

GREAT AMERICAN FINANCIAL RESOURCES INC
Form 10-Q
May 15, 2002

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, 2002

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 May 1, 2002, there were 42,450,536 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)

	March 31, <u>2002</u>	December 31, <u>2001</u>
Assets		
Investments:		
Fixed maturities - at market (amortized cost - \$6,481.2 and \$6,302.1)	\$6,541.7	\$6,431.1
Equity securities - at market (cost - \$37.1 and \$37.8)	62.8	59.0
Mortgage loans on real estate	24.5	24.8
Real estate	69.3	69.4
Policy loans	208.4	211.3
Short-term investments	<u>53.5</u>	<u>131.9</u>
 Total investments	 6,960.2	 6,927.5
 Cash	 14.9	 39.0
Accrued investment income	92.7	95.0
Unamortized insurance acquisition costs, net	579.2	556.1

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Other assets	264.4	253.2
Variable annuity assets (separate accounts)	<u>560.8</u>	<u>529.6</u>
	<u>\$8,472.2</u>	<u>\$8,400.4</u>
Liabilities and Capital		
Annuity benefits accumulated	\$5,931.6	\$5,832.1
Life, accident and health reserves	653.5	638.5
Notes payable	222.9	223.0
Payable to affiliates, net	86.2	95.7
Deferred taxes on unrealized gains	27.6	47.2
Accounts payable, accrued expenses and other liabilities	123.3	142.6
Variable annuity liabilities (separate accounts)	<u>560.8</u>	<u>529.6</u>
Total liabilities	7,605.9	7,508.7
Mandatorily redeemable preferred securities of subsidiary trusts	142.9	142.9
Stockholders' Equity:		
Common Stock, \$1 par value		
-100,000,000 shares authorized		
-42,412,738 and 42,353,464 shares outstanding	42.4	42.3
Capital surplus	347.2	346.7
Retained earnings	281.4	270.0
Unrealized gains on marketable securities, net	<u>52.4</u>	<u>89.8</u>
Total stockholders' equity	<u>723.4</u>	<u>748.8</u>
	<u>\$8,472.2</u>	<u>\$8,400.4</u>

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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	
	<u>March 31,</u>	
	<u>2002</u>	<u>2001</u>
Revenues		
:		
Life, accident and health premiums	\$ 70.9	\$ 69.2
Net investment income	134.5	122.8
Realized losses on investments	(9.6)	(1.8)
Other income	<u>17.8</u>	<u>26.8</u>
	213.6	217.0
Costs and Expenses		
:		
Annuity benefits	75.6	69.3
Life, accident and health benefits	55.9	54.0
Insurance acquisition expenses	24.8	21.3
Trust preferred distribution requirement	3.2	4.5
Interest and other debt expenses	2.7	2.8
Other expenses	<u>35.6</u>	<u>38.9</u>
	<u>197.8</u>	<u>190.8</u>
Operating earnings before income taxes	15.8	26.2

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Provision for income taxes	<u>4.4</u>	<u>8.3</u>
Net Income	<u>\$ 11.4</u>	<u>\$ 17.9</u>
Earnings per common share:		
Basic	\$0.27	\$0.42
Diluted	\$0.27	\$0.42
Average number of common shares:		
Basic	42.4	42.3
Diluted	42.8	42.8

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GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(In millions)

	Three months ended	
	<u>March 31,</u>	
	<u>2002</u>	<u>2001</u>
Common Stock:		
Balance at beginning of period	\$ 42.3	\$ 42.3
Common Stock issued	<u>0.1</u>	<u>-</u>
Balance at end of period	<u>\$ 42.4</u>	<u>\$ 42.3</u>

Capital Surplus:

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Balance at beginning of period	\$346.7	\$348.5
Common Stock issued	1.0	0.1
Common Stock retired	<u>(0.5)</u>	<u>-</u>
)	
Balance at end of period	<u>\$347.2</u>	<u>\$348.6</u>

Retained Earnings:

Balance at beginning of period	\$270.0	\$237.0
Net income	<u>11.4</u>	<u>17.9</u>
Balance at end of period	<u>\$281.4</u>	<u>\$254.9</u>

Unrealized Gains, Net:

Balance at beginning of period	\$ 89.8	\$ 43.9
Change during period	<u>(37.4)</u>	<u>38.5</u>
)	
Balance at end of period	<u>\$ 52.4</u>	<u>\$ 82.4</u>

Comprehensive Income (Loss):

Net income	\$ 11.4	\$ 17.9
Other comprehensive income(loss)- change in net unrealized gains	<u>(37.4)</u>	<u>38.5</u>
)	
Comprehensive income(loss)	<u>(\$ 26.0)</u>	<u>\$ 56.4</u>

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

(In millions)

