

GREAT AMERICAN FINANCIAL RESOURCES INC
Form 10-K
March 12, 2004

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the Fiscal Year Ended
December 31, 2003

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

Securities Registered Pursuant to Section 12(b) of the Act:

Title of Each Class

Name of Each Exchange
on which Registered

Great American Financial Resources, Inc.:

Common Stock, Par Value \$1.00 Per Share

New York

AAG Holding Company, Inc. (Guaranteed By Registrant):

7-1/2% Senior Notes due November 5, 2033

New York

7-1/4% Senior Notes due January 23, 2034

New York

Other Securities for which reports are submitted pursuant to Section 15(d) of the Act:

American Annuity Group Capital Trust II (Guaranteed by Registrant):

8-7/8% Trust Preferred Securities

AAG Holding Company, Inc. (Guaranteed by Registrant):

6-7/8% Senior Notes due June 1, 2008

Securities Registered Pursuant to Section 12(g) of the Act:

None

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing

requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and need not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the Registrant is an accelerated filer. Yes No

The aggregate market value of the Registrant's Common Stock held by non-affiliates as of the Registrant's most recently completed second fiscal quarter (June 30, 2003) was approximately \$99 million (based upon non-affiliate holdings of 7,553,904 shares and a market price of \$13.11 per share).

As of March 1, 2004, there were 47,051,260 shares of the Registrant's Common Stock outstanding, including 38,565,995 owned by its Parent Company.

Documents Incorporated by Reference:

Proxy Statement for the 2004 Annual Meeting of Stockholders (portions of which are incorporated by reference into Part III hereof).

GREAT AMERICAN FINANCIAL RESOURCES, INC.

INDEX TO ANNUAL REPORT

ON FORM 10-K

Part I

	<u>Page</u>
Item 1. Business	
Introduction	1
Annuities	1
Life Operations	5
Supplemental Insurance	5
GA Life of Puerto Rico	5
Investments	5
Competition	7
Regulation	7
Foreign Operations	8
Uncertainties	8
Item 2. Properties	9
Item 3. Legal Proceedings	9
Item 4. Submission of Matters to a Vote of Security Holders	*

Part II

Item 5.	Market for Registrant's Common Equity and Related Stockholder Matters	10
Item 6.	Selected Financial Data	12
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	13
Item 7A.	Quantitative and Qualitative Disclosures about Market Risk	26
Item 8.	Financial Statements and Supplementary Data	27
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	*
Item 9A.	Evaluation of Disclosure Controls and Procedures	27

Part III

Item 10.	Directors and Executive Officers of the Registrant	28
Item 11.	Executive Compensation	28
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	28
Item 13.	Certain Relationships and Related Transactions	28
Item 14.	Principal Accountant Fees and Services	28

Part IV

Item 15.	Exhibits, Financial Statement Schedules, and Reports On Form 8-K	S-1
----------	---	-----

(*) The response to this item is "none".

GREAT AMERICAN FINANCIAL RESOURCES, INC.

FORWARD-LOOKING STATEMENTS

This Form 10-K, chiefly in Items 1, 3, 5, 7 and 8, contains certain forward-looking statements that are subject to numerous assumptions, risks or uncertainties. 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 "anticipates", "believes", "expects", "estimates", "intends", "plans", "seeks", "could", "may", "should", "will", 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; recoverability of asset values; mortality and the adequacy of reserves for environmental pollution.

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-K

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;
- trends in mortality and morbidity;
- regulatory actions;
- changes in regulatory and legal environments;
- tax law changes;
- availability of reinsurance and ability of reinsurers to pay their obligations;
- competitive pressures; and
- changes in debt and claims paying ratings.

Forward-looking statements included in this Form 10-K 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.

PART I

ITEM 1

Business

Please refer to "Forward-Looking Statements" following the index in front of this Form 10-K.

Introduction

Great American Financial Resources, Inc. ("GAFRI" or "the Company"), which was incorporated as a Delaware corporation in 1987, is an 82%-owned subsidiary of American Financial Group, Inc. ("AFG"). GAFRI is a holding company that markets retirement products, primarily fixed and variable annuities, and various forms of life and supplemental health insurance through its subsidiaries listed below. GAFRI and its insurance subsidiaries employ approximately 850 people in the United States and 700 people (including approximately 500 company-employed agents) in Puerto Rico. SEC filings, news releases and other information may be accessed free of charge through GAFRI's Internet site at: www.gafri.com.

<u>Subsidiary</u>	<u>Year acquired</u>
Great American Life Insurance Company ("GALIC")	1992
Annuity Investors Life Insurance Company ("AILIC")	1994
Loyal American Life Insurance Company ("Loyal")	1995
Great American Life Assurance Company of Puerto Rico ("GAPR")	1997
United Teacher Associates Insurance Company ("UTA")	1999
Manhattan National Life Insurance Company ("MNL")	2002

Acquisitions in recent years have supplemented GAFRI's internal growth as the assets of the holding company and its operating subsidiaries have increased from \$4.5 billion at the end of 1992 to approximately \$10.2 billion at the end of 2003. Premiums over the last five years were as follows (in millions):

	<u>Premiums(1)</u>				
	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>
Life and Annuity Group					
Annuity	\$ 868	\$1,000	\$ 750	\$ 746	\$588
Life	50	66	61	52	42
Supplemental Insurance	218	185	194	158	35
GA Life of Puerto Rico	<u>68</u>	<u>63</u>	<u>56</u>	<u>52</u>	<u>49</u>
	<u>\$1,204</u>	<u>\$1,314</u>	<u>\$1,061</u>	<u>\$1,008</u>	<u>\$714</u>

1. Table does not include premiums of subsidiaries or divisions until their first full year following acquisition or formation. All periods exclude premiums of subsidiaries sold.

Annuities

GAFRI's principal products are Flexible Premium Deferred Annuities ("FPDAs") and Single Premium Deferred Annuities ("SPDAs"). Annuities are long-term retirement savings instruments that benefit from income accruing on a tax-deferred basis. The issuer of the annuity collects premiums, credits interest or earnings on the policy and pays out a benefit upon death, surrender or annuitization. FPDAs are characterized by premium payments that are flexible in both amount and timing as determined by the policyholder and generally made through payroll deductions. SPDAs are generally issued in exchange for a one-time lump-sum premium payment.

1

The following table (in millions) presents combined financial information of GAFRI's principal annuity operations.

Generally Accepted Accounting Principles ("GAAP") Basis

	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>
Total assets	\$8,663	\$8,014	\$7,456	\$7,052	\$6,657
Fixed annuity benefits accumulated	6,492	6,111	5,632	5,365	5,349
Variable annuity liabilities	568	455	530	534	354
Stockholder's equity	1,220	1,139	1,023	915	801

Statutory Accounting Principles Basis

	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>
Total assets	\$7,889	\$7,319	\$6,896	\$6,620	\$6,493
Fixed annuity reserves	6,578	6,192	5,729	5,536	5,564
Variable annuity liabilities	568	455	530	534	354
Capital and surplus	515	419	388	363	404
Asset valuation reserve(a)	53	63	79	77	67
Interest maintenance reserve(a)	22	27	11	3	10

Fixed annuity receipts:

Flexible premium:

First year	\$ 34	\$ 29	\$ 24	\$ 24	\$ 26
Renewal	<u>114</u>	<u>106</u>	<u>105</u>	<u>113</u>	<u>127</u>
	148	135	129	137	153
Single premium	<u>556</u>	<u>639</u>	<u>392</u>	<u>270</u>	<u>230</u>
Total fixed annuity receipts	<u>\$ 704</u>	<u>\$ 774</u>	<u>\$ 521</u>	<u>\$ 407</u>	<u>\$ 383</u>

Variable annuity receipts:

Flexible premium:

First year	\$ 9	\$ 16	\$ 30	\$ 39	\$ 28
Renewal	<u>65</u>	<u>71</u>	<u>62</u>	<u>39</u>	<u>18</u>
	74	87	92	78	46
Single premium	<u>48</u>	<u>95</u>	<u>107</u>	<u>242</u>	<u>159</u>
Total variable annuity receipts	<u>\$ 122</u>	<u>\$ 182</u>	<u>\$ 199</u>	<u>\$ 320</u>	<u>\$ 205</u>

(a) Allocation of surplus.

Sales of annuities, including renewal premiums, are affected by many factors, including: (i) competitive annuity products and rates; (ii) the general level of interest rates; (iii) the favorable tax treatment of annuities; (iv) commissions paid to agents; (v) services offered; (vi) ratings from independent insurance rating agencies; (vii) other alternative investments; (viii) performance of the equity markets and (ix) general economic conditions.

Annuity contracts are generally classified as either fixed rate (including equity-indexed) or variable. The following table presents premiums by classification:

<u>Annuity Premiums</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>
Traditional fixed	85%	77%	68%	50%	55%
Variable	14	18	27	43	35
Equity-indexed	<u>1</u>	<u>5</u>	<u>5</u>	<u>7</u>	<u>10</u>
	<u>100</u>	<u>100</u>	<u>100</u>	<u>100</u>	<u>100</u>
	%	%	%	%	%

With a traditional fixed rate annuity, the interest crediting rate is initially set by the issuer and thereafter may be changed from time to time by the issuer subject to any guaranteed minimum interest crediting rates or any guaranteed term in the policy.

The Company seeks to maintain a desired spread between the yield on its investment portfolio and the rate it credits to its fixed rate annuities. GAFRI accomplishes this by: (i) offering crediting rates which it has the option to change after any initial guarantee period; (ii) designing annuity products that encourage persistency and (iii) maintaining an appropriate matching of assets and liabilities.

