

GREAT AMERICAN FINANCIAL RESOURCES INC
Form 10-Q
November 14, 2001

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
September 30, 2001**

Commission File
No. 1-11632

GREAT AMERICAN FINANCIAL RESOURCES, INC.

**Incorporated under
the Laws of Delaware**

IRS Employer I.D.

No. 06-1356481

250 East Fifth Street, Cincinnati, Ohio 45202

(513) 333-5300

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 November 1, 2001, there were 42,315,365 shares of the Registrant's Common Stock outstanding.

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GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

PART I

FINANCIAL INFORMATION

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

(Dollars in millions)

	September 30, <u>2001</u>	December 31, <u>2000</u>
Assets		
Investments:		
Fixed maturities - at market (amortized cost - \$6,279.2 and \$6,088.0)	\$6,499.4	\$6,117.1
Equity securities - at market (cost - \$38.1 and \$30.5)	58.7	67.9
Investment in affiliate	-	2.7
Mortgage loans on real estate	24.3	24.4
Real estate	68.7	72.2
Policy loans	214.8	213.5
Short-term investments	<u>103.5</u>	<u>49.5</u>
 Total investments	 6,969.4	 6,547.3
Cash	38.7	38.0
Accrued investment income	91.4	99.2
Unamortized insurance acquisition costs, net	541.3	487.9
Other assets	249.7	269.8

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Variable annuity assets (separate accounts)	<u>453.8</u>	<u>533.7</u>
	<u>\$8,344.3</u>	<u>\$7,975.9</u>
Liabilities and Capital		
Annuity benefits accumulated	\$5,717.5	\$5,543.7
Life, accident and health reserves	614.7	599.4
Notes payable	224.0	151.9
Payable to affiliates, net	103.4	85.8
Deferred taxes on unrealized gains	75.9	22.6
Accounts payable, accrued expenses and other liabilities	203.7	149.2
Variable annuity liabilities (separate accounts)	<u>453.8</u>	<u>533.7</u>
Total liabilities	7,393.0	7,086.3
Mandatorily redeemable preferred securities of subsidiary trusts	142.9	217.9
Stockholders' Equity:		
Common Stock, \$1 par value		
-100,000,000 shares authorized		
- 42,313,613 and 42,302,788 shares outstanding	42.3	42.3
Capital surplus	348.2	348.5
Retained earnings	273.4	237.0
Unrealized gains on marketable securities, net	<u>144.5</u>	<u>43.9</u>
Total stockholders' equity	<u>808.4</u>	<u>671.7</u>
	<u>\$8,344.3</u>	<u>\$7,975.9</u>

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED INCOME STATEMENT

(In millions, except per share amounts)

	Three months ended		Nine months ended	
	<u>September 30,</u>		<u>September 30,</u>	
	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>
Revenues				
:				
Life, accident and health premiums	\$ 69.1	\$ 66.5	\$208.8	\$166.1
Net investment income	129.2	124.5	376.9	372.5
Realized gains (losses)	(1.3)	18.5	(25.8)	14.8
Other income	<u>25.3</u>	<u>26.7</u>	<u>76.0</u>	<u>65.7</u>
	222.3	236.2	635.9	619.1
Costs and Expenses				
:				
Annuity benefits	74.0	72.2	214.0	218.0
Life, accident and health benefits	53.9	50.7	160.2	124.3
Insurance acquisition expenses	22.9	16.8	64.0	50.8
Trust preferred distribution requirement	4.6	4.6	13.8	13.8
Interest and other debt expenses	2.4	3.6	7.9	10.9
Other expenses	<u>37.6</u>	<u>41.3</u>	<u>115.8</u>	<u>137.3</u>
	<u>195.4</u>	<u>189.2</u>	<u>575.7</u>	<u>555.1</u>
Operating earnings before income taxes	26.9	47.0	60.2	64.0
Provision for income taxes	<u>8.5</u>	<u>15.0</u>	<u>18.3</u>	<u>17.5</u>

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Net operating earnings	18.4	32.0	41.9	46.5
Equity in loss of affiliate, net of tax	<u>-</u>	<u>(1.5)</u>	<u>-</u>	<u>(0.5)</u>
))	
Income before accounting change	18.4	30.5	41.9	46.0
Cumulative effect of accounting change, net of tax	<u>-</u>	<u>-</u>	<u>(5.5)</u>	<u>-</u>
Net Income	<u>\$ 18.4</u>	<u>\$ 30.5</u>	<u>\$ 36.4</u>	<u>\$ 46.0</u>

Earnings per common share:

Basic earnings per common share:

Income before accounting change	\$0.43	\$0.72	\$0.99	\$1.09
Accounting change	<u>-</u>	<u>-</u>	<u>(0.13)</u>	<u>-</u>
))))
Net Income	<u>\$0.43</u>	<u>\$0.72</u>	<u>\$0.86</u>	<u>\$1.09</u>

Diluted earnings per common share:

Income before accounting change	\$0.43	\$0.72	\$0.98	\$1.08
Accounting change	<u>-</u>	<u>-</u>	<u>(0.13)</u>	<u>-</u>
))))
Net Income	<u>\$0.43</u>	<u>\$0.72</u>	<u>\$0.85</u>	<u>\$1.08</u>

Average number of common shares:

Basic	42.3	42.3	42.3	42.3
Diluted	42.7	42.8	42.7	42.7

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(In millions)

	Nine months ended <u>September 30,</u>	
	<u>2001</u>	<u>2000</u>
Common Stock:		
Balance at beginning of period	\$ 42.3	\$ 42.4
Common Stock retired	<u>—</u>	<u>(0.1)</u>
Balance at end of period	<u>\$ 42.3</u>	<u>\$ 42.3</u>
Capital Surplus:		
Balance at beginning of period	\$348.5	\$349.7
Common Stock issued	0.5	0.6
Common Stock retired	(0.3)	(1.8)
Capital transaction of subsidiary	<u>(0.5)</u>	<u>—</u>
Balance at end of period	<u>\$348.2</u>	<u>\$348.5</u>
Retained Earnings:		
Balance at beginning of period	\$237.0	\$186.5
Net income	<u>36.4</u>	<u>46.0</u>
Balance at end of period	<u>\$273.4</u>	<u>\$232.5</u>

Unrealized Gains (Losses), Net:		
Balance at beginning of period	\$ 43.9	(\$ 52.9)
Change during period	<u>100.6</u>	<u>21.2</u>
Balance at end of period	<u>\$144.5</u>	<u>(\$ 31.7)</u>

Comprehensive Income:		
Net income	\$ 36.4	\$ 46.0
Other comprehensive income - change in net unrealized gains	<u>100.6</u>	<u>21.2</u>
Comprehensive income	<u>\$137.0</u>	<u>\$ 67.2</u>

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GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

(In millions)

Nine months ended
September 30,

2001 2000

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Cash Flows from Operating Activities:

Net income	\$ 36.4	\$ 46.0
Adjustments:		
Equity in loss of affiliate, net of tax	-	0.5
Cumulative effect of accounting change	5.5	-
Increase in life, accident and health reserves	34.2	67.1
Benefits to annuity policyholders	214.0	218.0
Amortization of insurance acquisition costs	64.0	50.8
Depreciation and amortization	8.9	6.8
Realized (gains) losses	25.8	(14.8)
Increase in insurance acquisition costs	(111.4)	(106.8)
Other, net	<u>(13.2)</u>	<u>(18.7)</u>
))
	<u>264.2</u>	<u>248.9</u>

Cash Flows from Investing Activities:

Purchases of and additional investments in:		
Fixed maturity investments	(884.6)	(580.8)
Equity securities	(3.3)	(3.1)
Real estate, mortgage loans and other assets	(10.2)	(12.5)
Maturities and redemptions of fixed maturity investments	387.3	281.6
Sales of:		
Fixed maturity investments	309.3	296.4
Equity securities	1.2	20.8
Real estate, mortgage loans and other assets	20.4	1.1
Decrease (increase) in policy loans	<u>(1.3)</u>	<u>2.5</u>
))
	<u>(181.2)</u>	<u>6.0</u>
))

Cash Flows from Financing Activities:

Fixed annuity receipts	454.2	359.9
Annuity surrenders, benefits and withdrawals	(483.0)	(564.5)
Net transfers (to) from variable annuity assets	3.2	(44.3)
Additions to notes payable	87.5	2.0
Reductions of notes payable	(15.4)	(51.2)
Issuance of Common Stock	0.5	0.6
Retirement of Common Stock	(0.3)	(1.9)

Repurchase of trust preferred securities	<u>(75.0)</u>	<u>(1.4)</u>
))
	<u>(28.3)</u>	<u>(300.8)</u>
))
Net increase (decrease) in cash and short-term investments	54.7	(45.9)
Beginning cash and short-term investments	<u>87.5</u>	<u>119.6</u>
Ending cash and short-term investments	<u>\$142.2</u>	<u>\$ 73.7</u>

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GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A.

Description of the Company

Great American Financial Resources, Inc. ("GAFRI" or "the Company") markets retirement products, primarily fixed and variable annuities, and various forms of life and supplemental health insurance through independent agents, payroll deduction plans, financial institutions and in-home sales.

American Financial Group, Inc. ("AFG") and its subsidiaries owned 83% of GAFRI's Common Stock at November 1, 2001.

B.

Accounting Policies

Basis of Presentation

The accompanying Consolidated Financial Statements for GAFRI and its 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 periods to conform to the current period'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 stockholders' equity. Short-term investments are carried at cost; mortgage loans on real estate are generally carried at amortized cost; policy loans are stated at the aggregate unpaid balance. Premiums and discounts on mortgage-backed securities are amortized over a period based on estimated future principal prepayments and adjusted to reflect actual prepayments.

Gains or losses on securities are 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.

Emerging Issues Task Force Issue No. 99-20 ("EITF 99-20") established a new standard for recognizing impairment of certain asset-backed investments. Impairment losses on these investments must be recognized when (i) the fair value of the security is less than its carrying value and (ii) there has been an adverse change in the expected cash flows. The new standard became effective on April 1, 2001. Impairment losses on initial application of this rule were recognized as the cumulative effect of an accounting change. Subsequent impairments are recognized as a component of net realized gains and losses.

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

Investment in Affiliate

GAFRI's investments in equity securities of companies that are 20% to 50% owned by AFG and its subsidiaries are generally carried at cost, adjusted for a proportionate share of their undistributed earnings or losses.

Due to Chiquita's announced intention to pursue a plan to restructure its public debt, GAFRI wrote down its investment in Chiquita common stock to market value at December 31, 2000. In 2001, GAFRI suspended accounting for the investment under the equity method due to the expected restructuring, and reclassified the investment to "Equity securities."

Insurance Acquisition Costs and Expenses

Insurance acquisition costs and expenses consist primarily of deferred policy acquisition costs and the present value of future profits on business in force of acquired insurance companies. In addition, certain marketing and commission costs are expensed as paid and included in insurance acquisition expenses.

Deferred Policy Acquisition Costs ("DPAC")

DPAC (principally commissions, advertising, underwriting, policy issuance and sales expenses that vary with and are primarily related to the production of new business) is deferred to the extent that such costs are deemed recoverable.

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. These expected gross profits consist principally of estimated future net investment income and surrender, mortality and other policy charges, less estimated future interest on policyholders' funds, policy administration expenses and death benefits in excess of account values. DPAC is reported net of unearned revenue relating to certain policy charges that represent compensation for future services. These unearned revenues are recognized as income using the same assumptions and factors used to amortize DPAC.

To the extent that realized gains and losses result in adjustments to the amortization of DPAC, such adjustments are reflected as components of realized gains. To the extent that unrealized gains (losses) from securities would result in adjustments to DPAC, unearned revenues and policyholder liabilities had those gains (losses) actually been realized, such balance sheet amounts are adjusted, net of deferred taxes.

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. Such anticipated premium revenues were estimated using the same assumptions used for computing liabilities for future policy benefits.

Present Value of Future Profits

Included in insurance acquisition costs are amounts representing the present value of future profits on business in force of acquired insurance companies, which represent the portion of the costs to acquire such companies that is allocated to the value of the right to receive future cash flows from insurance contracts existing at the date of acquisition.

These amounts are amortized with interest over the estimated remaining life of the acquired policies for annuities and universal life products and over the expected premium paying period for traditional life and health insurance products.

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GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

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 yields, mortality, morbidity and surrenders and include provisions for unfavorable deviations.

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Reserves established for accident and health claims are modified as necessary to reflect actual experience and developing trends.

The liability for future policy benefits for interest sensitive life and universal life policies is equal to the sum of the accumulated fund balances under such policies.

Variable Annuity Assets and Liabilities

Separate accounts related to variable annuities represent deposits invested in underlying investment funds on which GAFRI earns a fee. Investment funds are selected and may be changed only by the policyholder.

Life, Accident and Health Premiums and Benefits

For traditional life, accident and health products, premiums are recognized as revenue when legally collectible from policyholders. Policy reserves have been established in a manner which allocates policy benefits and expenses on a basis consistent with the recognition of related premiums and generally results in the recognition of profits over the premium paying period of the policies.

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. Surrender benefits reduce the account value. Death benefits are expensed when incurred, net of the account value.

Income Taxes

GAFRI and Great American Life Insurance Company ("GALIC") have separate tax allocation agreements with American Financial Corporation ("AFC"), a subsidiary of AFG, which designate how tax payments are shared by members of the tax group. In general, both companies compute taxes on a separate return basis. GALIC is obligated to make payments to (or receive benefits from) AFC based on taxable income or loss without regard to temporary differences. If GALIC's taxable income (computed on a statutory accounting basis) exceeds a current period net operating loss of GAFRI, the taxes payable or recoverable by GALIC associated with the excess are payable to or receivable from AFC. If the AFC tax group utilizes any of GAFRI's net operating losses or deductions that originated prior to GAFRI's entering AFC's consolidated tax group, AFC will pay to GAFRI an amount equal to the benefit received. The tax allocation agreements with AFC do not impact the recognition of income tax expense and income tax payable in GAFRI's financial statements.

