempt investment income	(0.6)	(4.0)	(5.0)
Goodwill	0.2	1.0	0.4
Other	0.4	1.9	0.6
	35.0%	33.9%	31.0%

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2001 and 2000 are presented below:

	2001	2000
	(in thousands)	
Deferred tax assets:		
Unearned and advance premiums	$10,312	$ 6,160
Discounted unpaid losses	9,146	6,443
Net operating loss/AMT credit carryforward	30,213	15,468
Policy liabilities	5,514	4,204
Goodwill	8,804	9,653
Other	10,448	11,107
Total deferred tax assets	74,437	53,035
Deferred tax liabilities:		
Deferred acquisition costs	21,973	18,433
Unrealized gains (losses)	5,306	2,330
Fixed assets	2,384	1,874
Other	6,183	7,941
Total deferred tax liabilities	35,846	30,578
Net deferred tax asset	$38,591	$22,457

Deferred tax assets are to be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax assets will not be realized. Vesta has determined that the benefits of its deferred tax assets are realizable and accordingly, no valuation allowance has been recorded at December 31, 2001 and 2000. Net operating loss carryforwards expire in periods through 2021.

Note J - Shareholders' Equity

Vesta has a Shareholders' Rights Plan that provides for the payment of a dividend of one preferred stock purchase right to be attached for each outstanding share of common stock. Each Right, if and when it becomes exercisable, will entitle the registered holder to purchase from Vesta one one-hundreth (1/100) of a share of Vesta's Series B Junior participating Preferred Stock at a price of $30.00 per one one-hundreth of a share. The Rights will be excercisable only if a person or group acquires a beneficial ownership of 10% or more of the common stock. The Rights entitle the holder to purchase one one-hundreth of a share of a new series of preferred stock at an exercisable price of $30.00 and will expire on June 15, 2010.

On January 26, 2001, pursuant to the original terms, the holders of our Series A Convertible Preferred Stock, converted their preferred stock into 5.9 million shares of common stock. We subsequently purchased these shares for approximately $47.6 million.

In 2001, we sold 5.5 million share of common stock to third parties for approximately $32.3 million. In June, 2001, we completed a follow on offering of 8.625 million shares of common stock for approximately, $64.0 million, net of offering expenses. Additionally, in 2001, we purchased 1.4 million shares on the open market for approximately $9.7 million. These shares were used for various restricted stock awards, debt for equity exchanges or are held in treasury. As of December 31, 2001, the Board of Directors has authorized the Company to acquire up to 3.6 million of additional shares of treasury stock.

Vesta Insurance Group, Inc
Notes to Consolidated Financial Statements

In 2001, we redeemed $10.0 million face amount of Deferrable Capital Securities in exchange for approximately 965 thousand shares of common stock. We also redeemed preferred stock of a subsidiary with a stated value of $9.0 million and a carrying value of $8.4 million for approximately $5.2 million. Additionally, we were not required to pay the contingent amount recorded in 2000 as discussed below. The resulting after-tax gain from these transactions of $7.1 million was recorded directly to equity in accordance with EITF 86-32 "Early Extinguishment of a Subsidiary's Mandatorily Redeemable Preferred Stock." Also, we redeemed $7.0 million face amount of our Senior Debentures in exchange for approximately 568 thousand shares of common stock. The resulting after-tax gain of $.9 million ($0.03 per diluted share) was recorded on the statement of operations as an extraordinary gain on the extinguishments of debt.

On December 31, 2001, we issued 1.5 million shares of common stock in exchange for 9.2 million shares of Instant Insurance Holdings, Inc. held by a minority shareholder.

In the fourth quarter of 2000, Vesta redeemed preferred stock of a subsidiary with a stated value of $21 million and a carrying value of $18 million for $7.0 million including a $3.5 million contingent payable. In addition, we redeemed $8 million of Deferrable Capital Securities in exchange for 1.2 million shares of common stock. The resulting after-tax gain from these transactions of $9.2 million was recorded directly to equity in accordance with EITF 86-32 "Early Extinguishment of a Subsidiary's Mandatorily Redeemable Preferred Stock."

In the fourth quarter of 2000, Vesta established the Agent Stock Incentive Plan Trust to satisfy future obligations of Vesta to its Agents under the terms of the Agent's Stock Incentive Plan. Vesta issued 750,000 shares to the Trust in December 2000. At December 31, 2001 and 2000, respectively, 744,748 shares and 750,000 shares were held by the trust and are included in the Unearned stock caption on the Balance Sheet as contra equity.

During 2000, we engaged in a number of purchases and sales of our common stock. In two separate transactions, we repurchased 5.1 million shares of stock from our former parent, Torchmark Corporation. We disposed of the acquired stock in a number of private placements, two debt for equity exchanges, the acquisitions of Aegis Financial Corporation and Instant Insurance Holdings, and the establishment of the Agent Stock Incentive Plan Trust.

Unearned stock consists of shares of common stock issued by Vesta that remain subject to certain future restrictions, and therefore are shown as a reduction to stockholders' equity. Unearned stock compensation is composed of the following at December 31, 2001 and 2000, (in thousands):

	2001	2000
Unamortized restricted stock awards	$14,537	$1,804
Receivable from issuance of restricted stock	278	438
Agent's trust	4,692	4,725
	$19,507	$6,967

Note K - Segment Information

We operate several segments, which are distinguishable by their product offerings. The accounting policies of the operating segments are described in Note A. Segment pre-tax income is generally income before income tax and minority interest. Premiums, policy fees, other income, loss and benefit expenses, operating expenses, and policy acquisition expenses are attributed directly to each operating segment. Net investment income and interest expense are allocated only to those segments for which such amounts are considered an integral part of the financial results for that segment.

A brief description of each segment is as follows:

Standard Property-Casualty

The standard property-casualty segment primarily consists of the marketing and distribution of personal lines products including residential property and private passenger auto coverages. Vesta's products are distributed primarily through approximately 1,500 independent agencies in 24 states. Our standard personal auto line targets drivers over age thirty-five with above average driving records and our residential property products cover the full range of homes.