The majority of GAFRI's fixed rate annuities permit GAFRI to change the crediting rate at any time, subject to minimum interest rate guarantees (as determined by applicable law). In the fourth quarter of 2003, GAFRI began issuing products with guaranteed minimum crediting rates of less than 3% in states where required approvals have been received. At December 31, 2003, less than 1% of annuity benefits accumulated related to these policies. Approximately one-half of the annuity benefits accumulated relate to policies that have a minimum guarantee of 3%; the balance have a guarantee of 4%. Historically, management has been able to react to changes in market interest rates and maintain a desired interest rate spread. The recent interest rate environment has resulted in a spread compression, which could continue through at least 2004.

In addition to traditional fixed rate annuities, GAFRI offers variable annuities and, prior to 2003, sold equity-indexed annuities. Industry sales of such annuities increased substantially in the 1990's as investors sought to obtain the returns available in the equity markets while enjoying the tax-deferred status of annuities. With a variable annuity, the earnings credited to the policy vary based on the investment results of the underlying investment options chosen by the policyholder, generally without any guarantee of principal except in the case of death of the insured annuitant. Premiums directed to the variable options in policies issued by GAFRI are invested in funds maintained in separate accounts managed by various independent investment managers. GAFRI earns a fee on amounts deposited into variable accounts. Subject to contractual provisions, policyholders may also choose to direct all or a portion of their premiums to various fixed rate options, in which case GAFRI earns a spread on amounts deposited. With the downturn in the stock market during 2000 through 2002, industrywide sales of variable annuities, including GAFRI sales, decreased substantially.

An equity-indexed fixed annuity provides policyholders with a crediting rate tied, in part, to the performance of an existing stock market index while protecting them against the related downside risk through a guarantee of principal. GAFRI purchases call options designed to offset substantially all of the increases in the liabilities associated with equity-indexed annuities. In 2002, GAFRI suspended new sales of equity-indexed annuities due primarily to a lack of volume.

No individual state accounted for more than 10% of GAFRI's annuity premiums in the past three years except as follows:

	<u>2003</u>	<u>2002</u>	<u>2001</u>
California	19%	15%	17%
Ohio	*	*	13

* Less than 10%

The majority of GAFRI's flexible premium annuities are sold in the qualified markets under section 403(b) and 401(k) of the Internal Revenue Code. In the 403(b) market, schools and certain other not-for-profit organizations may allow employees to save for retirement through contributions made on a before-tax basis. In the 401(k) market, both

for-profit and not-for-profit organizations may establish qualified retirement plans where employees are eligible to save for retirement through contributions made primarily on a before-tax basis. For federal income tax purposes, before-tax contributions and earnings are not included in the employee's taxable income until amounts are withdrawn.

3

GAFRI distributes its fixed rate products primarily through a network of 130 managing general agents ("MGAs") who, in turn, direct approximately 1,600 actively producing independent agents. The top 15 MGAs accounted for more than two-thirds of GAFRI's fixed rate annuity premiums in 2003. No one MGA represented more than 10% of total fixed annuity premiums in 2003. In addition to the independent insurance agent channel, GAFRI also sells its annuity product lines through financial institutions. Sales of annuities from this distribution channel were approximately 3% of total annuity premiums in 2003.

In 2002, GAFRI exited the highly competitive single premium, non-qualified segment of the variable annuity market due primarily to insufficient returns and a lack of critical mass. The Company offers its variable annuity as an ancillary product solely through its 403(b) and 401(k) sales channels. Nearly one-half of GAFRI's variable annuity sales in 2003 were made through the Company's wholly-owned subsidiary, Great American Advisors, Inc. ("GAA"). GAA is a broker/dealer licensed in all 50 states to sell stocks, bonds, options, mutual funds and variable insurance contracts through independent representatives and financial institutions. GAA also acts as the principal underwriter and distributor for the Company's variable annuity products.

GAFRI designs its products with certain provisions to encourage policyholders to maintain their funds with GAFRI for at least five to ten years. Persistency rates reflect the proportion of reserves maintained by the Company and not paid out in the form of surrenders, annuitizations or death benefits. The following table illustrates GALIC's annual persistency rates for its major product groups over the past five years.

<u>Product Group</u>	<u>Persistency Rates</u>				
	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>
Flexible premium	94%	92%	90%	89%	89%
Single premium	89	90	88	87	88

Persistency rates are affected by many of the same factors that affect annuity sales. Although the stock market and interest rate environment affect persistency in the Company's fixed rate annuities, management believes that its persistency rate has benefited from the low interest rate environment and the two-tier design of certain of its in-force products. Two account values are maintained for two-tier annuities - the annuitization (or upper-tier) value and the surrender (or lower-tier) value. The annuitization value is paid upon a policyholder's death or election to annuitize (withdraw funds in a series of periodic payments for at least the minimum number of years specified in the policy). If a lump-sum payment is chosen by the policyholder, the surrender value is paid. GALIC's two-tier annuities are particularly attractive to policyholders who intend to accumulate funds to provide retirement income since the annuitization value is accumulated at a more competitive long-term interest rate. At December 31, 2003, two-tier annuities accounted for one-half of the Company's fixed annuity reserves.

In 2003, more than three-fourths of fixed annuity premiums received were on single-tier policies. After the initial surrender charges have been reduced to zero, single-tier annuities carry one value whether the policy is surrendered or annuitized.

GAFRI is licensed to sell its fixed annuity products in all 50 states; it is licensed to sell its variable products in all states except Vermont. At December 31, 2003, GAFRI had over 335,000 annuity policies in force.

4

Life Operations

In 1997, GALIC began offering traditional term and universal life insurance products through national marketing organizations. Beginning in May 2004, GAFRI will suspend new sales of this business due to inadequate volume and returns. The Company will continue to service its in-force block of over 140,000 policies and \$27 billion gross (\$11 billion net) of life insurance in force. The Company continues to sell life products through its supplemental insurance operations and GA Life of Puerto Rico (see below).

In June 2002, GAFRI acquired MNL for \$48.5 million in cash. GAFRI has reinsured 90% of MNL's business in force. While MNL is no longer writing new policies, as of December 31, 2003, it had approximately 75,000 life policies and \$10 billion gross (\$0.7 billion net) of life insurance in force (primarily term life).

-

Supplemental Insurance

In 1999, GAFRI acquired UTA. UTA offers a variety of supplemental insurance products and annuities through independent agents. UTA's principal health products include coverage for Medicare supplement, cancer and long-term care. UTA utilizes endorsements from various state retired teachers associations to sell some of its products.

Loyal American Life Insurance Company offers a variety of supplemental health and life products. The principal products sold by Loyal include cancer, accidental injury, short-term disability, hospital indemnity and traditional whole life. In 2001, Loyal reinsured a substantial portion of its life insurance business and reduced its marketing efforts in that line of business. During 2002, Loyal's remaining operations were moved to Austin, Texas and combined with UTA's operations. Together, UTA and Loyal employ more than 200 people in Austin.

At year-end 2003, GAFRI's operating units selling supplemental insurance products had assets of more than \$850 million and approximately 370,000 policies with annualized health premiums in force of more than \$225 million and gross life insurance in force of \$1.4 billion.

GA Life of Puerto Rico

GAPR sells in-home service life and supplemental health products through a network of company-employed agents. Ordinary life, cancer, credit and group life products are sold through independent agents. GAPR employs over 700 people in Puerto Rico (including approximately 500 company-employed agents), and is the largest in-home provider of life insurance in Puerto Rico.

Investments

Investments comprise almost 90% of the Company's assets (excluding variable annuity assets) and are the principal source of income. Fixed income investments (consisting of fixed maturity investments, policy loans, mortgage loans and short-term investments) comprise 98% of GAFRI's investment portfolio. Risks inherent in connection with fixed income securities include market price volatility and loss upon default. Factors which can affect the market price of these securities include: (i) changes in market interest rates; (ii) creditworthiness of issuers; (iii) the number of market makers and investors and (iv) defaults by major issuers of securities.

The Company's investment strategy emphasizes high-quality fixed income securities which management believes should produce a relatively consistent and predictable level of investment income.

The insurance laws of the domiciliary jurisdiction of each of GAFRI's life

insurance subsidiaries govern the types and amounts of investments which are permissible. These rules are designed to ensure the safety and liquidity of the insurers' investment portfolio by placing restrictions on the quality, quantity and diversification of permitted investments.

The National Association of Insurance Commissioners ("NAIC") is an organization comprised of the chief insurance regulators for each of the 50 states, the District of Columbia and the four U.S. territories. The NAIC assigns quality ratings to publicly traded as well as privately placed securities. These ratings range from Class 1 (highest quality) to Class 6 (lowest quality). The following table shows the Company's fixed maturity portfolio at market value by NAIC designation (and comparable Standard & Poor's Corporation rating).

<u>NAIC</u> <u>Rating</u>	<u>Comparable S&P Rating</u>	<u>2003</u>	<u>2002</u>
1	AAA, AA, A	73%	73%
2	BBB	<u>21</u>	<u>20</u>
	Total investment grade	<u>94</u>	<u>93</u>
3	BB	3	4
4	B	2	2
5	CCC, CC, C	1	1
6	D	<u>*</u>	<u>*</u>
	Total non-investment grade	<u>6</u>	<u>7</u>
	Total fixed maturities	<u>100</u>	<u>100</u>
		%	%

* less than one-half of 1%

GAFRI's primary investment objective in selecting securities for its fixed maturity portfolio is to optimize interest yields while maintaining an appropriate relationship of maturities between assets and liabilities. The Company invests in bonds that have primarily intermediate-term maturities. This practice provides flexibility to respond to fluctuations in the marketplace.

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-K

At December 31, 2003, the average maturity of GAFRI's fixed maturity investments was approximately seven and one-half years (including mortgage-backed securities, which had an estimated average life of approximately six and one-half years). The table below sets forth the maturities of the Company's fixed maturity investments based on their market value.