Deferred income tax assets and liabilities are determined based on differences between financial reporting and tax basis and are measured using enacted tax rates. The Company recognizes deferred tax assets if it is more likely than not that a benefit will be realized. Current and deferred tax assets and liabilities of companies in AFC's consolidated tax group are aggregated with other amounts receivable from or payable to affiliates.

Stock-Based Compensation

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As permitted under Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation", GAFRI accounts for stock options and other stock-based compensation plans using the intrinsic value based method prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees."

Benefit Plans

GAFRI sponsors an Employee Stock Ownership Retirement Plan ("ESORP") covering all employees who are qualified as to age and length of service. The ESORP, which invests primarily in securities of GAFRI, is a trustee, noncontributory plan for the benefit of the employees of GAFRI and its subsidiaries. Contributions are discretionary by the directors of GAFRI and are charged against earnings in the year for which they are declared.

Qualified employees having vested rights in the plan are entitled to benefit payments at age 60.

GAFRI and certain of its subsidiaries provide certain benefits to eligible retirees. The projected future cost of providing these benefits is expensed over the period the employees earn such benefits.

Derivatives

Effective October 1, 2000, GAFRI implemented 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 GAFRI's balance sheet consist primarily of investments in common stock warrants (included in equity securities), the equity-based component of certain annuity products (included in annuity benefits accumulated) and call options (included in other assets) used to mitigate the risk embedded in the equity-indexed annuity products.

Earnings Per Share

Basic earnings per share is calculated using the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share include the effect of the assumed exercise of dilutive common stock options.

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 annuity receipts, benefits and withdrawals and obtaining resources from owners and providing them with a return on their investments. 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.

C. Segments of Operations

GAFRI's life and annuity operations offer fixed and variable annuity products and traditional life insurance products. GAFRI's annuity products are sold through managing general agents and independent agents to employees of primary and secondary educational institutions, hospitals and in the non-qualified markets. Traditional term, universal and whole life insurance products are sold through national marketing organizations.

GAFRI's supplemental insurance businesses, United Teacher Associates Insurance Company ("UTA") and Loyal American Life Insurance Company, offer a variety of supplemental health and life products. Loyal's marketing strategy emphasizes third-party sponsorship, including employers and credit unions, while UTA offers its products through independent agents.

GA Life of Puerto Rico sells in-home life and supplemental health products through a network of company-employed agents. Sales in Puerto Rico accounted for approximately 20% of GAFRI's life, accident and health premiums in the first nine months of 2001 and 2000.

Corporate and other consists primarily of GAFRI (parent) and AAG Holding.

The following table shows GAFRI's revenues and operating profit by significant business segment (in millions):

	<u>Three months ended</u> <u>September 30,</u>		<u>Nine months ended</u> <u>September 30,</u>	
	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>
<u>Revenues</u>				
Life and annuity products	\$147.8	\$143.2	\$431.4	\$413.8
Supplemental insurance products	57.1	57.6	175.8	140.3
GA Life of Puerto Rico	16.3	14.7	47.6	43.7
Corporate and other	<u>2.4</u>	<u>2.2</u>	<u>6.9</u>	<u>6.5</u>
Total operating revenues	223.6	217.7	661.7	604.3
Realized gains (losses)	<u>(1.3</u>	<u>18.5</u>	<u>(25.8</u>	<u>14.8</u>
))		
Total revenues per income statement	<u>\$222.3</u>	<u>\$236.2</u>	<u>\$635.9</u>	<u>\$619.1</u>

Operating profit - pretax

Life and annuity products (excluding litigation charges)	\$ 31.7	\$ 35.4	\$102.7	\$105.0
Supplemental insurance products	-	0.5	(0.9)	(2.2)
GA Life of Puerto Rico	2.7	2.5	7.7	6.7
Litigation charges	-	-	-	(32.5)
Corporate and other	<u>(6.2)</u>	<u>(9.9)</u>	<u>(23.5)</u>	<u>(27.8)</u>
))))
Pretax earnings from operations	28.2	28.5	86.0	49.2
Realized gains (losses)	<u>(1.3)</u>	<u>18.5</u>	<u>(25.8)</u>	<u>14.8</u>
))))
Total pretax income per income statement	<u>\$ 26.9</u>	<u>\$ 47.0</u>	<u>\$ 60.2</u>	<u>\$ 64.0</u>

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GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

D. Investment in Affiliate

Investment in affiliate at December 31, 2000, reflects GAFRI's 4% ownership (2.7 million shares) of the common stock of Chiquita Brands International. AFG and its other subsidiaries own an additional 28% interest in the common stock of Chiquita. Chiquita is a leading international marketer, producer and distributor of quality fresh fruits and vegetables and processed foods.

In January 2001, Chiquita announced a restructuring initiative that included discontinuing all interest and principal payments on its public debt. A restructuring is expected to result in the conversion of a significant portion of Chiquita's \$862 million in public debt into common equity.

The market value of GAFRI's investment in Chiquita was approximately \$2.7 million at December 31, 2000.

E. Unamortized Insurance Acquisition Costs

Unamortized insurance acquisition costs consisted of the following (in millions):

September 30,	December 31,
<u>2001</u>	<u>2000</u>

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Deferred policy acquisition costs	\$589.6	\$536.9
Present value of future profits acquired	85.9	93.4
Unearned revenues	<u>(134.2)</u>	<u>(142.4)</u>
))
	<u>\$541.3</u>	<u>\$487.9</u>

F. Notes Payable

Notes payable consisted of the following (in millions):

	September 30, <u>2001</u>	December 31, <u>2000</u>
Direct obligations of GAFRI	\$ 1.7	\$ 2.0
Obligations of AAG Holding (guaranteed by GAFRI):		
6-7/8% Senior Notes due 2008	100.0	100.0
Bank Credit Line	121.1	48.5
Other subsidiary debt	<u>1.2</u>	<u>1.4</u>
 Total	 <u>\$224.0</u>	 <u>\$151.9</u>

In January 2001, AAG Holding replaced its existing bank line with a \$155 million unsecured credit agreement. Loans under the credit agreement mature on December 31, 2004. At September 30, 2001, the weighted-average interest rate on amounts borrowed under its credit line was 3.74%.

In September 2001, GAFRI borrowed under its credit agreement in connection with the redemption of its ROPES.

At September 30, 2001, scheduled principal payments on debt for the remainder of 2001 and the subsequent five years were as follows (in millions):

<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
\$0.2	\$0.7	\$0.6	\$121.3	\$0.2	\$0.2

G. Mandatorily Redeemable Preferred Securities of Subsidiary Trusts

Wholly-owned subsidiary trusts of GAFRI issued \$225 million of preferred securities and, in turn, purchased a like amount of subordinated debt which provides interest and principal payments to fund the Trusts' obligations. The preferred securities are mandatorily redeemable upon maturity or redemption of the subordinated debt. GAFRI effectively provides an unconditional guarantee of the Trusts' obligations. The three preferred securities issues are summarized as follows:

<u>Date of Issuance</u>	<u>Issue (Maturity Date)</u>	<u>09/30/01</u>	<u>12/31/00</u>	<u>Optional Redemption Dates</u>
November 1996	9-1/4% TOPrS* (2026)	\$72,912,500	\$72,912,500	On or after 11/7/2001
March 1997	8-7/8% Pfd (2027)	70,000,000	70,000,000	On or after 3/1/2007
May 1997	7-1/4% ROPES** (2041)	-	75,000,000	Redeemed 9/28/2001

* Trust Originated Preferred Securities

** Remarketed Par Securities

H. Stockholders' Equity

The Company is authorized to issue 25,000,000 shares of Preferred Stock, par value \$1.00 per share.