Life and Health Insurance

On June 30, 2000, we entered the life and annuity business through an investment in American Founders Financial Corporation, a holding company for two life insurance companies domiciled in Texas and we entered the health insurance business through the acquisition of Aegis Financial Corporation in December 2000. American Founders and Aegis have approximately $2.5 billion (face value) of life and annuity products in force and approximately $22.5 million of health insurance premiums in force at December 31, 2001. American Founders markets traditional life products, universal life products, fixed-rate annuities, pension contracts and related products through independent agents throughout the majority of the United States. Aegis Financial markets health insurance products through captive agents throughout the United States.

Specialty Lines

Specialty lines include our fronting operations and any underwriting risk retained from premiums written through our non-standard auto agencies. In fronting arrangements, we write targeted property-casualty insurance coverages and reinsure substantially all of the risks to reinsurers in exchange for fees. This business takes advantage of our certificates of authority granting us license to write insurance in many states. Income from fronting arrangements is primarily generated on a fee-for-service basis. For the premium written through our non-standard auto agencies, we determine based on market conditions,

and the prospective results of the underlying business, whether to keep 100% of the underwriting risk or reinsure this risk to various reinsurers. Our decision on how much underwriting risk to retain is dependent on the current rating environment and the amount of commissions offered by the reinsurers.

Non-Standard Auto Agency

The non-standard auto agency segment consists of our non-standard auto agency retail and wholesale operations. The primary sources of revenue are agent's commissions and fees collected by retailers and fees and commissions collected by wholesalers. These revenue streams are not risk-bearing.

Corporate and Other

Our corporate and other segment primarily consists of unallocated net investment income, unallocated interest expense, and certain overhead expenses not directly associated with a particular segment.

2001	Standard Property-Casualty	Life and Health Insurance	Specialty Lines	Non-Standard Auto Agenc
			(in thousands)	
Revenues:				
Premiums earned	$246,063	$ 30,572	$10,169	
Net investment income	--	43,494	--	$ 325
Policy fees	3,547	3,971	156	--
Realized gains (losses)	--	(3,311)	--	--
Other	718	1,060	4,237	5,892
Total revenues	250,328	75,786	14,562	6,217
Expenses:				
Loss, LAE and policyholder benefits	161,599	35,950	7,997	--
Policy acquisition costs	54,795	7,682	2,356	--
Litigation settlement charge	--	--	--	--
Operating expenses	32,356	12,520	276	9,087
Interest on debt	--	8,584	--	83
Goodwill and other intangible amortization	--	--	--	--
Total expenses	248,750	64,736	10,629	9,170
Pre-tax income (loss) from continuing operations	$ 1,578	$ 11,050	$ 3,933	$(2,953)
Operating segment assets:				
Investments and other assets	$267,686	$936,034	$55,056	$38,777
Deferred acquisition costs	36,800	21,538	494	--
	$304,486	$957,572	$55,550	$38,777

2000	Standard Property-Casualty	Life Insurance	Specialty Lines	Corpo O
			(in thousands)	
Revenues:				

Premiums earned	$212,809	$ 3,093	$1,097	
Net investment income	--	21,360	--	$
Policy fees	2,177	2,209	--	
Realized losses	--	--	--	
Other	--	712	977	
Total revenues	214,986	27,374	2,074	
Expenses:				
Loss, LAE and policyholder benefits	124,772	9,610	660	
Policy acquisition costs	52,361	619	244	
Operating expenses	26,616	5,855	--	
Interest on debt	--	5,179	--	
Goodwill and other intangible amortization	--	--	--	
Total expenses	203,749	21,263	904	
Pre-tax income (loss) from continuing operations	$ 11,237	$ 6,111	$1,170	$
Operating segment assets:				
Investments and other assets	$209,274	$885,578	$5,314	$3
Deferred acquisition costs	27,169	18,533	252	
	$236,443	$904,111	$5,566	$3

1999	Standard Property-Casualty	Life Insurance	Specialty Lines	Corpo C
		(in thousands)		
Revenues:				
Premiums earned	$248,076	--	--	
Net investment income	--	--	--	$ 2
Realized gains	--	--	--	1
Other	4,347	--	--	
Total revenues	252,423			3
Expenses:				
Loss, LAE and policyholder benefits	165,014	--	--	
Policy acquisition costs	46,289	--	--	
Operating expenses	28,811	--	--	1
Interest on debt	--	--	--	1
Goodwill and other intangible amortization	--	--	--	
Total expenses	240,114			2
Pre-tax income from continuing operations	$ 12,309			$1
Operating segment assets:				
Investment and other assets	$354,286	--	--	$38
Deferred acquisition costs	31,362	--	--	
	$385,648			$38

Vesta Insurance Group, Inc
Notes to Consolidated Financial Statements

Note L - Debt and Deferrable Capital Securities

Long-term debt and Deferrable Capital Securities at December 31, 2001 and 2000 consists of the following (in thousands):

	2001	2000
8.75% Senior Debentures, due July 15, 2025	$79,820	$86,820
Less: debt issue cost	(388)	(401)
Long-term debt	$79,432	$86,419
8.525% Deferrable Capital Securities, issued by Vesta Capital Trust I, due January 15, 2027	$23,250	$33,225

The Senior Debentures are unsecured and rank on parity with all other unsecured and unsubordinated indebtedness. The debentures contain certain restrictions on the ability of Vesta to issue, sell, or otherwise dispose of any restricted subsidiary or to pledge the capital stock of any subsidiary.