<u>Maturity</u>	<u>2003</u>	<u>2002</u>
One year or less	2%	6%
After one year through five years	20	21
After five years through ten years	33	28
After ten years	<u>16</u>	<u>13</u>
	71	68
Mortgage-backed securities	<u>29</u>	<u>32</u>
	<u>100</u>	<u>100</u>
	%	%

6

The following table shows the performance of GAFRI's investment portfolio, excluding real estate investments (dollars in millions).

	<u>2003</u>	<u>2002</u>	<u>2001</u>
Average cash and investments at cost	\$7,992	\$7,136	\$6,582
Gross investment income	517	532	508
Realized losses*	(9)	(46)	(52)
Yield earned:			
Excluding realized losses	6.5%	7.5%	7.7%
Including realized losses	6.3%	6.8%	6.9%

*Includes charges for "other than temporary" impairments of \$41.4 million, \$97.4 million and \$77.0 million in 2003, 2002 and 2001, respectively.

Competition

The Company's principal insurance subsidiaries ("Insurance Companies") operate in highly competitive markets. They compete with other insurers and financial institutions based on many factors, including: (i) ratings; (ii) financial strength; (iii) reputation; (iv) service to policyholders and agents; (v) product design (including interest rates credited and premium rates charged), (vi) commissions and (vii) number of school districts a company has approval to sell in.

Since policies are marketed and distributed primarily through independent agents (except at GAPR), the Insurance Companies must also compete for agents.

No single insurer dominates the markets in which the Insurance Companies compete. Competitors include: (i) individual insurers and insurance groups; (ii) mutual funds and (iii) other financial institutions. In a broader sense, GAFRI's Insurance Companies compete for retirement savings with a variety of financial institutions offering a full range of financial services. Financial institutions have demonstrated a growing interest in marketing investment and savings products other than traditional deposit accounts.

Regulation

The Insurance Companies are subject to comprehensive regulation under the insurance laws of their states of domicile and the other states in which they operate. These laws, in general, require approval of the particular insurance regulators prior to certain actions such as the payment of dividends in excess of statutory limitations, continuing service arrangements with affiliates and certain other transactions. Regulation and supervision are administered by a state insurance commissioner who has broad statutory powers with respect to granting and revoking licenses, approving forms of insurance contracts and determining types and amounts of business which may be conducted in light of the financial strength and size of the particular company.

The maximum amount of dividends which can be paid in any 12 month period to stockholders by life insurance companies domiciled in the State of Ohio (including GALIC, AILIC and Loyal) without prior approval of the Ohio Insurance Commissioner is the greater of 10% of policyholder surplus or prior year's net income, but only to the extent of earned surplus as of the preceding December 31. Under applicable restrictions, the maximum amount of dividends available to GAFRI in 2004 from GALIC, its principal Ohio domiciled insurance subsidiary, without seeking regulatory clearance, is \$56.5 million. In addition, the amount of dividends available to GAFRI in 2004 from GA Life of Puerto Rico is \$32.9 million.

7

State insurance departments periodically examine the business and accounts of the Insurance Companies and require such companies to submit detailed annual financial statements prepared in accordance with statutory requirements. State insurance laws also regulate the character of each insurance company's investments, reinsurance and security deposits.

The Insurance Companies may be required, under the solvency or guaranty laws of most states in which they do business, to pay assessments (up to certain prescribed limits) to fund policyholder losses or liabilities of insurance companies that become insolvent. These assessments may be deferred or forgiven under most guaranty laws if they would threaten an insurer's financial strength and, in certain instances, may be offset against future premium taxes.

One of the NAIC's major roles is to develop model laws and regulations affecting insurance company operations and encourage uniform regulation through the adoption of such model laws in all states. As part of the overall insurance regulatory process, the NAIC forms numerous task forces to review, analyze and recommend changes to a variety of areas affecting both the operating and financial aspects of insurance companies.

Many of the Company's other subsidiaries are subject to regulation by various state, federal and other regulatory authorities. Several subsidiaries are insurance agencies and as such are regulated by state insurance departments. Great American Advisors is subject to the rules of the National Association of Securities Dealers, Inc. and the securities

laws of the states in which it transacts business. AILIC's variable insurance products are subject to the rules and regulations of the Securities and Exchange Commission and "Blue Sky" laws of the states in which their products are sold.

Foreign Operations

In 1998, GAFRI opened an office in Bangalore, India. Employees located at this office perform computer programming and certain back office functions for the Company's insurance operations.

In 2003, GAFRI entered into an agreement to sell its Indian operation to an unaffiliated third party. The Company will receive a minimum of \$500,000 per year over the next four years based on the amount of business administered by the Indian operation. The Company has also entered into an agreement with the third party to obtain certain services currently provided by this operation for the next five years. This transaction did not have a material impact on the Company or its results.

GAFRI also owns an insurance company in Puerto Rico (see Item 1 - "GA Life of Puerto Rico").

Uncertainties

Proposed Retirement Account Changes The federal budget for fiscal year 2005 contains several proposals designed to increase private savings by simplifying and consolidating current retirement savings vehicles. Included is one proposal to consolidate 401(k), 403(b) and governmental 457 plans, as well as certain other retirement accounts, into one plan. It is too early to predict the specific proposals which might be included in any legislation to be introduced, whether such legislation would become law, or their impact if adopted.

8

Proposed Regulatory Changes Various competitors, schools and other entities have proposed measures that would restrict product designs and the number of companies qualified to sell annuities to teachers. In addition, certain school districts have proposed charging policy fees to annuity providers. While efforts in these areas have been largely unsuccessful to date, widespread acceptance of such measures could negatively impact GAFRI's 403(b) annuity operations to the extent the Company's access to school districts is limited or reduced, and to the extent policy fees are not recovered by GAFRI.

ITEM 2

Properties

GAFRI and GALIC rent office space in Cincinnati, Ohio totaling approximately 180,000 square feet under leases expiring primarily in 2006 through 2008. Several of the Company's subsidiaries lease marketing and administrative offices in locations throughout the United States.

GAPR rents office space in Puerto Rico totaling approximately 81,000 square feet under leases expiring primarily in 2005.

GAFRI owns a building in Austin, Texas totaling approximately 40,000 square feet, the vast majority of which is used by UTA for its own operations. The remainder of the space is leased to other tenants.

Management believes that its corporate offices are generally well maintained and adequate for the Company's present needs.

GAFRI owns facilities related to its former manufacturing operations totaling approximately 150,000 square feet in North Adams, Massachusetts and 60,000 square feet in Longwood, Florida. A portion of the space in these facilities is currently being leased to companies using it for manufacturing and other operations.

ITEM 3

Please refer to "Forward-Looking Statements" following the index in front of this Form 10-K.

Legal Proceedings

Federal and state laws and regulations, including the Federal Comprehensive Environmental Response, Compensation, and Liability Act and similar state laws, impose liability on the Company, (as the successor to Sprague Technologies, Inc.), for the investigation and clean-up of hazardous substances disposed of or spilled by its former manufacturing operations at facilities still owned by the Company, and facilities transferred in connection with the sales of certain operations, as well as at disposal sites operated by third parties. In addition, the Company has indemnified the purchasers of its former operations for the cost of such activities. At several sites, the Company is conducting clean-up activities of soil and ground water contamination in accordance with consent agreements between the Company and state environmental agencies. The Company has also conducted or is aware of investigations at a number of other locations of its former operations that have disclosed environmental contamination that could cause the Company to incur additional investigative, remedial and legal costs. The Company has also been identified by state and federal regulators as a potentially responsible party at a number of other disposal sites.

9

Based on the costs incurred by the Company over the past several years and discussions with its independent environmental consultants, management believes that reserves recorded are sufficient in all material respects to satisfy the estimated liabilities. However, the regulatory standards for clean-up are continually evolving and may impose more stringent requirements. In addition, many of the environmental investigations at the Company's former operating locations and third-party sites are still preliminary, and where clean-up plans have been proposed, they have not yet received full approval from the relevant regulatory agencies. Further, the presence of Company-generated wastes at third-party disposal sites exposes the Company to joint and several liability for the potential additional costs of cleaning up wastes generated by others.

Accordingly, there can be no assurance that the costs of environmental clean-up for the Company may not be significantly higher in future years, possibly necessitating additional charges.

There are certain other claims involving the Company, including claims relating to the generation, disposal or release into the environment of allegedly hazardous substances. In management's opinion, the outcome of these claims will not, individually or in the aggregate, have a material adverse effect on the Company's financial condition.

UTA was named a defendant in a purported class action lawsuit. ([Peggy Berry, et al. v. United Teacher Associates Insurance Company](#), Travis County District Court, Cause No. GN100461, filed February 11, 2001). The complaint seeks unspecified damages based on the alleged misleading disclosure of UTA's interest crediting practices on its

fixed rate annuities and various other allegations with respect to the marketing and administration of those annuities. The case was settled based on the agreement of UTA to make certain changes in its business practices with respect to fixed annuities and to pay the attorneys' fees of counsel for the plaintiffs. Settlement of this matter did not have a material impact on the Company or its financial results.

GAFRI is subject to other litigation and arbitration in the normal course of business. GAFRI is not a party to any material pending litigation or arbitration.

PART II

Please refer to "Forward-Looking Statements" following the index in front of this Form 10-K.

ITEM 5

Market for Registrant's Common Equity

and Related Stockholder Matters

GAFRI's Common Stock is listed and traded principally on the New York Stock Exchange ("NYSE") under the symbol GFR. On March 1, 2004, there were approximately 4,900 holders of record of Common Stock. The following table sets forth the range of high and low sales prices for the Common Stock on the NYSE Composite Tape.

	<u>2003</u>		<u>2002</u>	
	<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>
First quarter	\$17.45	\$13.25	\$18.85	\$16.99
Second quarter	16.20	13.08	20.00	16.80
Third quarter	15.00	13.10	19.86	13.35
Fourth quarter	16.25	14.34	17.60	14.82

10

The Company paid annual common dividends of \$0.10 per share in 2003 and 2002. Although no future dividend policy has been determined, management believes the Company will continue to have the capability to pay similar dividend amounts.

