

---

**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

**Quarterly Report Pursuant to Section 13 or 15(d) of the  
Securities Exchange Act of 1934**

**For the Quarterly Period Ended  
March 31, 2001**

**Commission File  
No. 1-7361**

**AMERICAN FINANCIAL CORPORATION**

**Incorporated under  
the Laws of Ohio**

**IRS Employer I.D.  
No. 31-0624874**

**One East Fourth Street, Cincinnati, Ohio 45202  
(513) 579-2121**

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, and (2) has been subject to such filing requirements for the past 90 days. Yes  No

As of May 1, 2001, there were 10,593,000 shares of the Registrant's Common Stock outstanding, all of which were owned by American Financial Group, Inc.

**AMERICAN FINANCIAL CORPORATION 10-Q**  
**PART I**  
**FINANCIAL INFORMATION**

**AMERICAN FINANCIAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEET**  
(Dollars In Thousands)

	March 31, 2001	December 31, 2000
<b>Assets:</b>		
Cash and short-term investments	\$ 210,562	\$ 437,263
Investments:		
Fixed maturities - at market (amortized cost - \$10,355,140 and \$10,148,248)	10,526,540	10,164,648
Other stocks - at market (cost - \$175,708 and \$174,959)	308,208	385,359
Investment in investee corporations	23,996	23,996
Policy loans	212,005	213,469
Real estate and other investments	249,485	270,250
Total investments	11,320,234	11,057,722
Recoverables from reinsurers and prepaid reinsurance premiums	1,940,462	1,845,171
Agents' balances and premiums receivable	706,746	700,215
Deferred acquisition costs	782,939	763,097
Other receivables	253,431	239,806
Variable annuity assets (separate accounts)	472,902	533,655
Prepaid expenses, deferred charges and other assets	484,025	508,163
Cost in excess of net assets acquired	328,033	322,380
	<u>\$16,499,334</u>	<u>\$16,407,472</u>
<b>Liabilities and Capital:</b>		
Unpaid losses and loss adjustment expenses	\$ 4,504,618	\$ 4,515,561
Unearned premiums	1,482,400	1,414,492
Annuity benefits accumulated	5,549,650	5,543,683
Life, accident and health reserves	598,133	599,360
Payable to American Financial Group, Inc.	424,706	439,371
Long-term debt:		
Holding companies	186,401	204,338
Subsidiaries	192,492	195,087
Variable annuity liabilities (separate accounts)	472,902	533,655
Accounts payable, accrued expenses and other liabilities	1,057,422	998,104
Total liabilities	14,468,724	14,443,651
Minority interest	522,191	509,705
<b>Shareholders' Equity:</b>		
Preferred Stock - at liquidation value	72,154	72,154
Common Stock, no par value		
- 20,000,000 shares authorized		
- 10,593,000 shares outstanding	9,625	9,625
Capital surplus	977,659	974,766
Retained earnings	275,381	258,371
Unrealized gain on marketable securities, net	173,600	139,200
Total shareholders' equity	1,508,419	1,454,116
	<u>\$16,499,334</u>	<u>\$16,407,472</u>

AMERICAN FINANCIAL CORPORATION 10-Q

AMERICAN FINANCIAL CORPORATION AND SUBSIDIARIES  
 CONSOLIDATED STATEMENT OF EARNINGS  
 (In Thousands, Except Per Share Data)

	Three months ended March 31,	
	<u>2001</u>	<u>2000</u>
<b>Income:</b>		
Property and casualty insurance premiums	\$644,723	\$572,137
Life, accident and health premiums	69,158	49,919
Investment income	209,790	209,015
Realized losses on sales of:		
Securities	(6,881)	(1,433)
Subsidiaries	(1,586)	-
Other income	58,292	54,627
	<u>973,496</u>	<u>884,265</u>
<b>Costs and Expenses:</b>		
Property and casualty insurance:		
Losses and loss adjustment expenses	496,216	417,651
Commissions and other underwriting expenses	184,974	178,432
Annuity benefits	69,264	66,161
Life, accident and health benefits	54,083	36,724
Interest charges on borrowed money	18,873	15,554
Other operating and general expenses	107,871	96,106
	<u>931,281</u>	<u>810,628</u>
Operating earnings before income taxes	42,215	73,637
Provision for income taxes	<u>14,952</u>	<u>24,255</u>
Net operating earnings	27,263	49,382
Minority interest expense, net of tax	(6,919)	(8,207)
Equity in net earnings (losses) of investees, net of tax	<u>(3,334)</u>	<u>7,175</u>
<b>Net Earnings</b>	<u>\$ 17,010</u>	<u>\$ 48,350</u>