During the year ended December 31, 2001, we extinguished $7.0 million of our 8.75% Senior Debentures for 568,644 shares of common stock. We recorded an extraordinary gain, net of tax, of $.9 million ($.03 per diluted share), as a result of the early redemption of this long term debt. During the year ended December 31, 2000, we extinguished $13.1 million of our 8.75% Senior Debentures for approximately $9.8 million plus accrued interest and all $44.1 million of our 12.5% Senior Notes for approximately $38.2 million plus accrued interest. We recorded extraordinary gains, net of tax, and related debt issue costs of $5.3 million ($.22 per diluted share), as a result of the early redemption of this long term debt. The redemptions were funded with internally generated cash. The warrants attached to the 12.5% Senior Notes have been cancelled.

Vesta's short-term debt outstanding at December 31, 2001 and 2000 is as follows (in thousands):

	Outstanding	Available
2001	$29,964	$ 36
2000	$ 5,000	$10,000

On March 3, 2000, we established a revolving credit facility with First Commercial Bank, Birmingham, Alabama ("First Commercial"). In May, 2001 we increased the amounts available and increased the term of the credit facility to the following:

- a $15 million unsecured line which bears interest at First Commercial's prime rate +1/4%;
- an additional $15 million line which bears interest at First Commercial's prime rate, secured by a pledge of the revenues received under management contract between our wholly owned management company,

J. Gordon Gaines, Inc., and our operating insurance subsidiaries.

Each of these credit facilities mature on April 30, 2003. These credit agreements contain covenants which require us to maintain minimum (i) statutory consolidated net income, (ii) GAAP consolidated net income, (iii) statutory surplus and (iv) risk based capital. For the period ending December 31, 2001, our GAAP consolidated net income and statutory surplus did not meet the minimum requirements as set forth in our credit agreements. First Commercial has agreed that any such non-compliance will not be deemed an event of default under the credit agreement.

In 1997, our single purpose finance subsidiary, Vesta Capital Trust I, issued $100 million principal amount of its 8.525% Deferrable Capital Securities. We have unconditionally guaranteed Vesta Capital Trust's obligation to make semi-annual distributions on these capital securities, and we have issued a debenture in a like amount to Vesta Capital Trust which requires us to make interest payments in the same amounts and at the same times as the distributions which are payable on these capital securities. These securities and the related distributions are treated in a manner similar to minority interest in the financial statements. The terms of the capital securities and the underlying debenture permit us to defer interest payments on the debentures, and, therefore, distributions on the capital securities, for up to ten years. We exercised this right of deferral with respect to the semi-annual payment originally due July 15, 1999. While we have elected to resume payment on these capital securities effective January 15, 2000, including all accrued amounts due since July 15, 1999, we may elect to defer payments again in the future. In the event we elect to defer such payments again in the future, we will not be permitted to pay any dividends on our common stock or other equity securities. In December, 1999, we exchanged $44.1 million of 12.5% senior notes, due 2006 for $58.8 million of the Deferrable Capital Securities. The resulting after-tax gain of $9.5 million was recorded directly to retained earnings in accordance with EITF 86-32 "Early Extinguishment of a Subsidiary's Mandatorily Redeemable Preferred Stock." In December, 2000, we exchanged 1.2 million shares of common stock for $8 million face amount of Deferrable Capital Securities. The resulting after-tax gain of $1.3 million was recorded directly to retained earnings in accordance with EITF 86-32. In 2001, we exchanged 965 thousand shares of common stock for $10 million face amount of Deferrable Capital Securities. The resulting after tax gain of $1.9 million was recorded directly to retained earning in accordance with EITF 86-32. The after tax gains from these transactions have been included in the respective computations of income available to common shareholders and related earnings per share computations in accordance with EITF Topic No. D-42, "The Effect on the Calculation of Earnings per Share for the Redemption or Induced Conversion of Preferred Stock.".

As of December 31, 2001, approximately $23.3 million of these capital securities remained outstanding and carried a semi-annual distribution obligation of approximately $ 1.0 million.

Note M - Federal Home Loan Bank Advances

Advances from the Federal Home Loan Bank as of December 31, 2001 and 2000 are as follows (in thousands):

	2001	2000
Short-term advances, bearing interest at 1.91% to 4.015% for 2001 and 6.62% for 2000	$ 95,100	$ 75,000
Amortizing advances with balloon payments, bearing interest at rates from 6.41% to 7.3%, maturing from 2010 to 2016	66,412	68,107
Fully amortizing advances, bearing interest at rates ranging From 6.19% to 7.48%, maturing from 2003 to 2017	7,102	7,584
	$168,614	$150,691

We are required to maintain a collateral deposit with FHLB. At December 31, 2001 and 2000 respectively, investments having a market value of approximately $176.8 million and $153.9 million at December 31, 2001 and 2000, respectively, were pledged to the FHLB. Interest expense was approximately $8.6 million and $9.6 million for the years ended December 31, 2001 and 2001, respectively.

Annual maturities of borrowings from FHLB as of December 31, 2001 are as follows (in thousands):

2002	$ 88,401
2003	15,337
2004	5,249
2005	3,290
2006	2,582
Thereafter	53,755
	$168,614

Note N - Stock Based Compensation

During 1995, the Financial Accounting Standards Board issued Financial Accounting Statement No. 123, Accounting for Stock-Based Compensation ("SFAS 123"). The Statement defines a fair value based method of accounting for an employee stock option. It also allows an entity to continue using the intrinsic value based accounting method prescribed by Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees. Vesta has continued to use this method to account for its stock options and other forms of stock based compensation. However, SFAS 123 requires entities electing to remain with the intrinsic method of accounting to provide pro forma disclosures of net income and earnings per share as if the fair value based method of accounting had been applied as well as other disclosures about Vesta's stock-based employee compensation plans. Information about Vesta's stock based compensation plans and the related required disclosures follow.