At September 30, 2001, there were 4.0 million shares of GAFRI Common Stock reserved for issuance under GAFRI's stock option plans. Under the plans, the exercise price of each option equals the market price of GAFRI Common Stock at the date of grant. Options generally become exercisable at the rate of 20% per year commencing one year after grant. All options expire ten years after the date of grant.

The change in net unrealized gains on marketable securities for the nine months ended September 30 included the following (in millions):

	<u>2001</u>			<u>2000</u>		
	<u>Pretax</u>	<u>Taxes</u>	<u>Net</u>	<u>Pretax</u>	<u>Taxes</u>	<u>Net</u>
Unrealized holding gains on securities arising during the period	\$129.6	(\$44.8)	\$ 84.8	\$46.0	(\$15.3)	\$30.7
Realized losses (gains) on securities	<u>24.3</u>	<u>(8.5)</u>	<u>15.8</u>	<u>(14.6)</u>	<u>5.1</u>	<u>(9.5)</u>
))))
Change in net unrealized gains on marketable securities	<u>\$153.9</u>	<u>(\$53.3)</u>	<u>\$100.6</u>	<u>\$31.4</u>	<u>(\$10.2)</u>	<u>\$21.2</u>

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

I. Earnings Per Share

The number of common shares outstanding used in calculating diluted earnings per share in both the third quarter and first nine months of 2001 includes 0.4 million shares compared to 0.5 million shares for the third quarter of 2000 and 0.4 million shares for the first nine months of 2000 for the effect of the assumed exercise of GAFRI's dilutive stock options.

J. Contingencies

In March 2000, a jury in Dallas, Texas, returned a verdict against GALIC with total damages of \$11.2 million in a lawsuit brought by two former agents of GALIC. The former agents had alleged that their agency agreement with GALIC had been wrongfully terminated. The Company believes the verdict was contrary to both the facts and the law and expects to prevail on appeal. The ultimate outcome of this case will not have a material adverse impact on the financial condition of the Company.

K. Additional Information

Statutory Information of Great American Life Insurance Company

Insurance companies are required to file financial statements with state insurance regulatory authorities prepared on an accounting basis prescribed or permitted by such authorities (statutory basis). Certain statutory amounts for GALIC, GAFRI's primary insurance subsidiary, were as follows (in millions):

	September 30, <u>2001</u>	December 31, <u>2000</u>
Capital and surplus	\$335.0	\$362.5
Asset valuation reserve	81.4	75.6
Interest maintenance reserve	4.4	3.3
	<u>Nine months ended September 30,</u>	
	<u>2001</u>	<u>2000</u>
Pretax income from operations	\$62.8	\$64.1
Net income from operations	39.6	50.4
Net income	24.1	47.5

The amount of dividends which can be paid by GALIC without prior approval of regulatory authorities is subject to restrictions relating to capital and surplus and statutory net income. Based on net income for the year ended December 31, 2000, GALIC may pay \$52.1 million in dividends in 2001 without prior approval. In the first nine months of 2001, GALIC paid \$18.0 million in dividends.

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GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

Condensed Consolidating Information GAFRI has guaranteed all of the outstanding debt of AAG Holding and the preferred securities of the Trusts. Condensed consolidating financial statements for GAFRI are as follows:

CONDENSED CONSOLIDATING BALANCE SHEET

(In millions)

<u>SEPTEMBER 30, 2001</u>	<u>GAFRI</u>	<u>AAG HOLDING</u>	<u>TOTAL ALL OTHER TRUSTS</u>	<u>___ SUBS</u>	<u>CONS ENTRIES</u>	<u>TOTAL CONS</u>
Assets						
Cash and investments	\$ 21.3	\$ -	\$ -	\$7,003.0	(\$ 16.2)	\$7,008.1
Investment in subsidiaries	728.5	1,108.3	-	0.9	(1,837.7)	-
Notes receivable from AAG Holding	102.4	-	154.6	-	(257.0)	-
Unamortized insurance acquisition costs, net	-	-	-	541.3	-	541.3
Other assets	25.5	15.8	2.9	259.6	37.3	341.1
Variable annuity assets (separate accounts)	<u>-</u>	<u>-</u>	<u>-</u>	<u>453.8</u>	<u>-</u>	<u>453.8</u>
	<u>\$877.7</u>	<u>\$1,124.1</u>	<u>\$157.5</u>	<u>\$8,258.6</u>	<u>(\$2,073.6)</u>	<u>\$8,344.3</u>
Liabilities and Capital						
Insurance liabilities	\$ -	\$ -	\$ -	\$6,336.9	(\$ 4.7)	\$6,332.2
Notes payable to GAFRI	-	102.4	-	0.1	(102.5)	-
Notes payable to Trusts	-	154.6	-	-	(154.6)	-
Other notes payable	1.9	221.2	-	1.0	(0.1)	224.0

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Other liabilities	67.4	-	2.9	328.3	(15.6)	383.0
Variable annuity liabilities (separate accounts)	<u>-</u>	<u>-</u>	<u>-</u>	<u>453.8</u>	<u>-</u>	<u>453.8</u>
	69.3	478.2	2.9	7,120.1	(277.5)	7,393.0
Mandatorily redeemable preferred securities of subsidiary trusts	-	-	150.0	-	(7.1)	142.9
Total stockholders' equity	<u>808.4</u>	<u>645.9</u>	<u>4.6</u>	<u>1,138.5</u>	<u>(1,789.0)</u>	<u>808.4</u>
)		
	<u>\$877.7</u>	<u>\$1,124.1</u>	<u>\$157.5</u>	<u>\$8,258.6</u>	<u>(\$2,073.6)</u>	<u>\$8,344.3</u>

DECEMBER 31, 2000

Assets

Cash and investments	\$ 30.0	\$ -	\$ -	\$6,571.4	(\$ 16.1)	\$6,585.3
Investment in subsidiaries	580.6	978.8	-	1.0	(1,560.4)	-
Notes receivable from AAG Holding	102.4	-	232.0	-	(334.4)	-
Unamortized insurance acquisition costs, net	-	-	-	487.9	-	487.9
Other assets	30.5	11.8	6.0	291.7	29.0	369.0
Variable annuity assets (separate accounts)	<u>-</u>	<u>-</u>	<u>-</u>	<u>533.7</u>	<u>-</u>	<u>533.7</u>
	<u>\$743.5</u>	<u>\$990.6</u>	<u>\$238.0</u>	<u>\$7,885.7</u>	<u>(\$1,881.9)</u>	<u>\$7,975.9</u>