	Three months ended	
	<u>March 31,</u>	
	<u>2002</u>	<u>2001</u>
Cash Flows from Operating Activities:		
Net income	\$ 11.4	\$ 17.9
Adjustments:		
Increase in life, accident and health reserves	14.9	17.7
Benefits to annuity policyholders	75.6	69.3
Amortization of insurance acquisition costs	24.8	21.3
Depreciation and amortization	5.0	2.4
Realized losses on investments	9.6	1.8
Increase in insurance acquisition costs	(38.6)	(35.6)
Decrease in other liabilities	(29.2)	(2.4)
Other, net	<u>2.4</u>	<u>(4.0)</u>
)	
	<u>75.9</u>	<u>88.4</u>
Cash Flows from Investing Activities:		
Purchases of and additional investments in:		
Fixed maturity investments	(891.7)	(267.5)
Equity securities	-	(2.0)
Real estate, mortgage loans and other assets	(1.4)	(4.0)
Maturities and redemptions of fixed maturity investments	285.8	82.9
Sales of:		
Fixed maturity investments	396.4	84.8
Equity securities	0.2	1.0
Real estate, mortgage loans and other assets	0.5	12.5
Decrease in policy loans	<u>2.9</u>	<u>1.5</u>

	<u>(207.3)</u>	<u>(90.8)</u>
))
Cash Flows from Financing Activities:		
Fixed annuity receipts	169.9	126.2
Annuity surrenders, benefits and withdrawals	(135.9)	(186.9)
Net transfers(to)from variable annuity assets	(5.6)	2.9
Additions to notes payable	-	4.6
Reductions of notes payable	(0.1)	(0.2)
Issuance of Common Stock	1.1	0.1
Retirement of Common Stock	<u>(0.5)</u>	<u>-</u>
)	
	<u>28.9</u>	<u>(53.3)</u>
)
Net decrease in cash and short-term investments	(102.5)	(55.7)
Beginning cash and short-term investments	<u>170.9</u>	<u>87.5</u>
Ending cash and short-term investments	<u>\$ 68.4</u>	<u>\$ 31.8</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 May 1, 2002.

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 cost basis of that investment is reduced.

Emerging Issues Task Force Issue No. 99-20 ("EITF 99-20") established a new standard for recognizing interest income and impairment on certain asset-backed investments. Interest income on these investments is recorded at a yield based on projected cash flows. The yield is adjusted prospectively to reflect actual cash flows and changes in projected amounts. Impairment losses on these investments must be recognized when (i) the fair value of the security is less than its cost basis and (ii) there has been an adverse change in the expected cash flows. The new standard became effective on April 1, 2001. Impairment losses at 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.

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GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

Goodwill

Goodwill represents the excess of cost of subsidiaries over GAFRI's equity in their underlying net assets. Through December 31, 2001, goodwill was being amortized over periods of 20 to 40 years. Effective January 1, 2002,

GAFRI implemented Statement of Financial Accounting Standards ("SFAS") No. 142, under which goodwill is no longer amortized but is subject to an impairment test at least annually. As required under SFAS No. 142, GAFRI will complete the transitional test for goodwill impairment (as of January 1, 2002) by the end of 2002. Any resulting write-down will be reported by restating first quarter 2002 results for the cumulative effect of a change in accounting principle.

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 related to annuities, such adjustments are reflected as components of realized gains. DPAC related to annuities is also adjusted, net of tax, for the change in amortization that would have been recorded if the unrealized gains (losses) from securities had actually been realized. This adjustment is included in unrealized gains (losses) on marketable securities.

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 the 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.

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. 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, who retains all investment risk. Accordingly, GAFRI's liability for these accounts equals the value of the account assets.

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 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 receivable 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 have not impacted 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.

GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

Stock-Based Compensation

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." Under GAFRI's stock option plan, options are granted to officers, directors, and key employees at exercise prices equal to the fair value of the shares at the dates of grant. No compensation expense is recognized for stock option grants.

Benefit Plans

GAFRI provides retirement benefits to qualified employees of participating companies through an Employee Stock Ownership Retirement Plan ("ESORP") and a 401(k) plan. Under the ESORP, contributions are at the discretion of the GAFRI Board of Directors and are invested primarily in GAFRI securities. Under the 401(k) plan, GAFRI matches a specific portion of employee contributions. Matching contributions are invested primarily in AFG securities. Company contributions to the ESORP and 401(k) plans are charged against earnings in the year for which they are declared.

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

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. Changes in the fair value of derivatives are included in current earnings.

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. Acquisition

Manhattan National Life Insurance

In March 2002, GAFRI reached an agreement to acquire Manhattan National Life Insurance Company ("MNL") from Conseco, Inc. for \$48.5 million in cash. GAFRI expects to close on this transaction in the second quarter of 2002 and to fund this acquisition with cash on hand and through reinsurance of up to 90% of the business in force. While MNL is not currently writing new policies, the company reported over \$43 million of statutory renewal premiums in 2001. At December 31, 2001, MNL had approximately 90,000 policies in force (primarily term life) representing over \$12 billion in face amount of insurance, statutory assets of \$297.8 million and statutory capital and surplus of \$23.1 million.

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GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

D. 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. UTA offers its products through independent agents. At December 31, 2001, Loyal reinsured a substantial portion of its life insurance business and has begun reducing its marketing efforts.

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 three months of 2002 and 2001.