Prior to completion of our initial public offering, our stockholders approved the Vesta Insurance Group, Inc. Long Term Incentive Plan ("Plan"), which provided for grants to our executive officers of restricted stock, stock options, stock appreciation rights, and deferred stock awards, and in certain instances grants of options to directors. Our stockholders approved certain amendments to the Plan effective August 27, 1999 and May 16, 1995, including an amendment to increase the shares of common stock available for awards to 2,221,998 shares and an amendment to delete the provision for the grant of options to non-employee directors. The stockholders also approved the Vesta Insurance Group, Inc. Non-Employee Director Stock Plan ("Director Plan") effective May 16, 1995, which provides for grants to Vesta's non-employee directors of stock options and restricted stock.

Pro forma information regarding net income and earnings per share is required by SFAS 123 and has been determined as if Vesta had accounted for its employee stock options under the fair value method of that Statement. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions for 2001, 2000 and 1999, respectively: risk-free interest rates of 5.13%, 6.50% and 6.22%; dividend yields of 1.0%, 1.0% and 1.67% percent; volatility factor of the expected market price of Vesta's common stock of 88.97, 78.39 and 67.02; and a weighted-average expected life of the options of ten years for all years.

43

Vesta Insurance Group,Inc
Notes to Consolidated Financial Statements

Vesta's actual and pro forma information follows (in thousands, except for earnings per share information):

	Year Ended December 31		
	2001	2000	1
Net income (loss) available to common shareholders			
As reported	$(22,425)	$ 16,722	$ 3
Pro forma	(22,689)	16,511	3
Net income (loss) available to common shareholder per share - basic			
As reported	$ (0.84)	$ 0.92	$
Pro forma	(0.85)	0.91	
Net income (loss) available to common shareholder per share - diluted			
As reported	$ (0.84)	$ 0.78	$
Pro forma	(0.85)	0.77	

The following summary sets forth activity under the Plans for the years ended December 31:

	2001		2000		1999	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price	Options	Wei Ave Exe Pr
Outstanding--beginning of the year	825,562	$ 10.92	860,636	$ 15.64	564,048	$
Granted	137,500	6.16	130,000	4.89	431,500	
Exercised	--	--	--	--	--	
Forfeited	95,085	4.50	165,074	30.79	134,912	
Outstanding--end of the year	867,977	$ 9.93	825,562	$ 10.92	860,636	$
Weighted-average fair value of options granted during the year	$ 3.85		$ 3.72		$ 2.92	

Of the 867,977 outstanding options at December 31, 2001, 460,477 were exercisable.

The following table shows expiration dates and weighted average exercise price for all outstanding options and options currently exercisable at December 31, 2001.

Expiration Date	Number of Shares	Weighted Average Exercise Price	Options Exercisable
2003	91,416	$ 16.60	91,416
2004	19,500	15.05	19,500
2005	92,061	22.09	92,061
2006	9,000	35.38	9,000
2007	15,000	31.00	15,000
2008	15,000	59.19	15,000
2009	358,500	4.51	138,500
2010	130,000	4.89	40,000
2011	137,500	6.16	40,000

At December 31, 2001, Vesta has issued 2,005,818 shares of restricted stock. 74,307 shares have been issued to officers of Vesta in exchange for promissory notes. The common stock is being held by Vesta as security for the repayment of the notes. The balance of the unamortized restricted stock and unpaid note receivable at December 31, 2001 and 2000, was $14.8 million and $2.2 million, respectively, and are shown as reductions to stockholders' equity. The restrictions on the remaining 1.9 million shares expire in 2002 - 2011.

44

Vesta Insurance Group,Inc
Notes to Consolidated Financial Statements

Note O - Quarterly Financial Information (Unaudited)

The following is a summary of quarterly financial data, in thousands except per share data:

	Three months ended			
	March 31, 2001	June 30, 2001	September 30, 2001	Dece 2
Premiums and policy fees earned	$ 66,648	$ 75,919	$ 75,927	$
Net investment income	15,603	17,110	15,450	
Operating costs and expenses	80,997	85,676	122,402	
Income tax (benefit) expense	1,787	4,341	(9,510)	
Minority interest and Deferrable Capital Securities	632	915	587	
Net income (loss) from continuing operations	2,629	7,215	(18,162)	
Preferred stock dividend	(163)	--	--	
Net income (loss) from discontinued operations	5	(163)	(19,800)	
Net income available to stockholders	3,036	7,052	(31,953)	
Basic per share data:				
Net (loss) income from continuing operations	0.14	0.30	(0.57)	

Net income (loss) from discontinued operations	--	(0.01)	(0.62)
Net income (loss) available to stockholders	0.16	0.30	(1.00)

	Three months ended			
	March 31, 2000	June 30, 2000	September 30, 2000	December 2000
Premiums and policy fees earned	$ 56,565	$ 52,138	$ 54,476	$ 56,02
Net investment income	7,003	5,258	16,854	16,78
Operating costs and expenses	65,761	50,116	64,005	67,67
Income tax expense	(777)	2,961	2,078	1,40
Minority interest and Deferrable Capital Securities	571	571	1,429	1,01
Net income (loss) from continuing operations	(1,659)	5,072	2,993	1,94
Preferred stock dividend	563	563	1,272	1,27
Net income(loss) from discontinued operations	3,913	(2,833)	1,003	(4,48
Net income available to stockholders	6,258	2,359	2,724	5,38
Basic per share data:				
Net (loss) income from continuing operations	(0.09)	0.28	0.16	0.1
Net (loss) income from discontinued operations	0.21	(0.15)	0.06	(0.2
Net income available to stockholders	0.33	0.13	0.15	0.2

As discussed in Note Q, Vesta discontinued its commercial operations effective in the fourth quarter of 1999 and its reinsurance assumed operations, effective the fourth quarter of 2000. Quarters prior to such effective dates have been reclassified in accordance with Accounting Principal Board Opinion No. 30 (APB 30) for presentation of discontinued operations.