Liabilities and Capital

Insurance liabilities	\$ -	\$ -	\$ -	\$6,147.8	\$ (4.7)	\$6,143.1
Notes payable to GAFRI	-	102.4	-	0.1	(102.5)	-
Notes payable to Trusts	-	232.0	-	-	(232.0)	-
Other notes payable	2.0	148.5	-	1.4	-	151.9
Other liabilities	69.8	-	6.1	208.8	(27.1)	257.6
Variable annuity liabilities (separate accounts)	<u>-</u>	<u>-</u>	<u>-</u>	<u>533.7</u>	<u>-</u>	<u>533.7</u>

	71.8	482.9	6.1	6,891.8	(366.3)	7,086.3
Mandatorily redeemable preferred securities of subsidiary trusts	-	-	225.0	-	(7.1)	217.9
Total stockholders' equity	<u>671.7</u>	<u>507.7</u>	<u>6.9</u>	<u>993.9</u>	<u>(1,508.5)</u>	<u>671.7</u>
	<u>\$743.5</u>	<u>\$990.6</u>	<u>\$238.0</u>	<u>\$7,885.7</u>	<u>(\$1,881.9)</u>	<u>\$7,975.9</u>

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GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

CONDENSED CONSOLIDATING INCOME STATEMENT

(In millions)

FOR THE THREE MONTHS ENDING

	AAG	TOTAL	ALL	CONS	TOTAL	
	GAFRI	HOLDING	OTHER	ENTRIES	CONS	
<u>SEPTEMBER 30, 2001</u>	<u>GAFRI</u>	<u>HOLDING</u>	<u>TRUSTS</u>	<u>SUBS</u>	<u>ENTRIES</u>	<u>CONS</u>

Revenues

:						
Life, accident and health premiums	\$ -	\$ -	\$ -	\$ 69.1	\$ -	\$ 69.1
Net investment income and other revenue	6.5	-	-	152.4	(5.7)	153.2
Interest income on AAG Holding notes	-	-	4.9	-	(4.9)	-
Equity in earnings of subsidiaries	<u>23.3</u>	<u>32.0</u>	<u>-</u>	<u>-</u>	<u>(55.3)</u>	<u>-</u>
	29.8	32.0	4.9	221.5	(65.9)	222.3

Costs and Expenses:

Insurance benefits and expenses	-	-	-	150.8	-	150.8
Interest expense on AAG Holding notes	-	4.9	-	-	(4.9)	-
Other interest and debt expenses	-	4.9	-	-	2.1	7.0
Other expenses	<u>2.9</u>	<u>1.7</u>	<u>-</u>	<u>36.2</u>	<u>(3.2)</u>	<u>37.6</u>

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	2.9	11.5	-	187.0	(6.0)	195.4
Operating earnings before income taxes	26.9	20.5	4.9	34.5	(59.9)	26.9
Provision for income taxes	<u>8.5</u>	<u>7.1</u>	<u>-</u>	<u>10.7</u>	<u>(17.8)</u>	<u>8.5</u>
Net income	<u>\$18.4</u>	<u>\$13.4</u>	<u>\$4.9</u>	<u>\$ 23.8</u>	<u>(\$42.1)</u>	<u>\$ 18.4</u>

FOR THE NINE MONTHS ENDING

SEPTEMBER 30, 2001

Revenues

:						
Life, accident and health premiums	\$ -	\$ -	\$ -	\$208.8	\$ -	\$208.8
Net investment income and other revenue	19.9	-	-	422.5	(15.3)	427.1
Interest income on AAG Holding notes	-	-	14.7	-	(14.7)	-
Equity in earnings of subsidiaries	<u>50.6</u>	<u>79.0</u>	<u>-</u>	<u>-</u>	<u>(129.6)</u>	<u>-</u>
	70.5	79.0	14.7	631.3	(159.6)	635.9

Costs and Expenses:

Insurance benefits and expenses	-	-	-	438.2	-	438.2
Interest expense on AAG Holding notes	-	14.7	-	-	(14.7)	-
Other interest and debt expenses	0.1	15.1	-	-	6.5	21.7
Other expenses	<u>10.2</u>	<u>6.4</u>	<u>-</u>	<u>106.8</u>	<u>(7.6)</u>	<u>115.8</u>
	10.3	36.2	-	545.0	(15.8)	575.7
Operating earnings before income taxes	60.2	42.8	14.7	86.3	(143.8)	60.2
Provision for income taxes	<u>18.3</u>	<u>14.6</u>	<u>-</u>	<u>26.0</u>	<u>(40.6)</u>	<u>18.3</u>
Income before accounting change	41.9	28.2	14.7	60.3	(103.2)	41.9

Cumulative effect of accounting change, net of tax	<u>(5.5)</u>	<u>-</u>	<u>-</u>	<u>(5.5)</u>	<u>5.5</u>	<u>(5.5)</u>
)))	
Net income	<u>\$36.4</u>	<u>\$28.2</u>	<u>\$14.7</u>	<u>\$ 54.8</u>	<u>(\$ 97.7)</u>	<u>\$ 36.4</u>

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GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued
CONDENSED CONSOLIDATING INCOME STATEMENT

(In millions)

FOR THE THREE MONTHS ENDING

	AAG	TOTAL	ALL	CONS	TOTAL	
	GAFRI	HOLDING	OTHER	ENTRIES	CONS	
<u>SEPTEMBER 30, 2000</u>	<u>TRUSTS</u>	<u>SUBS</u>	<u>ENTRIES</u>	<u>ENTRIES</u>	<u>CONS</u>	
Revenues						
:						
Life, accident and health premiums	\$ -	\$ -	\$ -	\$ 66.5	\$ -	\$ 66.5
Net investment income and other revenue	33.7	-	-	141.3	(5.3)	169.7
Interest income on AAG Holding notes	-	-	4.9	-	(4.9)	-
Equity in earnings of subsidiaries	<u>15.3</u>	<u>58.8</u>	<u>-</u>	<u>-</u>	<u>(74.1)</u>	<u>-</u>
	49.0	58.8	4.9	207.8	(84.3)	236.2
Costs and Expenses:						
Insurance benefits and expenses	-	-	-	139.7	-	139.7
Interest expense on AAG Holding notes	-	4.9	-	-	(4.9)	-
Other interest and debt expenses	-	6.1	-	-	2.1	8.2
Other expenses	<u>2.0</u>	<u>4.2</u>	<u>-</u>	<u>37.7</u>	<u>(2.6)</u>	<u>41.3</u>

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)		
	2.0	15.2	-	177.4	(5.4)	189.2
Operating earnings before income taxes	47.0	43.6	4.9	30.4	(78.9)	47.0
Provision for income taxes	<u>15.0</u>	<u>15.5</u>	<u>-</u>	<u>10.2</u>	<u>(25.7)</u>	<u>15.0</u>
)		
Net operating earnings	32.0	28.1	4.9	20.2	(53.2)	32.0
Equity in loss of affiliate, net of tax	<u>(1.5)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(1.5)</u>
))		
Net income	<u>\$30.5</u>	<u>\$28.1</u>	<u>\$4.9</u>	<u>\$ 20.2</u>	<u>(\$53.2)</u>	<u>\$ 30.5</u>