**AMERICAN FINANCIAL CORPORATION 10-Q**

**AMERICAN FINANCIAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY  
(Dollars in Thousands)**

	Preferred Stock	Common Stock and Capital Surplus	Retained Earnings	Unrealized Gain (Loss) on Securities	Total
<b>Balance at January 1, 2001</b>	<u>\$72,154</u>	<u>\$984,391</u>	<u>\$258,371</u>	<u>\$139,200</u>	<u>\$1,454,116</u>
Net earnings	-	-	17,010	-	17,010
Change in unrealized Comprehensive income	-	-	-	34,400	<u>34,400</u>
					51,410
Capital contribution from parent	-	3,067	-	-	3,067
Other	<u>-</u>	<u>(174)</u>	<u>-</u>	<u>-</u>	<u>(174)</u>
<b>Balance at March 31, 2001</b>	<u>\$72,154</u>	<u>\$987,284</u>	<u>\$275,381</u>	<u>\$173,600</u>	<u>\$1,508,419</u>
<b>Balance at January 1, 2000</b>	\$72,154	\$970,407	\$296,246	(\$14,700)	\$1,324,107
Net earnings	-	-	48,350	-	48,350
Change in unrealized Comprehensive income	-	-	-	(22,600)	<u>(22,600)</u>
					25,750
Capital contribution from parent	-	3,067	-	-	3,067
Other	<u>-</u>	<u>47</u>	<u>-</u>	<u>-</u>	<u>47</u>
<b>Balance at March 31, 2000</b>	<u>\$72,154</u>	<u>\$973,521</u>	<u>\$344,596</u>	<u>(\$37,300)</u>	<u>\$1,352,971</u>

AMERICAN FINANCIAL CORPORATION 10-Q

AMERICAN FINANCIAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF CASH FLOWS  
(In Thousands)

	Three months ended March 31,	
	<u>2001</u>	<u>2000</u>
<b>Operating Activities:</b>		
Net earnings	\$ 17,010	\$ 48,350
Adjustments:		
Equity in net (earnings) losses of investees	3,334	(7,175)
Depreciation and amortization	36,485	30,498
Annuity benefits	69,264	66,161
Changes in reserves on assets	4,637	1,088
Realized gains on investing activities	(6,840)	(7,611)
Deferred annuity and life policy acquisition costs	(35,551)	(33,668)
Decrease in reinsurance and other receivables	90	124,640
Decrease (increase) in other assets	(19,369)	13,710
Increase (decrease) in insurance claims and reserves	74,616	(50,957)
Increase in other liabilities	38,419	2,454
Increase (decrease) in minority interest	4,095	(285)
Other, net	(434)	(3,481)
	<u>185,756</u>	<u>183,724</u>
<b>Investing Activities:</b>		
Purchases of and additional investments in:		
Fixed maturity investments	(544,186)	(601,115)
Equity securities	(2,571)	(14,786)
Real estate, property and equipment	(13,278)	(18,935)
Maturities and redemptions of fixed maturity investments	131,547	154,704
Sales of:		
Fixed maturity investments	194,182	227,797
Equity securities	4,679	19,265
Subsidiaries	22,000	-
Real estate, property and equipment	24,562	1,504
Cash and short-term investments of former subsidiaries	(132,858)	-
Decrease (increase) in other investments	(673)	5,486
	<u>(316,596)</u>	<u>(226,080)</u>
<b>Financing Activities:</b>		
Fixed annuity receipts	126,223	126,416
Annuity surrenders, benefits and withdrawals	(186,921)	(192,820)
Net transfers from (to) variable annuity assets	2,929	(21,453)
Additional long-term borrowings	26,842	44,091
Reductions of long-term debt	(47,601)	(610)
Borrowings from AFG	1,000	-
Payments to AFG	(23,000)	(20,313)
Capital Contribution	4,667	4,667
Repurchases of trust preferred securities	-	(1,261)
	<u>(95,861)</u>	<u>(61,283)</u>
<b>Net Decrease in Cash and Short-term Investments</b>	(226,701)	(103,639)
Cash and short-term investments at beginning of period	<u>437,263</u>	<u>389,018</u>
Cash and short-term investments at end of period	<u>\$210,562</u>	<u>\$285,379</u>

## AMERICAN FINANCIAL CORPORATION 10-Q

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### A. Accounting Policies

**Basis of Presentation** The accompanying consolidated financial statements for American Financial Corporation ("AFC") and subsidiaries are unaudited; however, management believes that all adjustments (consisting only of normal recurring accruals unless otherwise disclosed herein) necessary for fair presentation have been made. The results of operations for interim periods are not necessarily indicative of results to be expected for the year. The financial statements have been prepared in accordance with the instructions to Form 10-Q and therefore do not include all information and footnotes necessary to be in conformity with generally accepted accounting principles.

Certain reclassifications have been made to prior years to conform to the current year's presentation. All significant intercompany balances and transactions have been eliminated. All acquisitions have been treated as purchases. The results of operations of companies since their formation or acquisition are included in the consolidated financial statements.

The preparation of the financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Changes in circumstances could cause actual results to differ materially from those estimates.

**Investments** All fixed maturity securities are considered "available for sale" and reported at fair value with unrealized gains and losses reported as a separate component of shareholders' equity. Short-term investments are carried at cost; loans receivable are carried primarily at the aggregate unpaid balance. Premiums and discounts on mortgage-backed securities are amortized over their expected average lives using the interest method.

Gains or losses on sales of securities are recognized at the time of disposition with the amount of gain or loss determined on the specific identification basis. When a decline in the value of a specific investment is considered to be other than temporary, a provision for impairment is charged to earnings and the carrying value of that investment is reduced.

**Investment in Investee Corporations** Investments in securities of 20%- to 50%-owned companies are generally carried at cost, adjusted for AFC's proportionate share of their undistributed earnings or losses.