Vesta Insurance Group,Inc
Notes to Consolidated Financial Statements

Note P - Fair Values of Financial Instruments

The carrying amounts and estimated fair values of Vesta's financial instruments, none of which were held for trading purposes, were as follows (in thousands):

	2001	2000

	Carrying Amount	Estimated Fair Value	Carrying Amount	E
Financial assets:				
Fixed maturities	$807,197	$807,197	$798,205	
Equity securities	31,431	31,431	31,285	
Cash and short-term investments	64,777	64,777	35,960	
Mortgage loans	16,870	16,870	26,708	
Collateral loans	27,108	27,108	36,352	
Policy loans	63,949	63,949	61,413	
Other invested assets	47,996	47,996	29,343	
Financial liabilites:				
Insurance liabilties for investment contracts	576,849	550,065	561,899	
FHLB advances	168,614	168,614	150,691	
Long term debt and deferrable capital securities	102,682	69,552	119,644	

The fair values presented represent management's best estimates and may not be substantiated by comparisons to independent markets and, in many cases, could not be realized in immediate settlement of the instruments. Certain financial instruments and all nonfinancial instruments are not required to be disclosed; therefore, the aggregate fair value amounts presented do not purport to represent the underlying fair value of Vesta. Except as noted below, fair values were estimated using quoted market prices.

- Equity Securities - The carrying value of unaffiliated common stock, except for stock of FHLB, approximates fair value. Because FHLB shares are not publicly traded, the market value of the stock was considered to be equivalent to its cost due to the fact that FHLB has historically redeemed the shares at the original cost.

- Mortgage Loans - The fair value of mortgage loans is calculated by discounting scheduled cash flows through the estimated maturity using the current rates at which similar loans would be made to borrowers with similar credit and interest rate risks. Approximately $66,000 of the loans were in the process of foreclosure.

- Other Invested Assets, Including Collateral Loans - The carrying value of certain other invested assets approximates fair value because existing rates of return approximates the current rates of return required on similar investments. The carrying amount of collateral loans approximates fair value as effective yields approximate current rates.

- Annuity Account Balances - Annuity account balances include single premium and flexible premium deferred and immediate annuity contracts, supplementary contracts not having significant mortality risk, policyholder dividend accumulations, and separate account liabilities. Cash surrender value is used in determining the fair value of single premium and flexible premium deferred annuity contracts. Carrying amounts approximated fair value for immediate annuities, supplementary contracts, policyholder dividend accumulations, and separate account liabilities.

- Borrowings - Fair values for the advances from FHLB were calculated using interest rates in effect as of each year end with the other terms of the advances unchanged. Carrying values of short term debt approximate fair value as effective rates approximate current rates. Fair values of long term debt and deferrable capital securities, were determined based on recent transactions involving the applicable securities.

It is not practical to estimate the fair value of policy loans as they have no stated maturity and their rates are set at a spread related to policy liability amounts.

Note Q - Discontinued Operations

In 1999, we elected to exit the assumed reinsurance business and ceased accepting new contracts. We sold the majority of our reinsurance assumed operations, including most renewal rights to Hartford Fire Insurance Company in the first quarter of 1999 for $15 million. In the fourth quarter of 2000, the last active reinsurance contract was commuted. Such commutation represented the measurement date for treatment of the reinsurance assumed business as a discontinued operation under Accounting Principles Board Opinion 30. Therefore, the reinsurance assumed operations have been segregated from continuing operations herein for all periods presented. Vesta will continue to pay losses on policies with coverage periods prior to the measurement date as those losses become due.

In 1999, we elected to exit all commercial lines programs by not accepting new commercial policy applications and non renewing existing in-force policies at their renewal dates. In November of 1999 we received final regulatory approval to non renew our commercial lines policies from all of the states in which we wrote commercial lines. Such approval represented the measurement date for treatment of the commercial segment as a discontinued operation under APB 30. Therefore, the commercial operations have been segregated from continuing operations herein for all periods presented. We will continue to earn premium and incur losses on policies which were in-force through November 1999.

As a result of an unexpected increase in the severity and volume of reported claims associated with both our discontinued commercial and assumed reinsurance lines and an increase in payments on claim reserves during 2001, we increased our expected losses from discontinued operations by approximately $19.5 million, net of tax. The increase in our expected losses with respect to our commercial business related to a variety of underlying coverages including general liability. These types of claims may take many years to fully develop and we must continue to monitor trends in their ultimate development. Similarly, we experienced negative development in some of our assumed reinsurance contracts, principally related to certain homeowner coverages. These types of claims should fully develop over a comparatively shorter period of time. While we believe that the recorded reserves for discontinued operations at December 31, 2001 are adequate, further adjustments to our estimates could be necessary as we continue to run off the remaining outstanding claims. Operating results of reinsurance assumed and commercial lines were as follows (in thousands):

	2001	2000
Net premium earned	$ (265)	$ 36,296
Income (loss) from discontinued operations before tax	(31,364)	(3,815)

Income tax expense (benefit)	(11,406)	(1,418)
Income (loss) from discontinued operations	(19,958)	(2,397)
Basic net income (loss) from discontinued operations per common share	(0.75)	(0.13)
Diluted net income (loss) from discontinued operations per common share	(0.75)	(0.10)

Assets and liabilities of the commercial lines and reinsurance assumed segments are primarily comprised of the following at December 31 (in thousands):

	2001	2000
Investments and other assets	$99,824	$128,794
Reserves for loss, LAE and unearned premium	99,824	128,794

Note R - Related Party Transactions

In June of 2001, the Company settled a contingent liability with three of its executives under the Executive Officer Incentive Compensation Plan, by issuing 1.25 million shares of restricted stock and giving the executives total loans of $5.0 million. The restricted stock, which is recorded as Unearned Stock at December 31, 2001, vest over a 10 year period. The loans, which are recorded as Other Assets at December 31, 2000, will be forgiven over a 10 year period. The Company will record the vesting of the restricted stock and the forgiveness of the loans as compensation expense in the appropriate periods. In addition, the Company has made a loan of $250 thousand to the Chairman of the Board related to his residential property in Alabama.