Corporate and other consists primarily of GAFRI (parent) and AAG Holding (intermediate holding company). The following table shows GAFRI's revenues and operating profit by significant business segment (in millions):

	Three months ended	
	<u>March 31,</u>	
	<u>2002</u>	<u>2001</u>
<u>Revenues</u>		
Life and annuity products	\$146.4	\$142.2

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Supplemental insurance products	57.6	59.2
GA Life of Puerto Rico	17.3	15.5
Corporate and other	<u>1.9</u>	<u>1.9</u>
Total operating revenues	223.2	218.8
Realized losses on investments	<u>(9.6)</u>	<u>(1.8)</u>
))
Total revenues per income statement	<u>\$213.6</u>	<u>\$217.0</u>
<u>Operating profit - pretax</u>		
Life and annuity products	\$ 29.5	\$ 35.4
Supplemental insurance products	1.1	(1.2)
GA Life of Puerto Rico	2.9	2.5
Corporate and other	<u>(8.1)</u>	<u>(8.7)</u>
))
Pretax earnings from operations	25.4	28.0
Realized losses on investments	<u>(9.6)</u>	<u>(1.8)</u>
))
Total pretax income per income statement	<u>\$ 15.8</u>	<u>\$ 26.2</u>

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GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

E. Goodwill

Effective January 1, 2002, goodwill is no longer amortized. If the \$0.4 million (\$0.01 per share) of goodwill amortization had not been deducted in the first quarter of 2001, net earnings for that period would have been \$18.3

million (\$0.43 per share). Net intangible assets, which are included in other assets on the Consolidated Balance Sheet, totalled approximately \$41 million at March 31, 2002 and December 31, 2001.

F. Unamortized Insurance Acquisition Costs

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

	March 31, <u>2002</u>	December 31, <u>2001</u>
Deferred policy acquisition costs	\$647.5	\$621.0
Present value of future profits acquired	69.8	71.2
Unearned revenues	<u>(138.1)</u>	<u>(136.1)</u>
)	<u>\$579.2</u>	<u>\$556.1</u>

G. Notes Payable

Notes payable consisted of the following (in millions):

	March 31, <u>2002</u>	December 31, <u>2001</u>
Direct obligations of GAFRI	\$ 1.8	\$ 1.9
Obligations of AAG Holding (guaranteed by GAFRI):		
6-7/8% Senior Notes due 2008	100.0	100.0
Bank Credit Line	<u>121.1</u>	<u>121.1</u>
Total	<u>\$222.9</u>	<u>\$223.0</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 March 31, 2002, the weighted-average interest rate on amounts borrowed under its credit line was 2.63%.

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At March 31, 2002, scheduled principal payments on debt for the remainder of 2002 and the subsequent five years were as follows (in millions):

<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
\$0.2	\$0.2	\$121.3	\$0.2	\$0.2	\$0.1

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GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

H. Mandatorily Redeemable Preferred Securities of Subsidiary Trusts

Wholly-owned subsidiary trusts of GAFRI issued 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 preferred securities consisted of the following:

<u>Date of Issuance</u>	<u>Issue (Maturity Date)</u>	<u>03/31/02</u>	<u>12/31/01</u>	<u>Optional Redemption Dates</u>
November 1996	9-1/4% TOPrS* (2026)	\$72,912,500	\$72,912,500	Currently redeemable
March 1997	8-7/8% Pfd (2027)	70,000,000	70,000,000	On or after 3/1/2007

* Trust Originated Preferred Securities

I. Stockholders' Equity

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

At March 31, 2002, there were 4.0 million shares of GAFRI Common Stock reserved for issuance under GAFRI's employee stock option plan. Under the plan, 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 three months ended March 31 included the following (in millions):

	<u>2002</u>			<u>2001</u>		
	<u>Pretax</u>	<u>Taxes</u>	<u>Net</u>	<u>Pretax</u>	<u>Taxes</u>	<u>Net</u>
Unrealized holding gains (losses) on securities arising during the period	(\$66.6)	\$23.0	(\$43.6)	\$57.1	(\$19.8)	\$37.3
Realized losses on securities	<u>9.6</u>	<u>(3.4)</u>	<u>6.2</u>	<u>1.8</u>	<u>(0.6)</u>	<u>1.2</u>
))			

Change in net unrealized gains on marketable securities		<u>\$19.6</u>	<u>\$58.9</u>	<u>(\$20.4)</u>	<u>\$38.5</u>
	<u>(\$57.0)</u>	<u>(\$37.4)</u>			

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GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

J. Earnings Per Share

The number of common shares outstanding used in calculating diluted earnings per share in the first quarter of 2002 includes 0.4 million shares compared to 0.5 million shares for the first quarter of 2001 for the effect of the assumed exercise of GAFRI's dilutive stock options.

K. 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. Oral arguments on the appeal were heard in November 2001 and a decision is expected in 2002. The ultimate outcome of this case will not have a material adverse impact on the financial condition of the Company.