Due to Chiquita's announced intention to pursue a plan to restructure its public debt, AFC wrote down its investment in Chiquita common stock to market value at December 31, 2000, and may suspend accounting for Chiquita under the equity method pending resolution of the current uncertainty.

**Cost in Excess of Net Assets Acquired** The excess of cost of subsidiaries and investees over AFC's equity in the underlying net assets ("goodwill") is being amortized over periods of 20 to 40 years. In February 2001, the Financial Accounting Standards Board issued a proposal to eliminate the amortization of goodwill and require that goodwill be tested for impairment.

**Insurance** As discussed under "Reinsurance" below, unpaid losses and loss adjustment expenses and unearned premiums have not been reduced for reinsurance recoverable. To the extent that unrealized gains (losses) from securities classified as "available for sale" would result in adjustments to deferred acquisition costs and policyholder liabilities had those gains (losses) actually been realized, such balance sheet amounts are adjusted, net of deferred taxes.

## AMERICAN FINANCIAL CORPORATION 10-Q

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

**Reinsurance** In the normal course of business, AFC's insurance subsidiaries cede reinsurance to other companies to diversify risk and limit maximum loss arising from large claims. To the extent that any reinsuring companies are unable to meet obligations under the agreements covering reinsurance ceded, AFC's insurance subsidiaries would remain liable. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policies. AFC's insurance subsidiaries report as assets (a) the estimated reinsurance recoverable on unpaid losses, including an estimate for losses incurred but not reported, and (b) amounts paid to reinsurers applicable to the unexpired terms of policies in force. AFC's insurance subsidiaries also assume reinsurance from other companies. Income on reinsurance assumed is recognized based on reports received from ceding reinsurers.

**Deferred Acquisition Costs** Policy acquisition costs (principally commissions, premium taxes and other underwriting expenses) related to the production of new business are deferred ("DPAC"). For the property and casualty companies, DPAC is limited based upon recoverability without any consideration for anticipated investment income and is charged against income ratably over the terms of the related policies. DPAC related to annuities and universal life insurance products is amortized, with interest, in relation to the present value of expected gross profits on the policies. DPAC related to traditional life and health insurance is amortized over the expected premium paying period of the related policies, in proportion to the ratio of annual premium revenues to total anticipated premium revenues.

**Unpaid Losses and Loss Adjustment Expenses** The net liabilities stated for unpaid claims and for expenses of investigation and adjustment of unpaid claims are based upon (a) the accumulation of case estimates for losses reported prior to the close of the accounting period on the direct business written; (b) estimates received from ceding reinsurers and insurance pools and associations; (c) estimates of unreported losses based on past experience; (d) estimates based on experience of expenses for investigating and adjusting claims and (e) the current state of the law and coverage litigation. These liabilities are subject to the impact of changes in claim amounts and frequency and other factors. In spite of the variability inherent in such estimates, management believes that the liabilities for unpaid losses and loss adjustment expenses are adequate. Changes in estimates of the liabilities for losses and loss adjustment expenses are reflected in the Statement of Earnings in the period in which determined.

**Annuity Benefits Accumulated** Annuity receipts and benefit payments are recorded as increases or decreases in "annuity benefits accumulated" rather than as revenue and expense. Increases in this liability for interest credited are charged to expense and decreases for surrender charges are credited to other income.

**Life, Accident and Health Reserves** Liabilities for future policy benefits under traditional life, accident and health policies are computed using the net level premium method. Computations are based on anticipated investment yield, mortality, morbidity and surrenders and include provisions for unfavorable deviations. Reserves established for accident and health claims are modified as necessary to reflect actual experience and developing trends.

## AMERICAN FINANCIAL CORPORATION 10-Q

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

**Variable Annuity Assets and Liabilities** Separate accounts related to variable annuities represent deposits invested in underlying investment funds on which Great American Financial Resources, Inc. ("GAFRI"), an 83%-owned subsidiary, earns a fee. The investment funds are selected and may be changed only by the policyholder.

**Premium Recognition** Property and casualty premiums are earned over the terms of the policies on a pro rata basis. Unearned premiums represent that portion of premiums written which is applicable to the unexpired terms of policies in force. On reinsurance assumed from other insurance companies or written through various underwriting organizations, unearned premiums are based on reports received from such companies and organizations. For traditional life, accident and health products, premiums are recognized as revenue when legally collectible from policyholders. For interest-sensitive life and universal life products, premiums are recorded in a policyholder account which is reflected as a liability. Revenue is recognized as amounts are assessed against the policyholder account for mortality coverage and contract expenses.

**Policyholder Dividends** Dividends payable to policyholders are included in "Accounts payable, accrued expenses and other liabilities" and represent estimates of amounts payable on participating policies which share in favorable underwriting results. The estimate is accrued during the period in which the related premium is earned. Changes in estimates are included in income in the period determined. Policyholder dividends do not become legal liabilities unless and until declared by the boards of directors of the insurance companies.