FOR THE NINE MONTHS ENDING

SEPTEMBER 30, 2000

Revenues

:						
Life, accident and health premiums	\$ -	\$ -	\$ -	\$166.1	\$ -	\$166.1
Net investment income and other revenue	47.9	-	-	421.6	(16.5)	453.0
Interest income on AAG Holding notes	-	-	14.7	-	(14.7)	-
Equity in earnings of subsidiaries	<u>24.5</u>	<u>89.4</u>	<u>-</u>	<u>-</u>	<u>(113.9)</u>	<u>-</u>
)		
	72.4	89.4	14.7	587.7	(145.1)	619.1

Costs and Expenses:

Insurance benefits and expenses	-	-	-	393.1	-	393.1
Interest expense on AAG Holding notes	-	14.7	-	-	(14.7)	-
Other interest and debt expenses	0.1	18.1	-	0.1	6.4	24.7
Other expenses	<u>8.3</u>	<u>9.7</u>	<u>-</u>	<u>127.6</u>	<u>(8.3)</u>	<u>137.3</u>
)		
	8.4	42.5	-	520.8	(16.6)	555.1

Operating earnings before income taxes	64.0	46.9	14.7	66.9	(128.5)	64.0
Provision for income taxes	<u>17.5</u>	<u>16.5</u>	<u>-</u>	<u>21.4</u>	<u>(37.9)</u>	<u>17.5</u>
)	
Net operating earnings	46.5	30.4	14.7	45.5	(90.6)	46.5
Equity in loss of affiliate, net of tax	<u>(0.5)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(0.5)</u>
))	
Net income	<u>\$46.0</u>	<u>\$30.4</u>	<u>\$14.7</u>	<u>\$ 45.5</u>	<u>(\$90.6)</u>	<u>\$ 46.0</u>

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GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

(In millions)

FOR THE NINE MONTHS ENDING

	AAG	TOTAL	ALL	CONS	TOTAL
			OTHER	ENTRIES	CONS
<u>SEPTEMBER 30, 2001</u>	<u>GAFRI</u>	<u>HOLDING</u>	<u>TRUSTS</u>	<u>SUBS</u>	<u>CONS</u>

Cash Flows from Operating Activities:

Net income	\$36.4	\$28.2	\$14.7	\$ 54.8	(\$97.7)	\$ 36.4
Adjustments:						
Cumulative effect of accounting change	5.5	-	-	5.5	(5.5)	5.5
Equity in undistributed earnings of subsidiaries and affiliates	(35.8)	(34.0)	-	-	69.8	-
Increase in life, accident and health reserves	-	-	-	34.2	-	34.2
Benefits to annuity policyholders	-	-	-	214.0	-	214.0
Amortization of insurance acquisition costs	-	-	-	64.0	-	64.0
Depreciation and amortization	0.5	3.7	-	4.7	-	8.9

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Realized losses	2.7	-	-	23.1	-	25.8
Increase in insurance acquisition costs	-	-	-	(111.4)	-	(111.4)
Other, net	<u>2.6</u>	<u>(15.0)</u>	<u>-</u>	<u>0.7</u>	<u>(1.5)</u>	<u>(13.2)</u>
)))	
	<u>11.9</u>	<u>(17.1)</u>	<u>14.7</u>	<u>289.6</u>	<u>(34.9)</u>	<u>264.2</u>
))		

Cash Flows from Investing Activities:

Purchases of investments and other assets	-	-	-	(898.1)	-	(898.1)
Maturities and redemptions of fixed maturity investments	-	-	-	387.3	-	387.3
Sales of investments and other assets	7.7	-	-	323.2	-	330.9
Decrease in policy loans	-	-	-	(1.3)	-	(1.3)
Decrease in intercompany notes receivable	<u>(1.5)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1.5</u>	<u>-</u>
)))	
	<u>6.2</u>	<u>-</u>	<u>-</u>	<u>(188.9)</u>	<u>1.5</u>	<u>(181.2)</u>
)))	

Cash Flows from Financing Activities:

Fixed annuity receipts	-	-	-	454.2	-	454.2
Annuity surrenders, benefits and withdrawals	-	-	-	(483.0)	-	(483.0)
Net transfers from variable annuity assets	-	-	-	3.2	-	3.2
Additions to notes payable	0.1	87.4	-	-	-	87.5
Reductions of notes payable	(0.2)	(14.8)	-	(0.4)	-	(15.4)
Issuance of Common Stock	0.5	-	-	-	-	0.5
Capital contribution from parent (to subsidiary)	(19.5)	19.5	-	(18.7)	18.7	-
Retirement of Common Stock	(0.3)	-	-	-	-	(0.3)
Redemption of ROPES	-	(75.0)	-	-	-	(75.0)
Trust dividend requirements	<u>-</u>	<u>-</u>	<u>(14.7)</u>	<u>-</u>	<u>14.7</u>	<u>-</u>
)))	
	<u>(19.4)</u>	<u>17.1</u>	<u>(14.7)</u>	<u>(44.7)</u>	<u>33.4</u>	<u>(28.3)</u>
)))	

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Net increase (decrease) in cash and short-term investments	(1.3)	-	-	56.0	-	54.7
Beginning cash and short-term investments	<u>3.2</u>	<u>-</u>	<u>-</u>	<u>84.3</u>	<u>-</u>	<u>87.5</u>
Ending cash and short-term investments	<u>\$ 1.9</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$140.3</u>	<u>\$ -</u>	<u>\$142.2</u>

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GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

(In millions)

FOR THE NINE MONTHS ENDING

	AAG	TOTAL	ALL	CONS	TOTAL	
	GAFRI	HOLDING	OTHER	ENTRIES	CONS	
<u>SEPTEMBER 30, 2000</u>	<u>GAFRI</u>	<u>HOLDING</u>	<u>TRUSTS</u>	<u>SUBS</u>	<u>CONS</u>	
Cash Flows from Operating Activities:						
Net income	\$46.0	\$30.4	\$14.7	\$ 45.5	(\$90.6)	\$ 46.0
Adjustments:						
Equity in undistributed earnings of subsidiaries and affiliates	(15.0)	(20.1)	-	-	35.6	0.5
Increase in life, accident and health reserves	-	-	-	67.1	-	67.1
Benefits to annuity policyholders	-	-	-	203.8	-	203.8
Amortization of insurance acquisition costs	-	-	-	50.8	-	50.8
Depreciation and amortization	0.7	5.8	-	0.3	-	6.8
Realized (gains) losses	(27.5)	-	-	12.7	-	(14.8)
Increase in insurance acquisition costs	-	-	-	(106.8)	-	(106.8)
Other, net	<u>9.1</u>	<u>(8.7)</u>	<u>-</u>	<u>(2.9)</u>	<u>(2.0)</u>	<u>(4.5)</u>
))))))
	<u>13.3</u>	<u>7.4</u>	<u>14.7</u>	<u>270.5</u>	<u>(57.0)</u>	<u>248.9</u>

)

Cash Flows from Investing Activities:

Purchases of investments and other assets	(2.5)	-	-	(593.9)	-	(596.4)
Maturities and redemptions of fixed maturity investments	0.6	-	-	317.7	-	318.3
Sales of investments and other assets	35.8	-	-	245.8	-	281.6
Decrease in policy loans	-	-	-	2.5	-	2.5
Decrease in intercompany notes receivable	<u>0.1</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(0.1)</u>	<u>-</u>
)	
	<u>34.0</u>	<u>-</u>	<u>-</u>	<u>(27.9)</u>	<u>(0.1)</u>	<u>6.0</u>
))		

Cash Flows from Financing Activities:

Fixed annuity receipts	-	-	-	359.9	-	359.9
Annuity surrenders, benefits and withdrawals	-	-	-	(564.5)	-	(564.5)
Net transfers to variable annuity assets	-	-	-	(44.3)	-	(44.3)
Additions to notes payable	-	2.0	-	-	-	2.0
Reductions of notes payable	(0.2)	(50.5)	-	(0.5)	-	(51.2)
Issuance of Common Stock	0.6	-	-	-	-	0.6
Capital contribution from parent (to subsidiary)	(41.1)	41.1	-	(42.4)	42.4	-
Retirement of Common Stock	(1.9)	-	-	-	-	(1.9)
Repurchase of trust preferred securities	-	-	-	(1.4)	-	(1.4)
Trust dividend requirements	<u>-</u>	<u>-</u>	<u>(14.7)</u>	<u>-</u>	<u>14.7</u>	<u>-</u>
)				
	<u>(42.6)</u>	<u>(7.4)</u>	<u>(14.7)</u>	<u>(293.2)</u>	<u>57.1</u>	<u>(300.8)</u>
))))))

Net increase (decrease) in cash and short-term investments

Net increase (decrease) in cash and short-term investments	4.7	-	-	(50.6)	-	(45.9)
Beginning cash and short-term investments	<u>1.1</u>	<u>-</u>	<u>-</u>	<u>118.5</u>	<u>-</u>	<u>119.6</u>

Ending cash and short-term investments	<u>\$ 5.8</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 67.9</u>	<u>\$ -</u>	<u>\$ 73.7</u>
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GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

Management's Discussion and Analysis

of Financial Condition and Results of Operations

GENERAL

Great American Financial Resources, Inc. ("GAFRI" or "the Company") and its subsidiary, AAG Holding Company, Inc., are organized as holding companies with nearly all of their operations being conducted by their subsidiaries. These companies, however, have continuing expenditures for administrative expenses, corporate services and for the payment of interest and principal on borrowings and stockholder dividends.

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;
- availability of reinsurance; and
- competitive pressures.

Forward-looking statements included in this Form 10-Q are made only as of the date of this report and under Section 27A of The Securities Act and Section 21E of The Exchange Act; we do not have any obligation to update any forward-looking statement to reflect subsequent events or circumstances.

LIQUIDITY AND CAPITAL RESOURCES

Ratios

GAFRI's consolidated debt to capital ratio was 22% at September 30, 2001. Capital represents the sum of consolidated debt, redeemable preferred securities of subsidiary trusts and stockholders' equity (excluding unrealized gains on marketable securities).

The National Association of Insurance Commissioners' ("NAIC") risk-based capital ("RBC") formulas determine the amount of capital that an insurance company needs to ensure that it has an acceptable expectation of not becoming financially impaired. At September 30, 2001, the capital ratio of GAFRI's principal insurance subsidiary was 4.1 times its authorized control level RBC.

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Sources and Uses of Funds

To pay interest and principal on borrowings and other holding company costs, GAFRI (parent) and AAG Holding use cash and investments on hand, capital distributions from their principal subsidiary, Great American Life Insurance Company ("GALIC") and bank borrowings. The amount of capital distributions which can be paid by GALIC is subject to restrictions relating to statutory surplus and earnings. The maximum amount of dividends payable by GALIC in 2001 without prior regulatory approval is \$52.1 million. In the first nine months of 2001, GALIC paid \$18.0 million in dividends and GAFRI made a capital contribution of \$10 million to GALIC.

In the third quarter of 2000, GAFRI paid down approximately \$50 million of its bank credit line using cash on hand. In January 2001, the Company replaced its existing agreement with a \$155 million unsecured credit agreement which matures on December 31, 2004. In September 2001, GAFRI redeemed its ROPES for \$75 million in cash using bank borrowings. At September 30, 2001, GAFRI (parent) had over \$30 million available under its bank credit line.

Based upon the current level of operations and anticipated growth, GAFRI believes that it will have sufficient resources to meet its liquidity requirements.

Investments

GAFRI invests primarily in fixed income investments which, including loans and short-term investments, comprised 98% of its investment portfolio at September 30, 2001. GAFRI generally invests in securities having intermediate-term maturities with an objective of optimizing interest yields while maintaining an appropriate relationship of maturities between GAFRI's assets and expected liabilities.

The NAIC assigns quality ratings to publicly traded as well as privately placed securities. At September 30, 2001, 92% of GAFRI's fixed maturity portfolio was comprised of investment grade bonds (NAIC rating of "1" or "2"). Management believes that the high credit quality of GAFRI's investment portfolio should generate a stable and predictable investment return.

At September 30, 2001, GAFRI's mortgage-backed securities ("MBSs") portfolio represented approximately one-third of its fixed maturity investments. GAFRI invests primarily in MBSs which have a lower risk of prepayment. In addition, the majority of MBSs held by GAFRI were purchased at a discount. Management believes that the structure and discounted nature of the MBSs will reduce the effect of prepayments on earnings over the anticipated life of the MBS portfolio.

More than 90% of GAFRI's MBSs are rated "AAA" with substantially all being investment grade quality. The market in which these securities trade is highly liquid. Aside from interest rate risk, GAFRI does not believe a material risk (relative to earnings or liquidity) is inherent in holding such investments.

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Management's Discussion and Analysis

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RESULTS OF OPERATIONS

General

Management believes the concept of net operating earnings (or "core" earnings) is helpful in comparing the operating performance of GAFRI with that of similar companies. However, core earnings should not be considered a substitute for net income as an indication of GAFRI's overall performance. The following table (in millions, except per share amounts) compares the Company's core earnings for the following periods.

	Three months ended		Nine months ended	
	<u>September 30.</u>		<u>September 30.</u>	
<u>GAFRI (Consolidated):</u>	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>
Revenues per income statement	\$222.3	\$236.2	\$635.9	\$619.1
Add back (subtract) realized losses (gains)	<u>1.3</u>	<u>(18.5)</u>	<u>25.8</u>	<u>(14.8)</u>
Core operating revenues	223.6	217.7	661.7	604.3
Expenses per income statement	195.4	189.2	575.7	555.1
Less litigation charges included in annuity benefits	-	-	-	14.2
Less litigation charges included in other expenses	<u>-</u>	<u>-</u>	<u>-</u>	<u>18.3</u>
Core operating expenses	<u>195.4</u>	<u>189.2</u>	<u>575.7</u>	<u>522.6</u>
Core operating earnings before tax	28.2	28.5	86.0	81.7
Income tax expense	<u>9.0</u>	<u>8.5</u>	<u>27.4</u>	<u>23.7</u>
Net core operating earnings	<u>\$ 19.2</u>	<u>\$ 20.0</u>	<u>\$ 58.6</u>	<u>\$ 58.0</u>
Net core operating earnings per common share (diluted)	\$ 0.45	\$ 0.47	\$ 1.37	\$ 1.36

Retirement Products

The following table summarizes GAFRI's premiums for its retirement annuities (in millions).