At March 1, 2004, approximately 82% of GAFRI's Common Stock was beneficially owned by AFG.

Equity Compensation Plan Information

The following reflects certain information about shares of GAFRI Common Stock authorized for issuance (at

December 31, 2003) under equity compensation plans.

<u>Equity Compensation Plans</u>	<u>Number of securities to be issued upon exercise of outstanding options</u>	<u>Weighted-average exercise price of outstanding options</u>	<u>Number of securities available for future issuance under equity compensation plans (excluding securities reflected in column (a))</u>
	(a)	(b)	(c)
Approved by shareholders	3,324,402	\$16.75	2,235,885 (1)
Not approved by shareholders	764,161	\$18.14	1,826,172 (2)

- Includes options exercisable into 1.4 million shares available for issuance under GAFRI's Stock Option Plans for employees and directors, 0.8 million shares issuable under GAFRI's Employee Stock Purchase Plan and 62,095 shares issuable under GAFRI's Non-employee Directors' Compensation Plan.
- Represents shares issuable under GAFRI's Deferred Compensation Plan (0.3 million shares), Agent Stock Purchase Plan (0.9 million shares), Agent Stock Option Plan (0.2 million shares) and GAFRI's Bonus Plan (0.4 million shares).

Under the GAFRI Deferred Compensation Plan, certain highly compensated employees of GAFRI and its subsidiaries may defer a portion of their annual salary and/or bonus. Participants may elect to have the value of deferrals (i) earn a fixed rate of interest set annually by the Board of Directors or a committee thereof, or (ii) fluctuate based on the market value of GAFRI Common Stock, as adjusted to reflect stock splits, distributions, dividends, and a 7-1/2% match to participant deferrals.

Under the Agent Stock Purchase Plan, selected agents are able to utilize commissions earned from the sale of insurance products issued by the Company's subsidiaries to purchase GAFRI Common Stock at 92.5% of the fair market value. The Plan provides that up to 1,000,000 shares of GAFRI Common Stock may be issued.

Under the Agent Stock Option Plan, selected agents are able to earn options to purchase GAFRI Common Stock based on the amount of premium the agents produce from the sale of insurance products issued by the Company's subsidiaries. The options have an exercise price equal to the fair market value of GAFRI Common Stock at the time of grant. The options include vesting provisions based on future premium production. The Plan provides that up to 1,000,000 shares of GAFRI Common Stock may be issued upon the exercise of options.

Under GAFRI's Bonus Plan covering the majority of the Company's officers, participants are required to receive 25% of their annual bonus in the form of GAFRI Common Stock. The Bonus Plan provides for the issuance of up to 500,000 shares of GAFRI Common Stock as partial payment of annual bonuses.

ITEM 6

Selected Financial Data

The following financial data has been summarized from, and should be read in conjunction with, the Company's Consolidated Financial Statements and "Management's Discussion and Analysis of Financial Condition and Results of Operations." The data reflects the acquisitions of MNL in June 2002 and UTA in October 1999 (in millions, except per share amounts).

	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>
<u>Income Statement Data:</u>					
Total revenues	\$920.6	\$883.2	\$830.1	\$824.3	\$661.5
Operating earnings before income taxes	\$ 69.6	\$ 38.9	\$ 59.9	\$ 81.1	\$ 92.0
Income before accounting changes	\$ 49.7	\$ 33.9	\$ 42.7	\$ 53.9	\$ 63.5
Cumulative effect of accounting changes (a)	<u>-</u>	<u>(17.7)</u>	<u>(5.5)</u>	<u>0.8</u>	<u>(4.7)</u>
Net income	<u>\$ 49.7</u>	<u>\$ 16.2</u>	<u>\$ 37.2</u>	<u>\$ 54.7</u>	<u>\$ 58.8</u>
Basic earnings per common share:					
Income before accounting changes	\$ 1.14	\$ 0.80	\$ 1.01	\$ 1.27	\$ 1.50
Accounting changes (a)	<u>-</u>	<u>(0.42)</u>	<u>(0.13)</u>	<u>0.02</u>	<u>(0.11)</u>
Net income	<u>\$ 1.14</u>	<u>\$ 0.38</u>	<u>\$ 0.88</u>	<u>\$ 1.29</u>	<u>\$ 1.39</u>
Diluted earnings per common share:					
Income before accounting changes	\$ 1.13	\$ 0.79	\$ 1.00	\$ 1.26	\$ 1.48
Accounting changes (a)	<u>-</u>	<u>(0.41)</u>	<u>(0.13)</u>	<u>0.02</u>	<u>(0.11)</u>

Net income	<u>\$ 1.13</u>	<u>\$ 0.38</u>	<u>\$ 0.87</u>	<u>\$ 1.28</u>	<u>\$ 1.37</u>
Cash dividends per common share	\$0.10	\$0.10	\$0.10	\$0.10	\$0.10
<u>Balance Sheet Data at year-end:</u>					
Total assets	\$10,194.3	\$9,362.6	\$8,400.4	\$7,975.9	\$7,530.7
Notes payable	214.0	250.3	223.0	151.9	201.3
Payable to subsidiary trusts	155.0	-	-	-	-
Mandatorily redeemable preferred securities of subsidiary trusts	-	142.9	142.9	217.9	219.6
Net unrealized gains (losses) included in stockholders' equity	162.6	180.0	89.8	43.9	(52.9)
<u>Total stockholders' equity</u>	<u>942.5</u>	<u>851.9</u>	<u>748.8</u>	<u>671.7</u>	<u>525.7</u>

a. Reflects the implementation of the following accounting changes mandated by recently enacted accounting standards:

2002 - SFAS #142 (Goodwill and Other Intangibles)

2001 - EITF #99-20 (Asset-backed Securities)

2000 - SFAS #133 (Derivatives)

1999 - SOP 98-5 (Start-up Costs)

12

ITEM 7

Management's Discussion and Analysis

of Financial Condition and Results of Operations

Index to MD&A

	<u>Page</u>		<u>Page</u>
General	13	Results of Operations	23
Overview	13	General	23
Critical Accounting Policies	14	Income Items	23
Liquidity and Capital Resources	14	Expense Items	24

Ratios	14	Other Items	25
Sources and Uses of Funds	14	Recent Accounting Standards	26
Contractual Obligations	15		
Independent Ratings	15		
2002 Acquisition	16		
Investments	16		
Uncertainties	20		

Please refer to "Forward-Looking Statements" following the index in front of this Form 10-K.

GENERAL

Following is a discussion and analysis of the financial statements and other statistical data that management believes will enhance the understanding of the financial condition and results of operations of Great American Financial Resources, Inc. ("GAFRI" or "the Company"). This discussion should be read in conjunction with the financial statements beginning on page F-1.

GAFRI 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.

OVERVIEW

Financial Condition

GAFRI strengthened its capital and liquidity during 2003 with stockholders' equity (excluding unrealized gains) growing by more than \$108 million (16%) to \$779.9 million and reduced its debt to capital ratio from 36% at December 31, 2002 to 31% at December 31, 2003. In addition, the combined statutory capital of GAFRI's insurance subsidiaries increased more than \$100 million (23%) in 2003.

GAFRI and its subsidiaries completed several major cash transactions in 2003, including the following:

- ◆ Issued \$20 million of trust preferred securities in May;
- ◆ Sold \$60 million (4.3 million shares) of Common Stock in a rights offering in September;
- ◆ Issued \$112.5 million of senior debt in November;
- ◆ Repaid nearly \$150 million in bank debt during the year.

In addition, GAFRI issued just over \$86 million of senior debt in January 2004 and used the proceeds to retire higher coupon rate trust preferred securities.

Results of Operations

Through the operations of its insurance subsidiaries, GAFRI is engaged in the sale of retirement annuities and various forms of supplemental insurance products.

GAFRI's 2003 results reflect significantly lower realized losses on investments and improved operating results in the Company's life, supplemental insurance and variable annuity operations, partially offset by the effects of lower interest rates on the Company's fixed annuity operations.

GAFRI's net income for 2003 was \$49.7 million (\$1.13 per diluted share). Included in net income were investment impairment provisions of \$26.9 million, after-tax, and \$9.9 million in after-tax DPAC write-offs related to the negative effect of lower interest rates on GAFRI's fixed annuities.

CRITICAL ACCOUNTING POLICIES

Significant accounting policies are described in Note B to the financial statements. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that can have a significant effect on amounts reported in the financial statements. As more information becomes known, these estimates and assumptions could change and thus impact amounts reported in the future. Management believes that the establishment of insurance reserves, the determination of "other than temporary" impairments on investments, the recoverability and carrying value of unamortized insurance acquisition costs and environmental reserves of GAFRI's former manufacturing operations are the areas where the degree of judgement required to determine amounts recorded in the financial statements make the accounting policies critical.

LIQUIDITY AND CAPITAL RESOURCES

Ratios

GAFRI's consolidated debt to capital ratio was 31% at December 31, 2003 compared to 36% at December 31, 2002. For purposes of this calculation, consolidated debt includes notes payable, payable to subsidiary trusts in 2003 and redeemable preferred securities of consolidated subsidiary trusts in 2002; capital represents the sum of consolidated debt and stockholders' equity (excluding unrealized gains on fixed maturity securities).

The National Association of Insurance Commissioners' ("NAIC") risk-based capital ("RBC") formula determines the amount of capital that an insurance company needs to ensure that it has an acceptable expectation of not becoming financially impaired. At December 31, 2003, the capital ratio of GAFRI's principal insurance subsidiary was 6.2 times its authorized control level RBC.