**Minority Interest** For balance sheet purposes, minority interest represents (i) the interests of noncontrolling shareholders in AFC subsidiaries, including preferred securities issued by trust subsidiaries of GAFRI and (ii) American Financial Group, Inc.'s ("AFG") direct ownership interest in American Premier Underwriters, Inc. ("American Premier" or "APU") and American Financial Enterprises, Inc. For income statement purposes, minority interest expense represents those shareholders' interest in the earnings of AFC subsidiaries as well as accrued distributions on the trust preferred securities.

**Income Taxes** AFC files consolidated federal income tax returns which include all 80%-owned U.S. subsidiaries, except for certain life insurance subsidiaries and their subsidiaries. Deferred income taxes are calculated using the liability method. Under this method, deferred income tax assets and liabilities are determined based on differences between financial reporting and tax bases and are measured using enacted tax rates. Deferred tax assets are recognized if it is more likely than not that a benefit will be realized.

**Benefit Plans** AFC provides retirement benefits to qualified employees of participating companies through contributory and noncontributory defined contribution plans contained in AFG's Retirement and Savings Plan. Under the retirement portion of the plan, company contributions are invested primarily in securities of AFG and affiliates. Under the savings portion of the plan, AFC matches a specific portion of employee contributions. Contributions to benefit plans are charged against earnings in the year for which they are declared.

AFC and many of its subsidiaries provide health care and life insurance benefits to eligible retirees. AFC also provides postemployment benefits to former or inactive employees (primarily those on disability) who were not deemed retired under other company plans. The projected future cost of providing these benefits is expensed over the period the employees earn such benefits.



## AMERICAN FINANCIAL CORPORATION 10-Q

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

**Derivatives** Effective October 1, 2000, AFC implemented Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities", which establishes accounting and reporting standards for derivative instruments (including derivative instruments that are embedded in other contracts) and for hedging activities. Prior year financial statements were not restated. SFAS No. 133 generally requires that derivatives (both assets and liabilities) be recognized in the balance sheet at fair value with changes in fair value included in current earnings.

Derivatives included in AFC's Balance Sheet consist primarily of investments in common stock warrants (included in other stocks), the equity-based component of certain annuity products (included in annuity benefits accumulated) and call options (included in other investments) used to mitigate the risk embedded in the equity-indexed annuity products.

**Statement of Cash Flows** For cash flow purposes, "investing activities" are defined as making and collecting loans and acquiring and disposing of debt or equity instruments and property and equipment. "Financing activities" include obtaining resources from owners and providing them with a return on their investments, borrowing money and repaying amounts borrowed. Annuity receipts, benefits and withdrawals are also reflected as financing activities. All other activities are considered "operating". Short-term investments having original maturities of three months or less when purchased are considered to be cash equivalents for purposes of the financial statements.

#### **B. Sale of Subsidiaries**

**Japanese division** In December 2000, AFC agreed to sell its Japanese property and casualty division to Mitsui Marine & Fire Insurance Company of America for approximately \$22 million in cash and recorded a \$10.7 million pretax loss on the sale. Upon completion of the sale in March 2001, AFC realized an additional pretax loss of \$1.6 million and deferred a gain of approximately \$21 million on ceded insurance which is being recognized over the estimated settlement period (weighted average of 4 years) of the ceded claims. At the same time, a reinsurance agreement under which Great American Insurance ceded a portion of its pool of insurance to Mitsui was terminated. The Japanese division generated net written premiums of approximately \$60 million per year to Great American while Great American ceded approximately \$45 million per year to Mitsui.

**C. Segments of Operations** AFC's property and casualty group is engaged primarily in private passenger automobile and specialty insurance businesses. The Personal group writes nonstandard and preferred/standard private passenger auto and other personal insurance coverage. The Specialty group includes a highly diversified group of specialty business units. Some of the more significant areas are inland and ocean marine, California workers' compensation, agricultural-related coverages, executive and professional liability, fidelity and surety bonds, collateral protection, and umbrella and excess coverages. AFC's annuity and life business markets primarily retirement products as well as life and supplemental health insurance. In addition, AFC owns a significant portion of the voting equity securities of Chiquita Brands International, Inc. (an investee corporation - see Note D).

**AMERICAN FINANCIAL CORPORATION 10-Q**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

The following table (in thousands) shows AFC's revenues and operating profit (loss) by significant business segment. Operating profit (loss) represents total revenues less operating expenses.

	Three months ended March 31,	
	<u>2001</u>	<u>2000</u>
<b>Revenues (a)</b>		
Property and casualty insurance:		
Premiums earned:		
Personal	\$327,632	\$297,313
Specialty	316,307	274,823
Other lines - primarily discontinued	784	1
	<u>644,723</u>	<u>572,137</u>
Investment and other income	107,335	121,167
	<u>752,058</u>	<u>693,304</u>
Annuities and life (b)	217,030	187,337
Other	4,408	3,624
	<u>\$973,496</u>	<u>\$884,265</u>
 <b>Operating Profit (Loss)</b>		
Property and casualty insurance:		
Underwriting:		
Personal	(\$ 27,782)	(\$10,933)
Specialty	(2,230)	(10,498)
Other lines - primarily discontinued	(6,455)	(2,515)
	<u>(36,467)</u>	<u>(23,946)</u>
Investment and other income	75,202	84,525
	<u>38,735</u>	<u>60,579</u>
Annuities and life	30,123	27,514
Other (c)	(26,643)	(14,456)
	<u>\$ 42,215</u>	<u>\$ 73,637</u>

- (a) Revenues include sales of products and services as well as other income earned by the respective segments.  
(b) Represents primarily investment income.  
(c) Includes holding company expenses.