47

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None

48

PART III

Item 10. Directors and Executive Officers of Registrant

Information required by this item is incorporated by reference from the sections entitled "Information about our Board of Directors and Executive Officers," and "Compensation and Other Transactions with Executive Officers and Directors" in the Proxy Statement for the Annual Meeting of Stockholders to be held May 28, 2002 (the "Proxy Statement"), which is to be filed with the Securities and Exchange Commission prior to May 1, 2002.

Item 11. Executive Compensation

Information required by this item is incorporated by reference from the section entitled "Compensation and Other Transactions with Executive Officers and Directors" in the Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management

(a) Security ownership of certain beneficial owners:

Information required by this item is incorporated by reference from the section entitled "Principal Stockholders" in the Proxy Statement.

(b) Security ownership of management:

Information required by this item is incorporated by reference from the section entitled "Information about our Board of Directors and Executive Officers" in the Proxy Statement.

(c) Changes in control:

We know of no arrangements, including any pledges by any person of its securities, the operation of which may at a subsequent date result in a change of control.

Item 13. Certain Relationships and Related Transactions

Information required by this item is incorporated by reference from the section entitled "Information about our Board of Directors and Executive Officers" in the Proxy Statement.

PART IV

Item 14. Exhibits, Financial Statements Schedules, and Reports on Form 8-K

(a) Index of documents filed as a part of this report:

(1) Financial Statements:

Vesta Insurance Group, Inc.

Report of Independent Accountants

Consolidated Balance Sheets at December 31, 2001 and 2000

Consolidated Statements of Operations for each of the years in the three-year period ended D

Consolidated Statements of Stockholders' Equity for each of the years in the three-year peri
31, 2001

Consolidated Statements of Cash Flow for each of the years in the three-year period ended De

Notes to Consolidated Financial Statements

(2) Schedules Supporting Financial Statements for the three years ended December 31, 2001

II. Condensed Financial Information of Registrant (Parent Company)

III. Supplemental Insurance Information (Consolidated)

IV. Reinsurance (Consolidated)

V. Valuation and Qualifying Accounts (Consolidated)

Schedules not referred to have been omitted as inapplicable or not required by Regulation S-X.

(3) Exhibits

Exhibits are listed in the index of Exhibits at page 51.

(b) Reports on Form 8-K: No reports on Form 8-K were filed during the last quarter of the period covered by this report.

EXHIBITS INDEX

Exhibit No.	Description
3.2	By-Laws of the Company (Amended and Restated as of October 1, 1993) (filed as an exhibit to Amendment No. 1 to the Registration Statement on Form S-1 (Registration No. 33-68114) of Vesta Insurance Group, Inc., filed on October 18, 1993 and incorporated herein by reference (File No. 1-12338))
4.1	Indenture between the Company and Southtrust Bank of Alabama, National Association, dated as of July 19, 1995 (filed as an exhibit to the Company's Form 10-K for the year ended December 31, 1995, filed on March 28, 1996 and incorporated herein by reference (File No. 1-12338))
4.2	Supplemental Indenture between the Company and Southtrust Bank of Alabama, National Association, dated July 19, 1995 (filed as an exhibit to the Company's Form 10-K for the year ended December 31, 1995, filed on March 28, 1996 and incorporated herein by reference (File No. 1-12338))
4.3	Indenture dated as of January 31, 1997, between the Company and First Union National Bank of North Carolina, as trustee (filed as an exhibit to the Company's Form 10-Q for the quarter ended March 31, 1997, filed on May 13, 1997 and incorporated herein by reference (File No. 1-12338))
4.4	Amended and Restated Declaration of Trust, dated as of January 31, 1997, of Vesta Capital Trust I (filed as an exhibit to the Company's Form 10-Q for the quarter ended March 31, 1997, filed on May 13, 1997 and incorporated herein by reference (File No. 1-12338))
4.5	Capital Securities Guarantee Agreement, dated as of January 31, 1997, between the Company and First Union National Bank of North Carolina, as trustee (filed as an exhibit to the Company's Form 10-Q for the quarter ended March 31, 1997, filed on May 13, 1997 and incorporated by reference (File No. 1-12338))

10.1	Amended and Restated Management Agreement between J. Gordon Gaines, Inc. and Vesta Fire Insurance Corporation and its subsidiary and affiliated companies, effective as of January 1, 1999 (filed as an exhibit to the Company's Form 10-K for the year ended December 31, 2000, filed on March 29, 2001 and incorporated herein by reference)
10.2	Office Lease between the Company and Torchmark Development Corporation, dated as of April 20, 1992 (filed as an exhibit to the Company's Form 10-K for the year ended December 31, 1993, filed on March 28, 1994 and incorporated herein by reference (File No. 1-12338))
10.3	Commercial/Personal Property Risk Excess Reinsurance Contracts, dated July 1, 1993, constituting the Company's Direct Per Risk Treaty Program, between Vesta Fire Insurance Corporation and its subsidiary and affiliated companies and various reinsurers (filed as an exhibit to Amendment No. 1 to the Registration Statement on Form S-1 (Registration No. 33-68114) of Vesta Insurance Group, Inc., filed on October 18, 1993 and incorporated herein by reference (File No. 1-12338)) Renewed August 1, 2001.
10.4	Casualty Excess of Loss Reinsurance Agreements, dated January 1, 1998, constituting the Company's Casualty Excess of Loss Reinsurance Program, between Vesta Fire Insurance Corporation and its subsidiary and affiliated companies and Employers Reinsurance Corporation, (filed as an exhibit to the Company's Form 10-Q for the quarter ended March 31, 1998, filed on May 13, 1998 and incorporated herein by reference (File No. 1-12338)). Renewed January 1, 2002
10.5	Amendment to Catastrophe Reinsurance Contracts, dated July 1, 1995, constituting the Company's Direct Property Catastrophe Program, between Vesta Fire Insurance Corporation, Vesta Insurance Corporation, Sheffield Insurance Corporation, Vesta Lloyds Insurance Company, Hawaiian Insurance & Guaranty Company, Limited and various reinsurers. (Filed as an exhibit to the Company's Form 10-Q for the quarter ended September 30, 1995, filed on November 14, 1995 and incorporated herein by reference (File No. 1-12338)). Renewed June 1, 2001.
10.6+	Amended and Restated Credit Agreement dated as of May 1, 2001 between Vesta Insurance Group, Inc. and First Commercial Bank establishing a $15 million revolving unsecured credit facility (the "Unsecured Credit Agreement").
10.7+	Waiver of certain covenant violations as of September 30, 2001 related to the Unsecured Credit Agreement.
10.8+	Waiver of certain covenant violations as of December 31, 2001 related to the Unsecured Credit Agreement.
10.9+	Amended and Restated Credit Agreement dated as of May 1, 2001 between Vesta Insurance Group, Inc. and First Commercial Bank establishing a $15 million revolving secured credit facility (the "Secured Credit Agreement").
10.10+	Waiver of certain covenant violations as of September 30, 2001 related to the Secured Credit Agreement.
10.11+	Waiver of certain covenant violations as of December 31, 2001 related to the Secured Credit Agreement.
10.12	Form of Restricted Stock Agreement (filed as an exhibit to the