L. Additional Information

Statutory Information

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):

	March 31, <u>2002</u>	December 31, <u>2001</u>
Capital and surplus	\$378.7	\$388.4
Asset valuation reserve	75.9	76.9
Interest maintenance reserve	8.8	11.0
	<u>Three months ended March 31</u>	
	<u>2002</u>	<u>2001</u>

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Pretax income from operations	\$13.5	\$10.5
Net income from operations	8.1	8.0
Net income(loss)	(0.1)	12.6

In January 2001, GAFRI's insurance subsidiaries implemented the codification of statutory accounting principles. The cumulative effect of these changes at implementation was not material.

Dividends which can be paid by GAFRI's insurance subsidiaries without prior approval of regulatory authorities are subject to restrictions relating to capital and surplus and statutory net income. Based on capital and surplus at December 31, 2001, GALIC and GA Life of Puerto Rico may pay \$38.8 million and \$24.6 million, respectively, in dividends in 2002 without prior approval. In the first three months of 2002, GALIC paid \$10.0 million in dividends.

Effective December 31, 2001, Loyal entered into a reinsurance treaty whereby a substantial portion of its life insurance was ceded to an unaffiliated company.

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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>GAFRI</u>	<u>AAG HOLDING</u>	<u>TOTAL TRUSTS</u>	<u>ALL OTHER SUBS</u>	<u>CONS ENTRIES</u>	<u>CONS</u>
<u>MARCH 31, 2002</u>						
Assets						
Cash and investments	\$ 12.3	\$ -	\$ -	\$6,964.4	(\$ 1.6)	\$6,975.1
Investment in subsidiaries	656.8	1,048.6	-	1.0	(1,706.4)	-
Notes receivable from AAG Holding	102.4	-	154.6	-	(257.0)	-
Unamortized insurance acquisition costs, net	-	-	-	579.2	-	579.2
Other assets	20.7	2.7	3.0	292.1	38.6	357.1

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Variable annuity assets (separate accounts)	<u>-</u>	<u>-</u>	<u>-</u>	<u>560.8</u>	<u>-</u>	<u>560.8</u>
	<u>\$792.2</u>	<u>\$1,051.3</u>	<u>\$157.6</u>	<u>\$8,397.5</u>	<u>(\$1,926.4)</u>	<u>\$8,472.2</u>
Liabilities and Capital						
Insurance liabilities	\$ -	\$ -	\$ -	\$6,590.1	(\$ 5.0)	\$6,585.1
Notes payable to GAFRI	-	102.4	-	0.1	(102.5)	-
Notes payable to Trusts	-	154.6	-	-	(154.6)	-
Other notes payable	1.8	221.1	-	-	-	222.9
Other liabilities	67.0	9.2	2.9	166.6	(8.6)	237.1
Variable annuity liabilities (separate accounts)	<u>-</u>	<u>-</u>	<u>-</u>	<u>560.8</u>	<u>-</u>	<u>560.8</u>
	68.8	487.3	2.9	7,317.6	(270.7)	7,605.9
Mandatorily redeemable preferred securities of subsidiary trusts	-	-	150.0	-	(7.1)	142.9
Total stockholders' equity	<u>723.4</u>	<u>564.0</u>	<u>4.7</u>	<u>1,079.9</u>	<u>(1,648.6)</u>	<u>723.4</u>
	<u>\$792.2</u>	<u>\$1,051.3</u>	<u>\$157.6</u>	<u>\$8,397.5</u>	<u>(\$1,926.4)</u>	<u>\$8,472.2</u>

DECEMBER 31, 2001

Assets						
Cash and investments	\$ 11.4	\$ -	\$ -	\$6,956.8	(\$ 1.7)	\$6,966.5
Investment in subsidiaries	689.1	1,080.6	-	1.9	(1,771.6)	-
Notes receivable from AAG Holding	102.4	-	154.6	-	(257.0)	-
Unamortized insurance acquisition costs, net	-	-	-	556.1	-	556.1
Other assets	17.2	1.4	4.7	282.2	42.7	348.2
Variable annuity assets (separate accounts)	<u>-</u>	<u>-</u>	<u>-</u>	<u>529.6</u>	<u>-</u>	<u>529.6</u>

	<u>\$820.1</u>	<u>\$1,082.0</u>	<u>\$159.3</u>	<u>\$8,326.6</u>	<u>(\$1,987.6)</u>	<u>\$8,400.4</u>
Liabilities and Capital						
Insurance liabilities	\$ -	\$ -	\$ -	\$6,475.3	(\$ 4.7)	\$6,470.6
Notes payable to GAFRI	-	102.4	-	0.1	(102.5)	-
Notes payable to Trusts	-	154.6	-	-	(154.6)	-
Other notes payable	1.9	221.1	-	-	-	223.0
Other liabilities	69.4	10.8	4.6	209.4	(8.7)	285.5
Variable annuity liabilities (separate accounts)	<u>-</u>	<u>-</u>	<u>-</u>	<u>529.6</u>	<u>-</u>	<u>529.6</u>
	71.3	488.9	4.6	7,214.4	(270.5)	7,508.7
Mandatorily redeemable preferred securities of subsidiary trusts	-	-	150.0	-	(7.1)	142.9
Total stockholders' equity	<u>748.8</u>	<u>593.1</u>	<u>4.7</u>	<u>1,112.2</u>	<u>(1,710.0)</u>	<u>748.8</u>
)		
	<u>\$820.1</u>	<u>\$1,082.0</u>	<u>\$159.3</u>	<u>\$8,326.6</u>	<u>(\$1,987.6)</u>	<u>\$8,400.4</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 ENDED		AAG	TOTAL	ALL	CONS	
				OTHER		
<u>MARCH 31, 2002</u>	<u>GAFRI</u>	<u>HOLDING</u>	<u>TRUSTS</u>	<u>SUBS</u>	<u>ENTRIES</u>	<u>CONS</u>