**D. Investee Corporations** Investment in investee corporations reflects AFC's ownership of 24 million shares (33%) of Chiquita common stock. The market value of this investment was \$31 million and \$24 million at March 31, 2001 and December 31, 2000, respectively. Chiquita is a leading international marketer, producer and distributor of quality fresh fruits and vegetables and processed foods. Summarized financial information for Chiquita follows (in millions):

	Three months ended March 31,	
	<u>2001</u>	<u>2000</u>
Net Sales	\$577	\$658
Operating Income	38	68
Net Income	4	35
Net Income Attributed to Common Shares	0.4	31

In January 2001, Chiquita announced a restructuring initiative that included discontinuing all interest and principal payments on its public debt. If successful, the restructuring would result in the conversion of a significant portion of Chiquita's \$862 million in public debt into common equity. Although the intended restructuring would not impact Chiquita's day-to-day operations, it would adversely affect the holders of its stock, including AFC.

AMERICAN FINANCIAL CORPORATION 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

**Start-up manufacturing businesses** Since 1998, AFC subsidiaries have made loans to two start-up manufacturing businesses which were previously owned by unrelated third-parties. During 2000, the former owners chose to forfeit their equity interests to AFC rather than invest additional capital. In the fourth quarter of 2000, AFC sold the equity interests to a group of employees for nominal cash consideration plus warrants to repurchase a significant ownership interest. Due to the absence of significant financial investment by the buyers relative to the amount of debt owed to AFC subsidiaries, the sale was not recognized as a divestiture for accounting purposes. Assets of the businesses transferred (approximately \$55 million at March 31, 2001 and December 31, 2000) are included in other assets; liabilities of the businesses transferred (approximately \$7 million at March 31, 2001 and December 31, 2000, after elimination of loans from AFC subsidiaries) are included in other liabilities. AFC's equity in the losses of these two companies during the first quarter of 2001 of \$3.3 million is included in investee losses in the statement of earnings.

**E. Payable to American Financial Group** AFC has a reciprocal Master Credit Agreement with various AFG holding companies under which these companies make funds available to each other for general corporate purposes.

**F. Long-Term Debt** The carrying value of long-term debt consisted of the following (in thousands):

	March 31, <u>2001</u>	December 31, <u>2000</u>
<b>Holding Companies:</b>		
AFC notes payable under bank line	\$160,000	\$178,000
APU 10-7/8% Subordinated Notes due May 2011	11,597	11,611
Other	<u>14,804</u>	<u>14,727</u>
	<u>\$186,401</u>	<u>\$204,338</u>
<b>Subsidiaries:</b>		
GAFRI 6-7/8% Senior Notes due June 2008	\$100,000	\$100,000
GAFRI notes payable under bank line	53,100	48,500
Notes payable secured by real estate	24,396	31,201
Other	<u>14,996</u>	<u>15,386</u>
	<u>\$192,492</u>	<u>\$195,087</u>

At March 31, 2001, sinking fund and other scheduled principal payments on debt for the balance of 2001 and the subsequent five years were as follows (in millions):

	<u>Holding Companies</u>	<u>Subsidiaries</u>	<u>Total</u>
2001	\$ 1.4	\$ 1.0	\$ 2.4
2002	170.4	1.5	171.9
2003	-	1.5	1.5
2004	-	61.5	61.5
2005	-	10.0	10.0
2006	-	.7	.7

Debentures purchased in excess of scheduled payments may be applied to satisfy any sinking fund requirement. The scheduled principal payments shown above assume that debentures previously purchased are applied to the earliest scheduled retirements.

AMERICAN FINANCIAL CORPORATION 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

AFC and GAFRI each have an unsecured credit agreement with a group of banks under which they can borrow up to \$300 million and \$155 million, respectively. Borrowings bear interest at floating rates based on prime or Eurodollar rates. Loans mature in December 2002 under the AFC credit agreement and in December 2004 under the GAFRI credit agreement.

- G. **Minority Interest** Minority interest in AFC's balance sheet is comprised of the following (in thousands):

	March 31, <u>2001</u>	December 31, <u>2000</u>
Interest of AFG (parent) and noncontrolling shareholders in subsidiaries' common stock	\$304,278	\$291,792
Preferred securities issued by subsidiary trusts	<u>217,913</u>	<u>217,913</u>
	<u>\$522,191</u>	<u>\$509,705</u>

**Trust Issued Preferred Securities** Wholly-owned subsidiary trusts of GAFRI have issued preferred securities and, in turn, purchased a like amount of subordinated debt which provides interest and principal payments to fund the respective trusts' obligations. The preferred securities must be redeemed upon maturity or redemption of the subordinated debt. GAFRI effectively provides unconditional guarantees of its respective trusts' obligations.