Sources and Uses of Funds

To pay interest and principal on borrowings and other holding company costs, GAFRI (parent) and AAG Holding use primarily capital distributions from their directly-owned insurance subsidiaries, (Great American Life Insurance Company ("GALIC") and GA Life of Puerto Rico ("GAPR")), bank borrowings and cash and investments on hand. Capital distributions from GAFRI's insurance subsidiaries are subject to regulatory restrictions relating to statutory surplus and earnings. The maximum amount of dividends payable by GALIC and GAPR in 2004 without prior regulatory approval is \$56.5 million and \$32.9 million, respectively. In 2003, GALIC paid \$11.0 million in dividends and GAPR paid \$1.2 million in dividends. In 2003, GAFRI made capital contributions to GALIC of \$47.2 million.

The Company has an unsecured bank credit agreement that matures on December 31, 2004. Amounts borrowed bear interest at floating rates based on prime or Eurodollar rates. Almost 75% of the combined net proceeds from a \$60 million common stock rights offering in September 2003 and a \$112.5 million issuance of 30 year Senior Debentures in November 2003 were used to repay borrowings under GAFRI's bank line. The remaining proceeds were used to increase insurance subsidiary capital and for general corporate purposes. GAFRI's credit agreement provides up to \$155 million of availability; there were no borrowings outstanding under the line of credit at March 1, 2004.

In January 2004, GAFRI raised approximately \$84 million through the issuance of 7-1/4% Senior Debentures due 2034 under a shelf registration statement. The majority of the proceeds were used to redeem the Company's 9-1/4% trust preferred securities. The remaining proceeds were used to repurchase a portion of its outstanding 8-7/8% preferred securities. Under a currently effective shelf registration, GAFRI can issue up to an aggregate of \$51.3 million in additional equity or debt securities. All debentures issued by GAFRI are rated investment grade by three nationally recognized rating agencies.

In recent years, the Company has entered into several reinsurance transactions in connection with certain of its life and supplemental insurance operations. These transactions provided additional capital and liquidity and were entered into in the normal course of business in order to exit certain lines, fund an acquisition and transfer risk. The Company may enter into additional reinsurance transactions in the future.

GAFRI believes that it has sufficient resources to meet its liquidity requirements.

Contractual Obligations

At December 31, 2003, GAFRI's material contractual obligations in the next five years and for all years thereafter detailed by type of obligation were as follows (in millions):

-	<u>Total</u>	<u>Less than One Year</u>	<u>1-4 Years</u>	<u>More than 4 Years</u>
<u>Contractual Obligations</u>				
Notes Payable	\$214.0	\$0.2	\$100.5	\$113.3
Payable to Subsidiary Trusts	155.0	-	-	155.0
Operating Leases	<u>26.0</u>	<u>8.0</u>	<u>10.0</u>	<u>8.0</u>
Total	<u>\$395.0</u>	<u>\$8.2</u>	<u>\$110.5</u>	<u>\$276.3</u>

GAFRI's Balance Sheet at December 31, 2003 includes estimated liabilities for benefits payable related to its insurance operations. GAFRI expects operating cash flows to be sufficient to meet these obligations and also has

marketable investments available for sale should the operating cash flows prove to be inadequate.

GAFRI has no material contractual purchase obligations or other long-term liabilities at December 31, 2003.

Independent Ratings

The Company's principal insurance subsidiaries are rated by A.M. Best, Fitch and Standard & Poor's. GALIC is rated A3 (good financial security) by Moody's. Such ratings are generally based on items of concern to policyholders and agents and are not directed toward the protection of investors.

15

Following are the Company's ratings as of December 31, 2003:

	<u>A.M. Best</u>	<u>Fitch</u>	<u>Standard & Poor's</u>
GALIC	A (Excellent)	A+ (Strong)	A- (Strong)
AILIC	A (Excellent)	A+ (Strong)	A- (Strong)
Loyal	A (Excellent)	A+ (Strong)	Not rated
UTA	A- (Excellent)	Not rated	Not rated
GAPR	A (Excellent)	Not rated	Not rated

All of the above ratings carry a "stable" outlook. In evaluating a company, independent rating agencies review such factors as the company's: (i) capital adequacy; (ii) profitability; (iii) leverage and liquidity; (iv) book of business; (v) quality and estimated market value of assets; (vi) adequacy of policy reserves; (vii) experience and competency of management and (viii) operating profile.

Management believes that the ratings assigned by independent insurance rating agencies are important because potential policyholders often use a company's rating as an initial screening device in considering annuity products. Management believes that (i) a rating in the "A" category by A.M. Best is necessary to successfully market tax-deferred annuities to public education employees and other not-for-profit groups and (ii) a rating in the "A" category by at least one rating agency is necessary to successfully compete in other annuity markets.

GAFRI's insurance entities also compete in markets other than the sale of tax-deferred annuities. Ratings are an important competitive factor, management believes that these entities can successfully compete in these markets with their respective ratings.

GAFRI's operations could be materially and adversely affected by ratings downgrades. In connection with recent reviews by independent rating agencies, management indicated that it intends to maintain lower ratios of debt to capital than it has in recent years and intends to maintain the capital of its significant insurance subsidiaries at levels currently indicated by the rating agencies as appropriate for the current ratings. Items which could adversely affect capital levels include (i) a sustained decrease in the stock market; (ii) a significant period of low interest rates and a resulting significant narrowing of annuity "spread" (the difference between earnings received by the Company on its investments less the amount credited to policyholders' annuity accounts); (iii) investment impairments; (iv) adverse mortality, and (v) higher than planned dividends paid due to liquidity needs by GAFRI and AAG Holding.

2002 Acquisition

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-K

In June 2002, GALIC acquired Manhattan National Life Insurance Company ("MNL") for \$48.5 million in cash. GAFRI has reinsured 90% of this in-force business.

Investments

Insurance laws restrict the types and amounts of investments which are permissible for life insurers. These restrictions are designed to ensure the safety and liquidity of insurers' investment portfolios.

GAFRI's investment portfolio at December 31, 2003, contained \$7.8 billion in "Fixed maturities" classified as available-for-sale, which are carried at market value with unrealized gains and losses reported as a separate component of stockholders' equity on an after-tax basis. At December 31, 2003, GAFRI had pretax net unrealized gains of \$277 million on fixed maturities and \$37 million on equity securities.

GAFRI invests primarily in fixed income investments which, including loans and short-term investments, comprised 98% of its investment portfolio at December 31, 2003. GAFRI generally invests in securities having intermediate-term

16

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 December 31, 2003, 94% of GAFRI's fixed maturity portfolio was comprised of investment grade bonds (NAIC rating of "1" or "2"). Management believes that a high quality investment portfolio is more likely to generate a stable and predictable investment return.

At December 31, 2003, GAFRI's mortgage-backed securities ("MBSs") portfolio represented less than 30% of its 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. Due to the significant decline in the general level of interest rates, GAFRI has experienced an increase in the level of prepayments on its MBS portfolio; these prepayments have not been reinvested at interest rates comparable to the rates earned on the prepaid MBSs. Partly as a result of this, the overall yield on GAFRI's fixed maturity portfolio dropped from 7.0% at year end 2002 to 6.2% at year end 2003.

More than 95% 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 the interest rate risk referred to above, GAFRI does not believe a material risk (relative to earnings or liquidity) is inherent in holding such investments.

Summarized information for the unrealized gains and losses recorded in GAFRI's balance sheet at December 31, 2003, is shown in the following table (dollars in millions). Approximately \$82 million of "Fixed Maturities" and \$6 million of "Equity Securities" had no unrealized gains or losses at December 31, 2003.

	Securities with Unrealized <u>Gains</u>	Securities with Unrealized <u>Losses</u>
<u>Available-for-sale Fixed maturities</u>		
Market value of securities	\$5,677	\$2,086

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-K

Amortized cost of securities	\$5,351	\$2,135
Gross unrealized gain or (loss)	\$ 326	(\$ 49)
Market value as % of amortized cost	106%	98%
Number of security positions	1,097	186
Number individually exceeding \$2 million gain or loss	4	1
Concentration of gains or (losses) by type or industry (exceeding 5% of unrealized):		
Banks, savings and credit institutions	\$ 47.6	(\$ 1.1)
Mortgage-backed securities	32.2	(32.6)
Gas and electric services	44.8	(3.1)
U.S. government	18.7	(2.4)
Air transportation (generally collateralized)	5.3	(2.6)
Percentage rated investment grade	93%	96%

Equity securities

Market value of securities	\$75	\$2
Cost of securities	\$38	\$2
Gross unrealized gain or (loss)	\$37	-
Market value as % of cost	197%	100%

GAFRI's investment in equity securities of Provident Financial Group, a Cincinnati-based commercial banking and financial services company, represents \$30 million of the \$37 million in unrealized gains on equity securities at December 31, 2003. (See Note R)

17

The table below sets forth the scheduled maturities of fixed maturity securities at December 31, 2003, based on their market values. Asset backed securities and other securities with sinking funds are reported at average maturity. Actual maturities may differ from contractual maturities because certain securities may be called or prepaid by the issuers.

<u>Maturity</u>	Securities with Unrealized <u>Gains</u>	Securities with Unrealized <u>Losses</u>
*	*	*
One year or less	3%	-%
After one year through five years	23	8
After five years through ten years	41	11
After ten years	<u>18</u>	<u>12</u>
	85	31
Mortgage-backed securities	<u>15</u>	<u>69</u>

100 100

%

*Excludes \$82 million of fixed maturities with no unrealized gains and losses.

GAFRI realized aggregate losses of \$4.5 million during 2003 on \$31.9 million in sales of fixed maturity securities (8 issues/7 issuers) that had individual unrealized losses greater than \$500,000 at December 31, 2002. Market values of six of the securities increased an aggregate of \$5.8 million from December 31, 2002 to date of sale. The market value of the remaining two securities decreased \$316,000 from December 31, 2002 to the sale date.