Revenues

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:						
Life, accident and health premiums	\$ -	\$ -	\$ -	\$ 70.9	\$ -	\$ 70.9
Net investment income and other revenue	5.6	-	-	142.0	(4.9)	142.7
Interest income on AAG Holding notes	-	-	3.5	-	(3.5)	-
Equity in earnings of subsidiaries	<u>12.2</u>	<u>20.9</u>	<u>-</u>	<u>-</u>	<u>(33.1)</u>	<u>-</u>
)		
	17.8	20.9	3.5	212.9	(41.5)	213.6
Costs and Expenses:						
Insurance benefits and expenses	-	-	-	156.3	-	156.3
Interest expense on AAG Holding notes	-	3.5	-	-	(3.5)	-
Other interest and debt expenses	-	5.1	-	-	0.8	5.9
Other expenses	<u>2.0</u>	<u>2.1</u>	<u>-</u>	<u>33.6</u>	<u>(2.1)</u>	<u>35.6</u>
)		
	2.0	10.7	-	189.9	(4.8)	197.8
Earnings before income taxes	15.8	10.2	3.5	23.0	(36.7)	15.8
Provision for income taxes	<u>4.4</u>	<u>3.4</u>	<u>-</u>	<u>6.6</u>	<u>(10.0)</u>	<u>4.4</u>
Net income	<u>\$11.4</u>	<u>\$ 6.8</u>	<u>\$3.5</u>	<u>\$ 16.4</u>	<u>(\$26.7)</u>	<u>\$ 11.4</u>

FOR THE THREE MONTHS ENDED
MARCH 31, 2001

Revenues

:						
Life, accident and health premiums	\$ -	\$ -	\$ -	\$ 69.2	\$ -	\$ 69.2
Net investment income and other revenue	6.9	-	-	145.9	(5.0)	147.8
Interest income on AAG Holding notes	-	-	4.9	-	(4.9)	-
Equity in earnings of subsidiaries	<u>22.4</u>	<u>32.5</u>	<u>-</u>	<u>-</u>	<u>(54.9)</u>	<u>-</u>
)		
	29.3	32.5	4.9	215.1	(64.8)	217.0

Costs and Expenses:

Insurance benefits and expenses	-	-	-	144.6	-	144.6
Interest expense on AAG Holding notes	-	4.9	-	-	(4.9)	-
Other interest and debt expenses	-	5.2	-	-	2.1	7.3
Other expenses	<u>3.1</u>	<u>2.6</u>	<u>-</u>	<u>35.5</u>	<u>(2.3)</u>	<u>38.9</u>
)		
	3.1	12.7	-	180.1	(5.1)	190.8
Earnings before income taxes	26.2	19.8	4.9	35.0	(59.7)	26.2
Provision for income taxes	<u>8.3</u>	<u>6.8</u>	<u>-</u>	<u>10.8</u>	<u>(17.6)</u>	<u>8.3</u>
)		
Net Income	<u>\$17.9</u>	<u>\$13.0</u>	<u>\$4.9</u>	<u>\$ 24.2</u>	<u>(\$ 42.1)</u>	<u>\$ 17.9</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 THREE MONTHS ENDED	AAG	TOTAL	ALL	CONS	
			OTHER	ENTRIES	
<u>MARCH 31, 2002</u>	<u>GAFRI</u>	<u>HOLDING</u>	<u>TRUSTS</u>	<u>SUBS</u>	<u>CONS</u>
Cash Flows from Operating Activities:					
Net income	\$11.4	\$ 6.8	\$ 3.5	\$ 16.4	(\$26.7) \$ 11.4
Adjustments:					
Equity in net earnings of subsidiaries and affiliates	(9.1)	(14.1)	-	-	23.2 -
Increase in life, accident and health reserves	-	-	-	14.9	- 14.9
Benefits to annuity policyholders	-	-	-	75.6	- 75.6