The preferred securities consisted of the following (in thousands):

Date of Issuance	Issue (Maturity Date)	March 31, <u>2001</u>	December 31, <u>2000</u>	Optional Redemption Dates
November 1996	GAFRI 9-1/4% TOPrS (2026)	\$72,913	\$72,913	On or after 11/7/2001
March 1997	GAFRI 8-7/8% Pfd (2027)	70,000	70,000	On or after 3/1/2007
May 1997	GAFRI 7-1/4% ROPES (2041)	75,000	75,000	After 9/28/2001

- Minority Interest Expense** Minority interest expense is comprised of (in thousands):

	Three months ended March 31,	
	<u>2001</u>	<u>2000</u>
Interest of AFG (parent) and noncontrolling shareholders in earnings of subsidiaries	\$4,005	\$5,192
Accrued distributions by subsidiaries on trust issued preferred securities, net of tax	<u>2,914</u>	<u>3,015</u>
	<u>\$6,919</u>	<u>\$8,207</u>

AMERICAN FINANCIAL CORPORATION 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

- H. **Shareholders' Equity** At March 31, 2001 and December 31, 2000, American Financial Group beneficially owned all of the outstanding shares of AFC's Common Stock.

**Preferred Stock** Under provisions of both the Nonvoting (4.0 million shares authorized) and Voting (4.0 million shares authorized) Cumulative Preferred Stock, the Board of Directors may divide the authorized stock into series and set specific terms and conditions of each series. At March 31, 2001 and December 31, 2000, the outstanding voting shares of AFC's Preferred Stock consisted of the following:

**Series J**, no par value; \$25.00 liquidating value per share; annual dividends per share \$2.00; redeemable at AFC's option at \$25.75 per share beginning December 2005 declining to \$25.00 at December 2007 and thereafter; 2,886,161 shares (stated value \$72.2 million) outstanding at March 31, 2001 and December 31, 2000.

The change in unrealized gain (loss) on marketable securities for the three months ended March 31 included the following (in millions):

	<u>Pretax</u>	<u>Taxes</u>	<u>Minority Interest</u>	<u>Net</u>
<u>2001</u>				
Unrealized holding gains on securities arising during the period	\$59.0	(\$20.6)	(\$8.2)	\$30.2
Reclassification adjustment for realized losses included in net income	<u>6.9</u>	<u>(2.4)</u>	<u>(.3)</u>	<u>4.2</u>
Change in unrealized gain on marketable securities, net	<u>\$65.9</u>	<u>(\$23.0)</u>	<u>(\$8.5)</u>	<u>\$34.4</u>
<u>2000</u>				
Unrealized holding losses on securities arising during the period	(\$40.3)	\$14.5	\$2.4	(\$23.4)
Reclassification adjustment for realized losses included in net income	<u>1.4</u>	<u>(.5)</u>	<u>(.1)</u>	<u>.8</u>
Change in unrealized gain (loss) on marketable securities, net	<u>(\$38.9)</u>	<u>\$14.0</u>	<u>\$2.3</u>	<u>(\$22.6)</u>

- I. **Commitments and Contingencies** There have been no significant changes to the matters discussed and referred to in Note M "Commitments and Contingencies" of AFC's Annual Report on Form 10-K for 2000.

# AMERICAN FINANCIAL CORPORATION 10-Q

## ITEM 2

### Management's Discussion and Analysis of Financial Condition and Results of Operations

#### GENERAL

AFC and American Premier are organized as holding companies with almost all of their operations being conducted by subsidiaries. These parent corporations, however, have continuing cash needs for administrative expenses, the payment of principal and interest on borrowings, shareholder dividends, and taxes. Therefore, certain analyses are best done on a parent only basis while others are best done on a total enterprise basis. In addition, since most of its businesses are financial in nature, AFC does not prepare its consolidated financial statements using a current-noncurrent format. Consequently, certain traditional ratios and financial analysis tests are not meaningful.

**IT Initiative** In 1999, AFC initiated an enterprise-wide study of its information technology ("IT") resources, needs and opportunities. The initiative entails extensive effort and costs. While the costs precede the expected savings, management believes the benefits in efficiencies and effectiveness will exceed the costs incurred, all of which have been and will be funded through available working capital.

**Forward-Looking Statements** The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. Some of the forward-looking statements can be identified by the use of forward-looking words such as "believes", "expects", "may", "will", "should", "seeks", "intends", "plans", "estimates", "anticipates" or the negative version of those words or other comparable terminology. Actual results could differ materially from those contained in or implied by such forward-looking statements for a variety of factors including:

- changes in economic conditions, including interest rates, performance of securities markets, and the availability of capital;
- regulatory actions;
- changes in legal environment;
- tax law changes;
- levels of catastrophes and other major losses;
- adequacy of loss reserves;
- availability of reinsurance; and
- competitive pressures, including the ability to obtain rate increases.

Forward-looking statements speak only as of the date made. AFC undertakes no obligations to update any forward-looking statements to reflect events or circumstances arising after the date on which they are made.

#### LIQUIDITY AND CAPITAL RESOURCES

**Ratios** AFC's debt to total capital ratio at the parent holding company level (excluding amounts due AFG) was approximately 11% at March 31, 2001 and 12% at December 31, 2000. Including amounts due AFG, the ratio was 29% at March 31, 2001 and 31% at December 31, 2000.