	Three months ended		Nine months ended	
	<u>September 30.</u>		<u>September 30.</u>	
	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>
<u>Annuity Premiums</u>				
Single premium fixed rate annuities	\$130	\$ 61	\$304	\$195

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Flexible premium fixed rate annuities	32	29	111	111
Single premium variable annuities	29	56	74	201
Flexible premium variable annuities	<u>20</u>	<u>19</u>	<u>68</u>	<u>55</u>
	<u>\$211</u>	<u>\$165</u>	<u>\$557</u>	<u>\$562</u>

Sales of variable annuity products linked to the performance of the stock market were down substantially in the third quarter and first nine months of 2001 compared to the same periods in 2000. Management believes this decrease was attributable to the volatile equity markets.

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Life, Accident and Health Premiums and Benefits

The following table summarizes GAFRI's life, accident and health premiums and benefits as shown in the Consolidated Income Statement (in millions).

	Three months ended		Nine months ended	
	<u>September 30.</u>		<u>September 30.</u>	
	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>
<u>Premiums</u>				
Supplemental insurance products	\$46	\$46	\$143	\$108
GA Life of Puerto Rico	14	12	40	37
Life products	<u>9</u>	<u>8</u>	<u>26</u>	<u>21</u>
	<u>\$69</u>	<u>\$66</u>	<u>\$209</u>	<u>\$166</u>
<u>Benefits</u>				
Supplemental insurance products	\$40	\$39	\$119	\$ 88
GA Life of Puerto Rico	7	5	21	18
Life products	<u>7</u>	<u>7</u>	<u>20</u>	<u>18</u>
	<u>\$54</u>	<u>\$51</u>	<u>\$160</u>	<u>\$124</u>

The increase in supplemental insurance premiums reflects the acquisition of a block of business in 2000.

Real Estate Operations

GAFRI is engaged in a variety of real estate operations including hotels and a marina; GAFRI also owns various parcels of land. Revenues and expenses of these operations, including gains on disposal, are included in GAFRI's Consolidated Income Statement as shown below (in millions).

	Three months ended	Nine months ended
	<u>September 30.</u>	<u>September 30.</u>

	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>
Other income	\$13.8	\$14.1	\$39.8	\$29.4
Other expenses	9.7	9.1	24.0	22.6

Other income included a pretax gain on the sale of real estate assets of \$10.6 million in the first nine months of 2001.

Other Income

Other income increased \$10.3 million in the first nine months of 2001 compared to the same period in 2000 due primarily to income from the sale of real estate and, to a lesser extent, increased fees earned on GAFRI's variable annuity and life business. These increases were partially offset by lower revenues at GAFRI's insurance agency and broker/dealer subsidiaries.

Realized Gains (Losses)

Realized gains (losses) on securities includes the following provisions for other than temporary impairment: third quarter of 2001 and 2000 - \$11.3 million and \$1.2 million; nine months of 2001 and 2000 - \$34.3 million and \$2.4 million, respectively.

In September 2000, GAFRI realized a pre-tax gain of \$27.2 million on the sale of its investment in a company engaged in the production of ethanol.

Annuity Benefits

Annuity benefits reflect amounts accrued on annuity policyholders' funds accumulated. In the third quarter and first nine months of 2000, annuity benefits also included \$14.2 million related to a class action lawsuit settlement. 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.

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Management's Discussion and Analysis

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On its deferred annuities (annuities in the accumulation phase), GAFRI generally credits interest to policyholders' accounts at their current stated "surrender" interest rates. Furthermore, for "two-tier" deferred annuities (annuities under which a higher interest amount can be earned if a policy is annuitized rather than surrendered), GAFRI accrues an additional liability to provide for expected deaths and annuitizations. Changes in crediting rates, actual surrender and annuitization experience or modifications in actuarial assumptions can affect this accrual.

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 less than a \$1 million net effect on annuity benefits in the first nine months of 2001.

Insurance Acquisition Expenses

Insurance acquisition expenses include amortization of deferred policy acquisition costs ("DPAC") as well as commissions on sales of life insurance products. Insurance acquisition expenses also include amortization of the present value of future profits of businesses acquired amounting to \$7.3 million in the first nine months of 2001 and \$9.2 million in the first nine months of 2000.

Interest and Other Debt Expenses

The decrease in interest and other debt expenses in the third quarter and first nine months of 2001 compared to the same periods in 2000 is due primarily to lower average bank borrowings as well as lower interest rates on these borrowings.

Other Expenses

In the second quarter of 2000, the Company recorded a charge of \$32.5 million for liabilities related to various litigation in which the Company or one of its subsidiaries is a defendant (\$18.3 million of that charge was included in other expenses; \$14.2 million of that charge was included in annuity benefits expense). The charge represents amounts that the Company agreed to pay and estimates of the ultimate liability in certain cases not yet finalized. The most significant case included in this charge was a policyholder class action which was approved for settlement in the fourth quarter of 2000.

Equity in Loss of Affiliate

Equity in loss of affiliate in 2000 represents GAFRI's proportionate share of the results of Chiquita Brands International. In 2001, due to Chiquita's restructuring plans, GAFRI suspended accounting for Chiquita under the equity method.

Cumulative Effect of Accounting Change

The cumulative effect of accounting change represents the implementation of a new accounting standard (EITF 99-20) which resulted in a write down of \$8.4 million (\$5.5 million or \$.13 per share after tax) of the carrying value of certain collateralized debt obligations as of April 1, 2001.

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Management's Discussion and Analysis

of Financial Condition and Results of Operations - Continued

Recent Accounting Standards

In July 2001, the Financial Accounting Standards Board issued SFAS No. 141, "Business Combinations", and No. 142, "Goodwill and Other Intangible Assets." Under SFAS No. 141, business combinations initiated after June 30, 2001 are required to be accounted for using the purchase method of accounting. Under SFAS No. 142, goodwill will no longer be amortized beginning January 1, 2002, but will be subject to an impairment test at least annually. A transitional test for

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impairment is required to be completed in 2002 with any resulting writedown reported during the first quarter as a cumulative effect of a change in accounting principle. Based on goodwill recorded at September 30, 2001, management expects that goodwill amortization in 2002 would have been less than \$2 million.

PART II

OTHER INFORMATION

Item 3

Quantitative and Qualitative Disclosure at Market Risk

As of September 30, 2001, there were no material changes to the information provided in GAFRI'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.

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, the Registrant has duly caused this report to be signed on its behalf by the undersigned duly authorized.

GREAT AMERICAN FINANCIAL RESOURCES, Inc.

November 14, 2001

BY: /s/Christopher P. Miliano

Christopher P. Miliano

Chief Financial Officer

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