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Amortization of insurance acquisition costs	-	-	-	24.8	-	24.8
Depreciation and amortization	-	0.1	-	4.9	-	5.0
Realized losses	(0.3)	-	-	9.9	-	9.6
Increase in insurance acquisition costs	-	-	-	(38.6)	-	(38.6)
Decrease in other liabilities	(2.6)	-	-	(26.6)	-	(29.2)
Other, net	<u>(2.2)</u>	<u>(0.3)</u>	<u>-</u>	<u>4.9</u>	<u>-</u>	<u>2.4</u>
))				
	<u>(2.8)</u>	<u>(7.5)</u>	<u>3.5</u>	<u>86.2</u>	<u>(3.5)</u>	<u>75.9</u>
)))		
Cash Flows from Investing Activities:						
Purchases of investments and other assets	-	-	-	(893.1)	-	(893.1)
Maturities and redemptions of fixed maturity investments	-	-	-	285.8	-	285.8
Sales of investments and other assets	-	-	-	397.1	-	397.1
Decrease in policy loans	<u>-</u>	<u>-</u>	<u>-</u>	<u>2.9</u>	<u>-</u>	<u>2.9</u>
	<u>-</u>	<u>-</u>	<u>-</u>	<u>(207.3)</u>	<u>-</u>	<u>(207.3)</u>
))	
Cash Flows from Financing Activities:						
Fixed annuity receipts	-	-	-	169.9	-	169.9
Annuity surrenders, benefits and withdrawals	-	-	-	(135.9)	-	(135.9)
Net transfers from variable annuity assets	-	-	-	(5.6)	-	(5.6)
Reductions of notes payable	(0.1)	-	-	-	-	(0.1)
Issuance of Common Stock	1.1	-	-	-	-	1.1
Capital contribution from parent (to subsidiary)	(8.6)	8.6	-	-	-	-
Dividends from subsidiaries(to parent)	11.1	(1.1)	-	(10.0)	-	-
Retirement of Common Stock	(0.5)	-	-	-	-	(0.5)
Trust dividend requirements	<u>-</u>	<u>-</u>	<u>(3.5)</u>	<u>-</u>	<u>3.5</u>	<u>-</u>
)				
	<u>3.0</u>	<u>7.5</u>	<u>(3.5)</u>	<u>18.4</u>	<u>3.5</u>	<u>28.9</u>
)				

Net increase (decrease) in cash and short-term investments	0.2	-	-	(102.7)	-	(102.5)
Beginning cash and short-term investments	<u>0.9</u>	<u>-</u>	<u>-</u>	<u>170.0</u>	<u>-</u>	<u>170.9</u>
Ending cash and short-term investments	<u>\$ 1.1</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 67.3</u>	<u>\$ -</u>	<u>\$ 68.4</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 THREE MONTHS ENDED	AAG		TOTAL	ALL OTHER	CONS	
<u>MARCH 31, 2001</u>	<u>GAFRI</u>	<u>HOLDING</u>	<u>TRUSTS</u>	<u>SUBS</u>	<u>ENTRIES</u>	<u>CONS</u>
Cash Flows from Operating Activities:						
Net income	\$17.9	\$13.0	\$ 4.9	\$ 24.2	(\$42.1)	\$ 17.9
Adjustments:						
Equity in net earnings of subsidiaries and affiliates	(15.5)	(21.6)	-	-	37.1	-
Increase in life, accident and health reserves	-	-	-	17.7	-	17.7
Benefits to annuity policyholders	-	-	-	69.3	-	69.3
Amortization of insurance acquisition costs	-	-	-	21.3	-	21.3
Depreciation and amortization	0.2	1.2	-	1.0	-	2.4
Realized losses	-	-	-	1.8	-	1.8
Increase in insurance acquisition costs	-	-	-	(35.6)	-	(35.6)
Increase(decrease)in other liabilities	(2.6)	-	-	0.2	-	(2.4)
Other, net	<u>8.2</u>	<u>(5.5)</u>	<u>-</u>	<u>(5.3)</u>	<u>(1.4)</u>	<u>(4.0)</u>

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))))))
	<u>8.2</u>	<u>(12.9)</u>	<u>4.9</u>	<u>94.6</u>	<u>(6.4)</u>	<u>88.4</u>
))))))
Cash Flows from Investing Activities:						
Purchases of investments and other assets	-	-	-	(273.5)	-	(273.5)
Maturities and redemptions of fixed maturity investments	-	-	-	82.9	-	82.9
Sales of investments and other assets	0.1	-	-	98.2	-	98.3
Decrease in policy loans	-	-	-	1.5	-	1.5
Decrease in intercompany notes receivable	<u>(1.5)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1.5</u>	<u>-</u>
))))))
	<u>(1.4)</u>	<u>-</u>	<u>-</u>	<u>(90.9)</u>	<u>1.5</u>	<u>(90.8)</u>
))))))
Cash Flows from Financing Activities:						
Fixed annuity receipts	-	-	-	126.2	-	126.2
Annuity surrenders, benefits and withdrawals	-	-	-	(186.9)	-	(186.9)
Net transfers to variable annuity assets	-	-	-	2.9	-	2.9
Additions to notes payable	-	4.6	-	-	-	4.6
Reductions of notes payable	(0.1)	-	-	(0.1)	-	(0.2)
Issuance of Common Stock	0.1	-	-	-	-	0.1
Capital contribution from parent (to subsidiary)	(8.3)	8.3	-	-	-	-
Trust dividend requirements	<u>-</u>	<u>-</u>	<u>(4.9)</u>	<u>-</u>	<u>4.9</u>	<u>-</u>
))))))
	<u>(8.3)</u>	<u>12.9</u>	<u>(4.9)</u>	<u>(57.9)</u>	<u>4.9</u>	<u>(53.3)</u>
))))))
Net decrease in cash and short-term investments	(1.5)	-	-	(54.2)	-	(55.7)
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>\$ 1.7</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 30.1</u>	<u>\$ -</u>	<u>\$ 31.8</u>

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. Examples of such forward-looking statements relate to: expectations concerning market and other conditions and their effect on future premiums, revenues, earning and investment activities; the adequacy of reserves for environmental pollution and expected expense savings resulting from recent initiatives.