AFC's ratio of earnings to fixed charges, excluding and including preferred dividends, (on a total enterprise basis) was 2.39 and 2.20 for the first three months of 2001 and 2.02 and 1.87 for the entire year of 2000.

## AMERICAN FINANCIAL CORPORATION 10-Q

### Management's Discussion and Analysis of Financial Condition and Results of Operations - Continued

**Sources of Funds** Management believes the parent holding companies have sufficient resources to meet their liquidity requirements, primarily through funds generated by their subsidiaries' operations. If funds provided by subsidiaries through dividends and tax payments are insufficient to meet fixed charges in any period, the holding companies would be required to generate cash through borrowings, sales of securities or other assets, or similar transactions.

AFC has a revolving credit agreement with several banks under which it can borrow up to \$300 million. This credit line provides ample liquidity and can be used to obtain funds for operating subsidiaries or, if necessary, for the parent companies. There was \$160 million borrowed under the line at March 31, 2001 and \$212 million at May 1, 2001.

Dividend payments from subsidiaries have been very important to the liquidity and cash flow of the individual holding companies during certain periods in the past. However, the reliance on such dividend payments has been lessened in recent years by the combination of (i) reductions in the amounts and cost of debt at the holding companies from historical levels (and the related decrease in ongoing cash needs for interest and principal payments), (ii) the ability to obtain financing in capital markets, as well as (iii) the sales of certain noncore investments.

**Investments** Approximately 92% of the fixed maturities held by AFC were rated "investment grade" (credit rating of AAA to BBB) by nationally recognized rating agencies at March 31, 2001. Investment grade securities generally bear lower yields and lower degrees of risk than those that are unrated and noninvestment grade. Management believes that the high quality investment portfolio should generate a stable and predictable investment return.

AFC's equity securities are concentrated in a relatively limited number of major positions. This approach allows management to more closely monitor the companies and the industries in which they operate.

## RESULTS OF OPERATIONS

**General** Pretax operating earnings for the first quarter of 2001 were \$42.2 million compared to \$13.7 million for the fourth quarter of 2000 and \$73.6 million for the first quarter of 2000. Pretax operating earnings improved compared to the fourth quarter of 2000 due primarily to decreased realized losses and improved underwriting results. The decrease in pretax operating earnings compared to the first quarter of 2000 reflects a decline in the Personal group's underwriting results and increased realized losses.

**Property and Casualty Insurance - Underwriting** AFC's property and casualty group consists of two major business groups: Personal and Specialty.

The Personal group sells nonstandard and preferred/standard private passenger auto insurance and, to a lesser extent, homeowners' insurance. Nonstandard automobile insurance covers risk not typically accepted for standard automobile coverage because of the applicant's driving record, type of vehicle, age or other criteria.

The Specialty group includes a highly diversified group of business lines. Some of the more significant areas are inland and ocean marine, California workers' compensation, agricultural-related coverages, executive and professional liability, fidelity and surety bonds, collateral protection, and umbrella and excess coverages.

**AMERICAN FINANCIAL CORPORATION 10-Q**

**Management's Discussion and Analysis  
of Financial Condition and Results of Operations - Continued**

Underwriting profitability is measured by the combined ratio which is a sum of the ratios of underwriting losses, loss adjustment expenses, underwriting expenses and policyholder dividends to premiums. When the combined ratio is under 100%, underwriting results are generally considered profitable; when the ratio is over 100%, underwriting results are generally considered unprofitable. The combined ratio does not reflect investment income, other income or federal income taxes.

For certain lines of business and products where the credibility of the range of loss projections is less certain (primarily the various specialty businesses listed above), management believes that it is prudent and appropriate to use conservative assumptions until such time as the data, experience and projections have more credibility, as evidenced by data volume, consistency and maturity of the data. While this practice mitigates the risk of adverse development on this business, it does not eliminate it.

Net written premiums and combined ratios for AFC's property and casualty insurance subsidiaries were as follows (dollars in millions):

	Three months ended	
	March 31,	
	<u>2001</u>	<u>2000</u>
<u>Net Written Premiums (GAAP)</u>		
Personal	\$370.5	\$349.8
Specialty	356.6(a)	297.7
Other lines	-	-
	<u>\$727.1</u>	<u>\$647.5</u>
 <u>Combined Ratios (GAAP)(b)</u>		
Personal	108.5%	103.7%
Specialty	100.6	103.8
Aggregate (including discontinued lines)	105.6	104.2

(a) Before a reduction of \$29.7 million for unearned premium transfer related to the sale of the Japanese division.

(b) Combined ratios for the fourth quarter of 2000 were: Personal - 111.0%, Specialty - 104.3%, Aggregate - 106.1%. Combined ratios for the entire year of 2000 were: Personal - 108.6%, Specialty - 107.9%, Aggregate - 108.0%.

**Personal** The Personal group's increase in net written premiums reflects the impact of significant rate increases implemented primarily in the second half of 2000, partially offset by lower business volume. The combined ratio improved compared to the 2000 fourth quarter due primarily to the impact of these rate increases. The increase in the combined ratio compared to the first quarter of 2000 reflects the impact of inadequate rates on policies written during the first part of 2000. To further improve underwriting results, AFC implemented rate increases averaging 5% in the first quarter of 2001 and expects rate increases to be in excess of 10% by the end of 2001.