Registration Statement on Form S-1 (Registration No. 33-68114) of Vesta Insurance Group, Inc., filed on August 31, 1993 and incorporated herein by reference (File No. 1-12338))

10.13*	The Company's Incentive Compensation Plan (filed as an exhibit to the Company's Proxy Statement on Schedule 14A, filed on April 9, 2001 and incorporated herein by reference)
10.14*	The Company's Long Term Incentive Plan as amended effective as of August 27, 1999 (filed as an exhibit to the Company's Proxy Statement on Schedule 14A, filed on August 9, 1999) and incorporated herein by reference

Exhibit No.	Description
10.15*	Form of Non-Qualified Stock Option Agreement entered into by and between the Company and certain of its executive officers and directors (filed as an exhibit to the Company's Form 10-K for the year ended December 31, 1995, filed on March 28, 1996 and incorporated herein by reference (File No. 1-12338))
10.16*	Cash Bonus Plan of the Company (filed as an exhibit to the Company's Form 10-K for the year ended December 31, 1993, filed on March 28, 1994 and incorporated herein by reference (File No. 1-2338))
10.17*	J. Gordon Gaines, Inc. Post Retirement Benefits Plan (filed as an exhibit to the Company's Form 10-K for the year ended December 31, 1994, filed on March 29, 1995 and incorporated herein by reference (File No. 1-12338))
10.18	The Company's Non-Employee Director Stock Plan (filed as an exhibit to the Company's 10-Q for the quarter ended March 30, 2000, filed on May 15, 2000 and incorporated herein by reference (File No. 1-12338))
10.19	Employment Agreement between the registrant and Norman W. Gayle, III, dated as of September 30, 1999. (filed as an exhibit to the Company's Registration Statement on Form S-1, filed on November 5, 1999 and incorporated herein by reference.)
10.20	Employment Agreement between the registrant and James E. Tait, dated as of September 30, 1999.(filed as an exhibit to the Company's Registration Statement on Form S-1, filed on November 5, 1999 and incorporated herein by reference.)
10.21	Employment Agreement between the registrant and Donald W. Thornton, dated as of September 30, 1999. (filed as an exhibit to the Company's Registration Statement on Form S-1, filed on November 5, 1999 and incorporated herein by reference.)
10.22	Employment Agreement between the registrant and W. Perry Cronin, dated as of February 5, 2001 (filed as an exhibit to the Company's Form 10-Q for the period ending September 30, 2001, filed on November 14, 2001 and incorporated herein by reference.)
10.23+	Employment Agreement between a subsidiary company and Kenneth W. Phillips, effective June 30, 2000.

10.24+	Employment Agreement between a subsidiary company and Wayne A. Schreck, effective June 30, 2000.
10.25	Vesta Insurance Group, Inc. Executive Officer Incentive Compensation Plan. (filed as an exhibit to the Company's Registration Statement on Form S-1, filed on November 5, 1999 and incorporated herein by reference.)
10.26+	Settlement Agreement, made as of July 23, 2001, relating to the Vesta Insurance Group, Inc. Executive Officer Incentive Compensation Plan.
21.0+	Subsidiaries of Vesta Insurance Group, Inc.
23.1+	Consent of PricewaterhouseCoopers LLP
99.1+	Comments concerning forward looking statements

*These are the Company's compensatory plans.
+Filed herewith.

52

Vesta Insurance Group, Inc.
(Parent Company)
Schedule II - Condensed Balance Sheets
(in thousands except share data)

	At De 2001
Assets	
Investment in affiliates *	$ 394,607
Short-term investments	100
Total investments	394,707
Cash	--
Other assets	10,803
Total assets	$ 405,510
Liabilities	
Other liabilities	$ 36,807
Short term debt	29,964
Long term debt	79,432
Total liabilities	146,203
Stockholders' equity	
Preferred stock $.01 par value, 5,000,000 shares, authorized, issued: 2001 - 0 and 2000 - 2,950,000	--
Common stock, $.01 par value, 100,000,000 shares authorized, issued: 2001 - 36,994,464 and 2000 - 18,964,322 shares	370
Additional paid-in capital	244,640
Accumulated other comprehensive income, net of tax (benefit) expense of $4,191 and	

$1,453 in 2001 and 2000, respective	7,784
Retained earnings	32,611
Unearned stock	(19,507
Treasury stock	(6,591
Total stockholders' equity	259,307
Total liabilities and stockholders' equity	$ 405,510

* Eliminated in consolidation

Vesta Insurance Group, Inc.
(Parent Company)
Schedule II--Condensed Statements of Operations
(in thousands)