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 21% at March 31, 2002, and 22% at December 31, 2001. For purposes of the calculation of consolidated debt to capital, 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 March 31, 2002, the capital ratio of GAFRI's principal insurance subsidiary was 5.7 times its authorized control level RBC.

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GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

Management's Discussion and Analysis

of Financial Condition and Results of Operations - Continued

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. Capital distributions from GAFRI's insurance subsidiaries are subject to restrictions relating to statutory surplus and earnings. The maximum amount of dividends payable in 2002 by GALIC without prior regulatory approval is \$38.8 million. In the first three months of 2002, GALIC paid \$10.0 million in dividends.

In January 2001, the Company replaced its existing bank credit line agreement with a \$155 million unsecured credit agreement which matures on December 31, 2004. At March 31, 2002, GAFRI 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.

2002 Acquisition

On March 14, 2002, GAFRI reached an agreement to acquire Manhattan National Life Insurance Company ("MNL") from a subsidiary of Consec, Inc. for \$48.5 million in cash. GAFRI expects to close on this transaction in the second quarter of 2002 and to fund this acquisition with cash on hand and through reinsurance of up to 90% of the business in force. While MNL is not currently writing new policies, the company reported over \$43 million of statutory renewal premiums in 2001. MNL has approximately 90,000 policies in force (primarily term life) representing over \$12 billion in face amount of insurance. Following is a summary of certain statutory information for MNL at December 31, 2001 (in millions):

Total Assets	\$297.8
Capital and Surplus	23.1
Asset Valuation Reserve	0.4
Interest Maintenance Reserve	1.2

Investments

GAFRI invests primarily in fixed income investments which, including loans and short-term investments, comprised 98% of its investment portfolio at March 31, 2002. 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 March 31, 2002, 93% 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 March 31, 2002, GAFRI's mortgage-backed securities ("MBSs") portfolio represented more than one-third of its fixed maturity investments. MBSs are subject to significant prepayment risk due to the fact that, in periods of declining interest rates, mortgages may be repaid more rapidly than scheduled as borrowers refinance higher rate mortgages to take advantage of the lower current rates. As a result, holders of MBSs may receive prepayments on their securities, which cannot be reinvested at an interest rate comparable to the rate on the prepaid MBSs. The majority of MBSs held by GAFRI were purchased at a discount. Management believes that the discounted nature of the MBSs will reduce the effect of prepayments on earnings over the anticipated life of the MBS portfolio.

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GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

Management's Discussion and Analysis

of Financial Condition and Results of Operations - Continued

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.

At March 31, 2002, GAFRI had a net unrealized gain of \$60.5 million (before income taxes) on fixed maturity securities consisting of \$158.3 million in unrealized gains and \$97.8 million in unrealized losses. At that same date, GAFRI also had a net unrealized gain of \$25.7 million on equity securities consisting of \$27.2 million in gains and \$1.5 million in losses. Individual portfolio securities are sold creating gains or losses as market opportunities exist. Since all of these securities are carried at market value in the balance sheet, there is virtually no effect on liquidity or financial condition upon the sale and ultimate realization of unrealized gains and losses.

Based on market value, approximately 11% of the securities with unrealized losses at March 31, 2002, had noninvestment grade ratings.

The table below sets forth the scheduled maturities of fixed maturity securities with unrealized losses at March 31, 2002, based on their market values. Mortgage-backed securities with unrealized losses had an estimated average remaining life of approximately eight years.

<u>Maturity</u>	
One year or less	1%
After one year through five years	12
After five years through ten years	31
After ten years	<u>15</u>

	59
Mortgage-backed securities	<u>41</u>
	<u>100</u>
	%

GAFRI realized aggregate losses of \$3.6 million during the first three months of 2002 on sales of \$43.3 million in fixed maturity securities that had unrealized losses at December 31, 2001. Although GAFRI had the ability to continue holding these investments, its intent to hold them changed due to a variety of reasons including further deterioration in the issuer's credit and decisions to lessen exposure to a particular credit or industry.

The length of time securities with unrealized losses at March 31, 2002, have been in an unrealized loss position varies by individual security. Of the 46 individual securities at that date with unrealized losses exceeding \$500,000, 24 have been in that position for less than one year, including 16 that have been in that position for less than six months.

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 (accounted for as a realized loss) and the cost basis of that investment is reduced. The determination of whether unrealized losses are "other than temporary" requires judgment based on subjective as well as objective factors. A listing of factors considered and resources used is contained in the discussion of "Investments" under Management's Discussion and Analysis in GAFRI's 2001 Form 10-K.