**Specialty** The Specialty group's increase in net written premiums reflects the impact of rate increases implemented in 2000 and 2001 and the realization of growth opportunities in certain commercial markets. In its California workers' compensation business, AFC implemented rate increases averaging 40% on renewals in the first quarter 2001 and expects rate increases of at least 30% on renewals in this business during the second quarter. Rate increases implemented in the



## AMERICAN FINANCIAL CORPORATION 10-Q

### Management's Discussion and Analysis of Financial Condition and Results of Operations - Continued

other specialty operations averaged 17% for the first quarter of 2001. The improvement in the combined ratio compared to both the fourth and first quarters of 2000 reflects the impact of these rate increases. Excluding the California workers' compensation business, the Specialty group's combined ratio for the first quarter of 2001 was 98.0%.

**Life, Accident and Health Premiums and Benefits** The increase in life, accident and health premiums and benefits is due primarily to increased sales of supplemental health insurance products.

**Real Estate Operations** AFC's subsidiaries are engaged in a variety of real estate operations including hotels, apartments, office buildings and recreational facilities; they also own several parcels of land. Revenues and expenses of these operations, including gains and losses on disposal, are included in AFC's statement of earnings as shown below (in millions).

	Three months ended	
	March 31,	
	<u>2001</u>	<u>2000</u>
Other income	\$32.0	\$17.9
Other operating and general expenses	15.0	14.3
Interest charges on borrowed money	.7	.7
Minority interest expense, net	1.9	.2

Other income includes net pretax gains on the sale of real estate assets of \$15.3 million in the first quarter of 2001 and \$2.1 million in the first quarter of 2000.

**Other Income** Other income increased \$3.7 million (7%) in the first quarter of 2001 compared to 2000 due primarily to increased income from the sale of real estate which exceeded income from the sale of operating assets and lease residuals in the first quarter of 2000.

**Realized Gains** Realized capital gains have been an important part of the return on investments in marketable securities. Individual securities are sold creating gains and losses as market opportunities exist.

Under Statement of Financial Accounting Standards ("SFAS") No. 133, which was adopted as of October 1, 2000, warrants to purchase common stock of publicly traded companies are generally considered derivatives and marked to market through current earnings as realized gains and losses. Realized losses on sales of securities includes \$.8 million in losses recognized during the first quarter of 2001 to adjust the carrying value of AFC's investment in warrants to market value at March 31, 2001.

**Loss on Sale of Subsidiaries** In 2001, AFC recognized a \$1.6 million pretax loss representing an adjustment to the fourth quarter 2000 loss recorded on the sale of its Japanese division.

**Annuity Benefits** Annuity benefits reflect amounts accrued on annuity policyholders' funds accumulated. The majority of GAFRI's fixed rate annuity products permit GAFRI to change the crediting rate at any time (subject to minimum interest rate guarantees of 3% or 4% per annum). As a result, management has been able to react to changes in market interest rates and maintain a desired interest rate spread.

## AMERICAN FINANCIAL CORPORATION 10-Q

### Management's Discussion and Analysis of Financial Condition and Results of Operations - Continued

GAFRI's equity-indexed fixed annuities provide policyholders with a crediting rate tied, in part, to the performance of an existing stock market index. GAFRI attempts to mitigate the risk in the equity-based component of these products through the purchase of call options on the appropriate index. GAFRI's strategy is designed so that an increase in the liabilities due to an increase in the market index will be substantially offset by unrealized gains on the call options. Under SFAS No. 133, both the equity-based component of the annuities and the related call options are considered derivatives and marked to market through current earnings as annuity benefits. Adjusting these derivatives to market value had virtually no net effect on annuity benefits during the first quarter of 2001.

**Interest on Borrowed Money** Interest expense increased \$3.3 million (21%) in the first quarter of 2001 compared to the first quarter of 2000 due to higher average indebtedness to AFG under the Master Credit Agreement.

**Other Operating and General Expenses** Other operating and general expenses increased \$11.8 million (12%) in the first quarter of 2001 compared to the first quarter of 2000 due primarily to increased expenses associated with the IT initiative and slightly higher holding company expenses.

**Investee Corporations** For 2001, equity in earnings (losses) of investee corporations represents losses of two start-up manufacturing businesses. Equity in net earnings (losses) of investees in 2000 represents AFC's proportionate share of Chiquita's earnings. Chiquita reported net income of \$.01 per share for the first quarter of 2001 and \$.46 per share for the first quarter of 2000.

---

### Item 3

#### **Quantitative and Qualitative Disclosure of Market Risk**

As of March 31, 2001, there were no material changes to the information provided in AFC's Form 10-K for 2000 under the caption "Exposure to Market Risk" in Management's Discussion and Analysis of Financial Condition and Results of Operations.

AMERICAN FINANCIAL CORPORATION 10-Q  
PART II  
OTHER INFORMATION

Item 6

Exhibits and Reports on Form 8-K

(a) Exhibits: none

(b) Reports on Form 8-K: none

---

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934, American Financial Corporation has duly caused this Report to be signed on its behalf by the undersigned duly authorized.

American Financial Corporation

May 11, 2001

BY: Fred J. Runk  
Fred J. Runk  
Senior Vice President and Treasurer