Although GAFRI had the ability to continue holding these investments, its intent to hold them changed due primarily to deterioration in the issuers' creditworthiness, decisions to lessen exposure to a particular credit or industry, or to modify asset allocation within the portfolio. None of the securities were sold out of a necessity to raise cash. GAFRI has the ability and intent to hold securities with unrealized losses at December 31, 2003, for a period of time sufficient to allow for a recovery in market value.

The table below (dollars in millions) summarizes the unrealized gains and losses on all securities by dollar amount.

	Aggregate Market <u>Value</u>	Aggregate Unrealized <u>Gain (Loss)</u>	Market Value as % of Cost <u>Basis</u>
<u>Fixed Maturities at December 31, 2003</u>			
Securities with unrealized gains at 12/31/03:			
Exceeding \$500,000 (215 issues):	\$2,045	\$194	110.5%
Less than \$500,000 (882 issues):	<u>3,632</u>	<u>132</u>	103.8%
	<u>\$5,677</u>	<u>\$326</u>	106.1%
Securities with unrealized losses at 12/31/03:			
Exceeding \$500,000 (30 issues):	\$ 774	(\$ 29)	96.4%
Less than \$500,000 (156 issues):	<u>1,312</u>	<u>(20)</u>	98.5%
	<u>\$2,086</u>	<u>(\$ 49)</u>	97.7%
<u>Equity Securities at December 31, 2003</u>			
Securities with unrealized gains at 12/31/03:			
Exceeding \$500,000 (3 issues):	\$ 58	\$ 35	252.2%
Less than \$500,000 (18 issues):	<u>17</u>	<u>2</u>	113.3%

	<u>\$ 75</u>	<u>\$ 37</u>	197.4%
Securities with unrealized losses at 12/31/03:			
	\$ -	\$ -	-%
Exceeding \$500,000 (- issues):			
	<u>2</u>	<u>-</u>	100%
Less than \$500,000 (3 issues):			
	<u>\$ 2</u>	<u>\$ -</u>	100%

18

The following table (dollars in millions) summarizes the unrealized loss for all securities with unrealized losses by issuer quality and length of time those securities have been in an unrealized loss position.

	<u>Aggregate Market Value</u>	<u>Aggregate Unrealized Gain/(Loss)</u>	<u>Market Value as % of Cost Basis</u>
Fixed Maturities with Unrealized			
<u>Losses at December 31, 2003</u>			
Investment grade with losses for:			
One year or less (139 issues)	\$1,966	(\$41)	98.0%
Greater than one year (12 issues)	<u>40</u>	<u>(2</u>	95.2
)	
	<u>\$2,006</u>	<u>(\$43)</u>	97.9%
Non-investment grade with losses for:			
	\$ 12	(\$ 1)	92.3%

One year or less (13 issues)

68 (5 93.2

Greater than one year (22 issues)

)
\$ 80 (\$ 6) 93.0%

Equity Securities with Unrealized

Losses at December 31, 2003

One year or less (2 issues)

\$ 2 \$ - 100.0%

Greater than one year (1 issue)

- - -
\$ 2 \$ - 100.0%

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. Factors considered and resources used by management include:

- a. whether the unrealized loss is credit-driven or a result of changes in market interest rates,
- b. the extent to which market value is less than cost basis,
- c. historical operating, balance sheet and cash flow data contained in issuer SEC filings,
- d. issuer news releases,
- e. near-term prospects for improvement in the issuer and/or its industry,
- f. industry research and communications with industry specialists,
- g. third party research and credit rating reports,
- h. internally generated financial models and forecasts,
- i. discussions with issuer management, and
- j. ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value.

Based on its analysis of the factors enumerated above, management believes (i) GAFRI will recover its cost basis in the securities with unrealized losses and (ii) that 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.

19

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. While management believes it is not likely that future impairment charges will have a significant effect on GAFRI's liquidity, impairment charges could have an effect on the Company's ratings.

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-K

Net realized gains (losses) on investments sold and charges for "other than temporary" impairment on investments held were as follows (in millions):

	Net Realized Gains(Losses) <u>on Sales</u>	Charges for <u>Impairment</u>	<u>Other(a)</u>	<u>Total</u>
2003	\$31.0	(\$41.4)	\$1.2	(\$ 9.2)
2002	53.1	(97.4)	(1.4)	(45.7)
2001	19.1	(77.0)(b)	6.3	(51.6)
2000	21.0	(14.3)	1.1	7.8
1999	(0.6)	(8.6)	2.1	(7.1)

- a. Includes adjustments to carry derivatives at market and to reflect the impact of realized gains and losses on the amortization of deferred policy acquisition costs.
- b. Does not include an \$8.4 million write-down of certain collateralized debt obligations, which was recorded as the cumulative effect of an adoption of an accounting change at April 1, 2001.

Increased impairment charges in recent years reflect a rise in corporate defaults in the marketplace resulting from the weakened economy and other factors.

Uncertainties

Exposure to Market Risk

Market risk represents the potential economic loss arising from adverse changes in the fair value of financial instruments. GAFRI's exposures to market risk relate primarily to its fixed maturity investment portfolio and annuity contracts which are exposed to interest rate risk and, to a lesser extent, equity price risk. In addition, a portion of GAFRI's long-term debt is also exposed to interest rate risk.

Fixed Maturity Portfolio The fair value of GAFRI's fixed maturity portfolio is directly impacted by changes in market interest rates. GAFRI's fixed maturity portfolio is comprised of substantially all fixed rate investments with primarily short-term and intermediate-term maturities. This practice allows flexibility in reacting to fluctuations of interest rates. GAFRI's portfolio is managed with an attempt to achieve an adequate risk-adjusted return while maintaining sufficient liquidity to meet policyholder obligations. GAFRI attempts to align the duration of invested assets to the projected cash flows of policyholder liabilities.

The following table provides information about GAFRI's "available-for-sale" fixed maturity investments at December 31, 2003 and 2002, that are sensitive to interest rate risk. These tables show (dollars in millions) principal cash flows and related weighted-average interest rates by expected maturity date for each of the five subsequent years and for all years thereafter. Callable bonds and notes are included based on call date or maturity date depending upon which date produces the most conservative yield. MBSs and sinking fund issues are included based on maturity year adjusted for expected payment patterns. Actual cash flows may differ from those expected.

	<u>December 31, 2003</u>			<u>December 31, 2002</u>	
	<u>Principal</u>			<u>Principal</u>	
	<u>Cash Flows</u>	<u>Rate</u>		<u>Cash Flows</u>	<u>Rate</u>
2004	\$ 472	7.3%	2003	\$ 822	11.3%
2005	753	5.0	2004	548	8.5
2006	569	6.9	2005	556	7.3
2007	455	7.2	2006	629	6.8
2008	447	7.4	2007	653	5.8
Thereafter	<u>4,845</u>	6.1	Thereafter	<u>3,622</u>	6.3
Total	<u>\$7,541</u>	6.2%	Total	<u>\$6,830</u>	7.2%
Fair Value	<u>\$7,845</u>		Fair Value	<u>\$7,181</u>	

Annuity Contracts

Substantially all of GAFRI's fixed rate annuity contracts permit GAFRI to change crediting rates (subject to minimum interest rate guarantees of 3% to 4% per annum as determined by applicable law) enabling management to react to changes in market interest rates. Nonetheless, due to the drop in interest rates, GAFRI's spreads have narrowed and will likely continue to narrow through at least 2004. In the fourth quarter of 2003, GAFRI began to issue a portion of new business using a minimum interest guarantee of less than 3% in states where required approvals have been received. Actuarial assumptions used to estimate Deferred Policy Acquisition Costs ("DPAC") and Annuity Benefits, as well as GAFRI's ability to maintain spread, could be impacted if the current interest rate environment continues for an extended period and causes policyholder behavior to be altered.

Projected payments in each of the next five years and for all years thereafter on GAFRI's fixed annuity liabilities at December 31 are as follows (dollars in millions):

	<u>First</u>	<u>Second</u>	<u>Third</u>	<u>Fourth</u>	<u>Fifth</u>	<u>There</u>	<u>Total</u>	<u>Fair</u>
						<u>after</u>		<u>Value</u>
2003	\$610	\$710	\$870	\$740	\$690	\$3,355	\$6,975	\$6,781
2002	\$550	\$610	\$740	\$810	\$700	\$3,044	\$6,454	\$6,284

Approximately one-half of GAFRI's fixed annuity liabilities at December 31, 2003, were two-tier in nature in that policyholders can receive a higher amount if they annuitize rather than surrender their policy, even if the surrender

charge period has expired. At December 31, 2003, the average stated crediting rate on the in-force block of GAFRI's principal fixed annuity products was approximately 4.1%. The current stated crediting rates (excluding bonus interest) on new sales of GAFRI's products generally range from 2.8% to 3.3%. GAFRI estimates that its effective weighted-average crediting rate on its in-force business over the next five years will approximate 3.8%. This rate reflects actuarial assumptions as to: (i) expected investment spread (ii) deaths; (iii) annuitizations; (iv) surrenders and (v) renewal premiums. Actual experience and changes in actuarial assumptions may result in different effective crediting rates than those above.

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. The Company'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 and realized gains on the call options purchased by the Company. 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.

21

Adjusting these derivatives to market value had a net effect of less than 1% of annuity benefits in 2003 and 2002. In 2002, GAFRI chose to suspend new sales of equity-indexed annuities due primarily to lack of volume.