	For the Year Ended December 31, 2001	2000	1999
Revenues:			
Net other income (loss)	$ 4,470	$ 443	$ (4,109)
Expenses:			
Interest expenses	15,125	16,636	18,080
Operating expenses	29,325	2,318	2,724
Total expenses	44,450	18,954	20,804
Net loss before income tax, gain on debt extinguishment and equity in earnings of affiliate	(39,980)	(18,511)	(24,913)
Income tax benefit	13,993	6,479	8,720
Loss before equity in earnings of affiliates, and gain on debt extinguishment	(25,987)	(12,032)	(16,193)
Extraordinary gain on debt extinguishment	2,879	5,250	
Equity in earnings of affiliates *	(6,222)	17,984	39,648
Net income (loss)	$(29,330)	$ 11,202	$ 23,455

* Eliminated in consolidation

Vesta Insurance Group, Inc.
(Parent Company)
Schedule II--Condensed Statement of Cash Flows
(in thousands)

	For the Year Ended December 31, 2001	2000	1999
Cash (used in) provided from operations	$(61,342)	$ 24,862	$ 29,002
Cash used in investing activities:			
Net (increase) decrease in short-term investments	--	3,484	1,207
Cash provided by (used) in investing activities	--	3,484	1,207
Cash (used in) provided from financing activities:			
Dividends paid	(2,770)	(4,611)	(698)
Acquisition of common stock	(57,269)	(56,303)	--
Issuance of common stock	96,381	32,678	--
Net change in short term debt	24,964	--	--
Preferred Stock issuance	--	--	25,075
Capital Contributions from exercising stock options	--	--	324
Issuance(retirement) of debt and deferrable capital securities	--	--	(65,507)
Cash (used in) provided from financing activities	61,306	(28,236)	(40,806)
Net increase (decrease) in cash	(36)	110	(10,597)
Cash balance at beginning of period	$ 36	$ (74)	$ 10,523
Cash balance at end of period	$ --	$ 36	$ (74)

Vesta Insurance Group, Inc.
Schedule III--Supplemental Insurance Information (Consolidated)
As of December 31, 2001 and 2000
(in thousands)

	Deferred Policy Acquisition Costs	Future Policy Benefits,Loss and Loss Adjustment Expense Reserve	Unearned Premiums
As of December 31, 2001			
Standard Property-Casualty	$ 36,800	$156,085	$149,419
Life and Health Insurance	21,538	695,170	--
Specialty lines	494	25,088	30,460
Discontinued operations	--	99,824	--
	58,832	976,167	179,879
As of December 31, 2000			
Standard Property-Casualty	$ 27,169	$130,312	$103,666
Life Insurance	18,533	660,284	--
Specialty lines	252	4,477	1,089
Discontinued operations	--	128,900	--

45,954	923,973	104,755
========	========	========

For the Years Ended December 31, 2001, 2000 and 1999
(in thousands)

	Net Earned Premium	Net Investment Income	Benefits, Claim and Loss Adjustment Expenses	Amortization of DAC
As of December 31, 2001				
Standard Property-Casualty	$246,063	--	$161,599	$ 54,795
Life and Health Insurance	30,572	$ 43,494	35,950	7,682
Specialty lines	10,169	--	7,997	2,356
Non-standard Auto Agency	--	325	--	--
Corporate and other	--	20,099	--	--
	$286,804	$ 63,918	$205,546	$ 64,833
As of December 31, 2000				
Standard Property-Casualty	$212,809	--	$124,772	$ 52,361
Life Insurance	3,093	$ 21,360	9,610	619
Specialty lines	1,097	--	660	(733)
Corporate and other	--	24,543	--	--
	$216,999	$ 45,903	$135,042	$ 52,247

56

Vesta Insurance Group, Inc.
Schedule IV--Reinsurance (Consolidated)
For the Years Ended December 31, 2001, 2000 and 1999
(in thousands)

Premiums Earned	Gross Direct Amount	Ceded to other Companies	Assumed from other Companies	Net Amount	Percentage of Amount Assumed to Net
2001	$ 405,314	$ 130,473	$ 11,698	$ 286,539	4.08%
2000	255,257	43,413	38,240	250,084	15.29%
1999	362,830	83,173	116,678	396,335	29.50%

Vesta Insurance Group, Inc.
Schedule V - Valuation and Qualifying Accounts
(Consolidated) For the Years Ended December 31, 2001, 2000 and 1999
(in thousands)

Description	Balance at Beginning of Period	Additions Charges to Costs and Expenses	Deductions	B
Allowance for premiums in course of collection:				
2001	$ 3,937	$ 3,797	$ 5,050	
2000	2,412	7,707	6,182	
1999	14,212	1,550	13,350	

57

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

VESTA INSURANCE GROUP, INC.

By /s/ NORMAN W. GAYLE, III

Norman W. Gayle, III, President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title
/s/ James E. Tait James E. Tait	Chairman of the Board of Directors (Co-Executive Officer)
/s/ Norman W. Gayle, III Norman W. Gayle, III	Director, President (Co-Executive Officer)
/s/ William P. Cronin William P. Cronin	Chief Financial Officer (Principal Financial Officer)
/s/ Hopson B. Nance Hopson B. Nance	Controller (Principal Accounting Officer)

/s/ Robert B. D. Batlivala, PhD. ------------------------------------ Robert B. D. Batlivala, PhD.	Director
/s/ Walter M. Beale, Jr. ------------------------------------ Walter M. Beale, Jr.	Director
/s/ Ehney A. Camp, III ------------------------------------ Ehney A. Camp, III	Director
/s/ T. Owen Vickers, Sr. ------------------------------------ T. Owen Vickers, Sr.	Director
/s/ Stephen R. Windom ------------------------------------ Stephen R. Windom	Director
/s/ Alan S. Farrior ------------------------------------ Alan S. Farrior	Director