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GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

Management's Discussion and Analysis

of Financial Condition and Results of Operations - Continued

The \$97.8 million in gross unrealized losses on fixed maturities at March 31, 2002, represents unrealized losses on approximately 400 positions with an aggregate market value of \$2.3 billion. None of the individual losses exceeds \$6 million and only three have unrealized losses exceeding \$2 million. Of the \$97.8 million in gross unrealized losses at March 31, 2002, \$13.9 million were from investments in telephone/communications companies and \$5.2 million were from investments in air transportation companies. In addition, \$23.6 million of the gross unrealized losses were on securities in GAFRI's \$2.5 billion mortgage-backed securities portfolio. At March 31, 2002, all of the securities with unrealized losses were current in payment of principal and interest.

Based on its analysis, management believes (i) GAFRI will recover its cost basis in the securities with unrealized losses (ii) GAFRI has the ability and intent to hold the securities until they mature or recover in value. Should either of these beliefs change with regard to a particular security, a charge for impairment would likely be required. While it is not possible to accurately predict if or when a specific security will become impaired, charges for other than temporary impairment could be material to results of operations in a future period. Management believes it is not likely that future impairment charges will have a significant effect on GAFRI's liquidity.

RESULTS OF OPERATIONS

General

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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	
	<u>March 31,</u>	
	<u>2002</u>	<u>2001</u>
Revenues per income statement	\$213.6	\$217.0
Add back realized losses on investments	<u>9.6</u>	<u>1.8</u>
Core operating revenues	223.2	218.8
Expenses per income statement	<u>197.8</u>	<u>190.8</u>
Core operating earnings before tax	25.4	28.0
Income tax expense	<u>7.8</u>	<u>8.9</u>
Net core operating earnings	<u>\$ 17.6</u>	<u>\$ 19.1</u>
Net core operating earnings per common share (diluted)	<u>\$ 0.41</u>	<u>\$ 0.45</u>

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Management's Discussion and Analysis

of Financial Condition and Results of Operations - Continued

Retirement Products

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

Three months ended
March 31,

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2002 2001

Annuity Premiums

Single premium fixed rate annuities	\$106	\$ 78
Flexible premium fixed rate annuities	44	38
Single premium variable annuities	35	22
Flexible premium variable annuities	<u>23</u>	<u>24</u>
	<u>\$208</u>	<u>\$162</u>

Management believes that fixed annuity sales increased over the same period in the prior year due to the introduction of a new product, the volatile equity markets, and the relative attractiveness of fixed annuities compared to other interest bearing instruments.

Variable annuity premiums increased over the same period in the prior year due primarily to increased sales of a product attractive to policyholders with a short-term investment horizon.

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
March 31,
2002 2001

Premiums

Supplemental insurance products	\$47	\$48
GA Life of Puerto Rico	15	13
Life products	<u>9</u>	<u>8</u>
	<u>\$71</u>	<u>\$69</u>

Benefits

Supplemental insurance products	\$40	\$39
GA Life of Puerto Rico	7	7
Life products	<u>9</u>	<u>8</u>

\$56\$54Net Investment Income

Net investment income increased due to a higher yield on the portfolio as well as higher invested assets.

Realized Losses on Investments

Realized losses on investments included the following provisions for other than temporary impairment: first quarter of 2002 and 2001 - \$11.3 million and \$2.5 million, respectively.

Other Income

Other income decreased \$9.0 million in the first three months of 2002 compared to the same period in 2001 due primarily to income from the sale of real estate in 2001 (see below).

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GREAT AMERICAN FINANCIAL RESOURCES, INC. 10-Q

Management's Discussion and Analysis

of Financial Condition and Results of Operations - ContinuedReal Estate Operations

GAFRI is engaged in a variety of real estate operations including hotels and a marina; GAFRI also owns several 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	
	<u>March 31,</u>	
	<u>2002</u>	<u>2001</u>
Other income	\$5.3	\$14.8
Other expenses	5.8	6.7

Other income included a pretax gain on the sale of real estate assets of \$8.5 million in the first quarter of 2001.

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.

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, death and annuitization experience or modifications in actuarial assumptions can affect this accrual.

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 \$1.8 million in the first quarter of 2002 and \$3.3 million in the first quarter of 2001.

The increase in insurance acquisition expenses in the first quarter of 2002 compared to the same period in 2001 is due primarily to increased amortization and overall level of DPAC resulting from the Company's growth in business.

Trust Preferred Distribution Requirement

The decrease in trust preferred distribution requirement in 2002 reflects the Company's September 2001 redemption of one issue of its trust preferred securities.

Other Expenses

Other expenses decreased in the first quarter of 2002 compared to the same period in 2001 due primarily to reductions in marketing and employee related expenses in GAFRI's supplemental insurance segment.

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PART II

OTHER INFORMATION

Item 3

Quantitative and Qualitative Disclosure at Market Risk

As of March 31, 2002, there were no material changes to the information provided in GAFRI's Form 10-K for 2001 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.

May 15, 2002

BY: /s/Christopher P. Miliano

Christopher P. Miliano

Chief Financial Officer