Debt and Preferred Securities

The following table shows scheduled principal payments on fixed rate long-term debt of GAFRI and related weighted-average interest rates for the next five years and for all years thereafter (in millions):

	<u>December 31, 2003</u>			<u>December 31, 2002</u>	
	Scheduled Principal Payments	Rate		Scheduled Principal Payments	Rate
2004 through 2008	\$100.7	5.8%	2003 through 2007	*	
Thereafter	<u>113.3</u>	7.5%	Thereafter	<u>\$100.8</u>	6.9%
Total	<u>\$214.0</u>	6.7%	Total	<u>\$101.7</u>	6.8%
Fair Value	<u>\$220.4</u>		Fair Value	<u>\$ 91.7</u>	

* Less than \$1 million

Under the terms of the Company's bank credit facility, GAFRI and its subsidiaries have no variable-rate debt maturing until December 2004. There were no borrowings outstanding on the bank credit facility at December 31, 2003. The weighted-average interest rate on GAFRI's variable-rate debt was 2.2% at December 31, 2002. There were \$155 million and \$143 million of subsidiary trust preferred securities outstanding at December 31, 2003 and 2002, respectively, none of which are scheduled for maturity or mandatory redemption during the next five years; the weighted-average interest rate on these trust securities at December 31, 2003 and 2002 was 8.8% and 9.1%,

respectively. See Note R "Subsequent Events" for information on the recent redemption and repurchase of trust preferred securities.

In December 2003, GAFRI entered into an interest rate swap agreement under which it effectively converted \$40 million principal amount of its 6-7/8% Senior Notes due 2008 from fixed to floating rate interest. At December 31, 2003, the effective interest rate on this debt was approximately 4.1%. The Company expects to enter into similar swap agreements in 2004 covering up to an additional \$60 million principal amount of these notes.

Reinsurance

In the normal course of business, GAFRI's insurance subsidiaries cede reinsurance to other companies under various coinsurance agreements to diversify risk and limit maximum exposure.

To the extent that any reinsuring companies are unable to meet obligations under agreements covering reinsurance ceded, GAFRI's insurance subsidiaries would remain liable. GAFRI reviews the financial condition of its reinsurers and monitors the amount of reinsurance it has with each company. At December 31, 2003, approximately 25% of the Company's total face amount of life insurance in force was reinsured with a single company.

Proposed Retirement Account Changes The federal budget for fiscal year 2005 contains several proposals designed to increase private savings by simplifying and consolidating current retirement savings vehicles. Included is one proposal to consolidate 401(k), 403(b) and governmental 457 plans, as well as certain other retirement accounts, into one plan. It is too early to predict the specific proposals which might be included in any legislation to be introduced, whether such legislation would become law, or their impact if adopted.

22

Proposed Regulatory Changes Various competitors, schools and other entities have proposed measures that would restrict product designs and the number of companies qualified to sell annuities to teachers. In addition, certain school districts have proposed charging policy fees to annuity providers. While efforts in these areas have been largely unsuccessful to date, widespread acceptance of such measures could negatively impact GAFRI's 403(b) annuity operations to the extent the Company's access to school districts is limited or reduced, and to the extent policy fees are not recovered by GAFRI.

RESULTS OF OPERATIONS

General

The comparability of GAFRI's financial statements is affected by the acquisition of a subsidiary discussed in Note C to its financial statements.

Results of operations as shown in the accompanying financial statements are prepared in accordance with generally accepted accounting principles. Operating earnings before income taxes increased \$30.7 million in 2003 compared to 2002. The 2003 results reflect significantly lower realized losses on investments and improved operating results in the Company's life, supplemental insurance and variable annuity operations, partially offset by the effects of lower interest rates on the Company's fixed annuity operations.

The lower earnings in 2002 compared to 2001 reflect (i) the effect of narrower spreads in GAFRI's fixed annuity operations, (ii) the impact of declines in the equity markets on the Company's variable annuity operations and (iii) the

effects of adverse mortality in GAFRI's life insurance operations. These decreases were partially offset by higher earnings in the Company's supplemental insurance operations; in addition, 2001 included a pretax operating gain of \$11.2 million related to GAFRI's real estate operations.

The following table summarizes GAFRI's annuity sales (in millions).

<u>Annuity Premiums</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
:			
Single premium fixed rate annuities	\$567	\$ 654	\$401
	179	165	151
Flexible premium fixed rate annuities	48	95	107
	<u>75</u>	<u>87</u>	<u>92</u>
Single premium variable annuities			
Flexible premium variable annuities			
	<u>\$869</u>	<u>\$1,001</u>	<u>\$751</u>

Fixed annuity sales decreased in 2003 compared to 2002 as the Company has maintained its pricing targets and its commission and interest crediting discipline during a period of historically low interest rates, as well as the Company's decision to suspend new sales of its equity-indexed annuities.

Variable annuity premiums decreased in 2003 and 2002 compared to 2001, reflecting the poor performance of the stock market and GAFRI's exit from certain segments of the variable annuity market. GAFRI now primarily focuses on selling its variable annuity products in the 403(b) market.

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).

<u>Premiums</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Supplemental insurance products	\$222	\$191	\$190
GA Life of Puerto Rico	66	61	54
Life products	<u>44</u>	<u>54</u>	<u>36</u>
	<u>\$332</u>	<u>\$306</u>	<u>\$280</u>
<u>Benefits</u>			
Supplemental insurance products	\$170	\$157	\$157
GA Life of Puerto Rico	34	31	27
Life products	<u>47</u>	<u>57</u>	<u>29</u>
	<u>\$251</u>	<u>\$245</u>	<u>\$213</u>

The increase in premiums and benefits for the supplemental insurance products represents the addition of new distribution sources. The increase in supplemental insurance product benefits, due to higher premiums, was partially offset by favorable experience on the Medicare supplement products in 2003 compared to 2002.

Although results have improved in 2003, GAFRI continues to experience adverse mortality in GALIC's life division. While stricter underwriting standards have resulted in higher quality business in 2003, these standards have led to a significant drop in first year premiums. Beginning in May 2004, GALIC's life division will no longer be issuing life insurance policies.

Sales of life products in 2003 and 2002 include premiums of \$3 million and \$14 million, respectively, and benefits of \$14 million and \$19 million, respectively, related to Manhattan National Life, which was acquired in June 2002.

Net Investment Income

Net investment income decreased \$16.9 million (3%) in 2003 compared to 2002, due primarily to lower reinvestment rates on GAFRI's fixed maturity portfolio. The yield on GAFRI's fixed maturity portfolio was approximately 6.2% at December 31, 2003 compared to approximately 7.0% at December 31, 2002 and 7.7% at December 31, 2001.

Net investment income increased \$21.3 million (4%) in 2002 due primarily to higher average invested assets (partially as a result of the MNL acquisition), somewhat offset by lower yields in the portfolio.

Realized Losses on Investments

Realized gains (losses) on investments included the following provisions for other than temporary impairment: \$41.4 million, \$97.4 million and \$77.0 million for the years ended 2003, 2002 and 2001, respectively.

Other Income

Other income decreased \$8.4 million (9%) in 2003 compared to 2002 due primarily to a reinsurance treaty entered into by GALIC's Life Division in December 2002.

Real Estate Operations

GAFRI is engaged in a variety of real estate operations including hotels and marinas; 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).

	<u>2003</u>	<u>2002</u>	<u>2001</u>
Other income	\$43.3	\$41.2	\$46.7
Other expenses	36.0	34.1	30.9

Other income included a pretax gain on the sale of real estate assets of \$11.2 million in 2001.

Annuity Benefits

Annuity benefits reflect amounts accrued on annuity policyholders' funds accumulated. On its deferred annuities (annuities in the accumulation phase), GAFRI generally credits interest to policyholders' accounts at their current stated 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 interest and crediting rates, actual surrender, death and annuitization experience or modifications in actuarial assumptions can affect this accrual.

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 (as determined by applicable law). Approximately one-half of GAFRI's annuity

benefits accumulated relate to policies that have a minimum guarantee of 3%; the

24

majority of the balance has a guarantee of 4%. Beginning in the fourth quarter of 2003, in states where required approvals have been received, the Company has begun issuing products with guaranteed minimum crediting rates of less than 3%.

Historically, management has been able to react to changes in market interest rates and maintain a desired interest rate spread. The recent interest rate environment has resulted in a spread compression that could continue through at least 2004. Significant changes in projected investment yields could result in charges (or credits) to earnings in the period the projections are modified.

Insurance Acquisition Expenses

Insurance acquisition expenses include amortization of DPAC as well as a portion of commissions on sales of insurance products. Insurance acquisition expenses also include amortization of the present value of future profits of businesses acquired amounting to \$8.5 million in 2003, \$11.8 million in 2002 and \$9.2 million in 2001.

The increase in insurance acquisition expenses in 2003 is due primarily to the continued narrowing of spreads in GAFRI's fixed annuity operations and an increase of in-force policies primarily in the annuities and supplemental insurance businesses. Insurance acquisition expenses in 2003 included \$15.2 million in DPAC write-offs related to spread narrowing.

The increase in insurance acquisition expenses in 2002 reflects (i) DPAC write-offs; (ii) the amortization costs associated with GAFRI's purchase of MNL in June 2002 and (iii) higher commission expense due to the Company's growth in premiums. Included in 2002 and 2001 were DPAC write-offs related to variable annuities of \$13.5 million and \$3.0 million, respectively, resulting from the actual performance of the equity markets and a reduction of assumed future returns.

Included in 2002 is a DPAC write-off of \$4 million related primarily to adverse mortality in the Company's life operations. Partially offsetting the DPAC write-offs in 2002 was a reduction of approximately \$7 million in DPAC amortization on fixed annuities relating to decreases in crediting rates on certain fixed annuity products.

The vast majority of GAFRI's DPAC asset relates to its fixed annuity, variable annuity and life insurance lines of business. Continued spread compression, decreases in the stock market and adverse mortality could lead to further write-offs of DPAC in the future.

Preferred Distribution Requirement on Consolidated Subsidiary Trusts

The decrease in preferred distribution requirement on consolidated subsidiary trusts in 2002 compared to 2001 reflects the Company's September 2001 redemption of one issue of its trust preferred securities.

Interest and Other Debt Expenses

The increase in interest and other debt expenses in 2003 compared to 2002 reflects the paydown of lower interest rate bank debt with proceeds from a 7-1/2% Senior Debenture offering in the fourth quarter of 2003.

Other Expenses

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-K

Other expenses increased in 2002 compared to 2001 due to (i) an increase in expenses from real estate operations resulting from the 2002 acquisition of property and (ii) the acquisition of MNL in June 2002.

Income Taxes

The provision for income taxes in all periods presented reflects the effects of non-taxable foreign operations. In 2002 the provision for income taxes also reflects the effect (\$3.3 million) of reductions in the valuation allowance associated with certain deferred tax assets. (See Note K)

25

Cumulative Effect of Accounting Changes

Effective January 1, 2002, GAFRI implemented Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets," under which goodwill is no longer amortized, but is subject to an impairment test at least annually. The initial impairment testing resulted in an after-tax charge of \$17.7 million for the cumulative effect of an accounting change.

In 2001, the cumulative effect of accounting change represents the implementation of a new accounting standard (EITF 99-20) which resulted in a writedown of \$8.4 million (\$5.5 million or \$0.13 per share after-tax) of the cost basis of certain collateralized debt obligations in the second quarter.

RECENT ACCOUNTING STANDARDS

The following accounting standards have been, or will be implemented by GAFRI. The implementation of these standards is discussed under various subheadings of Note B to the Financial Statements. Effects of each are shown in the relevant Notes.

Accounting

<u>Standard</u>	<u>Subject of Standard (Year Implemented)</u>	<u>Reference</u>
EITF 99-20	Asset-backed Securities (2001)	"Investments"
SFAS #141	Business Combinations (2001)	"Business Combinations"
SFAS #142	Goodwill and Other Intangibles (2002)	"Goodwill"
SFAS #148	Stock-based Compensation (2002)	"Stock-based Compensation"
FIN 46	Consolidation of Variable Interest Entities (2003)	"Payable to Subsidiary Trusts"
SFAS #133 B36	Embedded Derivatives in Reinsurance Contracts (2003)	"Reinsurance"

Other standards issued in recent years did not apply to GAFRI or had only negligible effects on GAFRI.

SOP 03-1

In July 2003, the American Institute of Certified Public Accountants ("AICPA") issued Statement of Position ("SOP") 03-1, "Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts." The most significant accounting implications to GAFRI of the SOP are as follows: (1) changing GAFRI's method of accounting for assets and liabilities related to two-tier annuities and persistency bonuses; (2)

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-K

amortizing DPAC over the life of deferred annuity contracts excluding the annuitization phase; and (3) establishing an additional liability for guaranteed minimum death benefits for variable annuity contracts.

The Company will adopt the SOP effective January 1, 2004. Although interpretation of accounting for certain items covered by the SOP has not been finalized, the effect of initially adopting this SOP is expected to be less than 2% of stockholders' equity and will be reported as a cumulative effect of a change in accounting principle in the 2004 results of operations. This effect results primarily from the change in accounting for persistency bonuses and the Company's two-tier annuities. GAFRI does not expect that the final amount will have a material adverse impact on the Company.

26

ITEM 7A

Quantitative and Qualitative Disclosures About Market Risk

The information required by Item 7A is included in Management's Discussion and Analysis of Financial Condition and Results of Operations.

ITEM 8

Please refer to "Forward-Looking Statements" following the index in front of this Form 10-K.

Financial Statements and Supplementary Data

	<u>PAGE</u>
Report of Independent Auditors	F-1
Consolidated Balance Sheet:	
December 31, 2003 and 2002	F-2

Consolidated Income Statement:

Years Ended December 31, 2003, 2002 and 2001 F-3

Consolidated Statement of Changes in Stockholders' Equity:

Years Ended December 31, 2003, 2002 and 2001 F-4

Consolidated Statement of Cash Flows:

Years Ended December 31, 2003, 2002 and 2001 F-5

Notes to Consolidated Financial Statements F-6

"Selected Quarterly Financial Data" has been included in Note Q to the Consolidated Financial Statements.

Please refer to "Forward-Looking Statements" following the index in front of this Form 10-K.

Item 9A

Evaluation of Disclosure Controls and Procedures

GAFRI's chief executive officer and chief financial officer, with the participation of management, have evaluated GAFRI's disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rule 13a-14c) as of a date within 90 days prior to filing this report. Based on the evaluation, they concluded that the controls and procedures are effective. There have been no significant changes in GAFRI's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.

27

PART III

The information required by the following Items will be included in GAFRI's definitive Proxy Statement for the 2004 Annual Meeting of Stockholders which will be filed with the Securities and Exchange Commission within 120 days of the Company's fiscal year-end and is herein incorporated by reference:

ITEM 10 Directors and Executive Officers of the Registrant

ITEM 11 Executive Compensation

ITEM 12 Security Ownership of Certain Beneficial Owners and Management and
Related Stockholder Matters

(See Item 5 "Market for Registrant's Common Equity and Related Stockholder
Matters")

ITEM 13 Certain Relationships and Related Transactions

ITEM 14 Principal Accountant Fees and Services

28

REPORT OF INDEPENDENT AUDITORS

Board of Directors

Great American Financial Resources, Inc.

We have audited the accompanying consolidated balance sheet of Great American Financial Resources, Inc. and subsidiaries as of December 31, 2003 and 2002, and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2003. Our audits also included the financial statement schedules listed in the Index at Item 15(a). These financial statements and schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedules based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Great American Financial Resources, Inc. and subsidiaries at December 31, 2003 and 2002, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedules, when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set forth therein.

As discussed in Notes B and F to the consolidated financial statements, in 2002, the Company implemented Statement of Financial Accounting Standard No. 142, which required a change in the method of accounting for goodwill.

Ernst & Young LLP

Cincinnati, Ohio

February 12, 2004

F-1

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

(Dollars in millions)

	<u>December 31,</u>	
	<u>2003</u>	<u>2002</u>
Assets		
Investments:		
Fixed maturities:		
Available-for-sale - at market (amortized cost - \$7,568.3 and \$6,894.1)	\$ 7,845.2	\$7,181.1
Trading securities - at market	195.4	-
Equity securities - at market (cost - \$45.9 and \$47.0)	83.4	73.5
Mortgage loans on real estate	15.8	18.9
Real estate	79.4	78.6
Policy loans	215.6	214.9
Short-term investments	<u>143.4</u>	<u>400.0</u>
Total investments	8,578.2	7,967.0

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-K

Cash	20.6	2.2
Accrued investment income	100.5	95.3
Unamortized insurance acquisition costs, net	614.2	591.0
Reinsurance recoverable	206.6	134.0
Other assets	105.8	118.0
Variable annuity assets (separate accounts)	<u>568.4</u>	<u>455.1</u>
	<u>\$10,194.3</u>	<u>\$9,362.6</u>
Liabilities and Capital		
Annuity benefits accumulated	\$ 6,974.6	\$6,453.9
Life, accident and health reserves	1,018.9	902.4
Notes payable	214.0	250.3
Payable to subsidiary trusts (issuers of preferred securities)	155.0	-
Payable to affiliates, net	94.2	62.4
Deferred taxes on unrealized gains	84.2	93.3
Accounts payable, accrued expenses and other liabilities	142.5	150.4
Variable annuity liabilities (separate accounts)	<u>568.4</u>	<u>455.1</u>
Total liabilities	9,251.8	8,367.8
Mandatorily redeemable preferred securities of subsidiary trusts	-	142.9
Stockholders' Equity:		
Common Stock, \$1 par value		
-100,000,000 shares authorized		
-46,978,151 and 42,456,843 shares outstanding	47.0	42.4
Capital surplus	406.0	347.6
Retained earnings	326.9	281.9
Unrealized gains on marketable securities, net	<u>162.6</u>	<u>180.0</u>
Total stockholders' equity	<u>942.5</u>	<u>851.9</u>

\$10,194.3 \$9,362.6

See Notes to Consolidated Financial Statements.

F-2

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED INCOME STATEMENT

(In millions, except per share amounts)

	<u>Year ended December 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>2001</u>
Revenues:			
Life, accident and health premiums	\$331.9	\$305.7	\$280.1
Net investment income	510.9	527.8	506.5
Realized losses on investments	(9.2)	(45.7)	(51.6)
Other income	<u>87.0</u>	<u>95.4</u>	<u>95.1</u>
	920.6	883.2	830.1
Costs and Expenses:			
Annuity benefits	295.0	301.0	294.7
Life, accident and health benefits	250.7	245.3	213.0
Insurance acquisition expenses	121.3	114.5	79.3
Preferred distribution requirement on consolidated subsidiary trusts	12.8	13.0	17.1
Interest and other debt expenses	12.1	10.8	10.8
Other expenses	<u>159.1</u>	<u>159.7</u>	<u>155.3</u>
	<u>851.0</u>	<u>844.3</u>	<u>770.2</u>

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-K

Operating earnings before income taxes	69.6	38.9	59.9
Provision for income taxes	<u>19.9</u>	<u>5.0</u>	<u>17.2</u>
Income before accounting changes	49.7	33.9	42.7
Cumulative effect of accounting changes, net of tax	<u>-</u>	<u>(17.7)</u>	<u>(5.5)</u>
))	
Net Income	<u>\$ 49.7</u>	<u>\$ 16.2</u>	<u>\$ 37.2</u>
Basic earnings per common share:			
Income before accounting changes	\$1.14	\$0.80	\$1.01
Accounting changes	<u>-</u>	<u>(0.42)</u>	<u>(0.13)</u>
))	
Net income	<u>\$1.14</u>	<u>\$0.38</u>	<u>\$0.88</u>
Diluted earnings per common share:			
Income before accounting changes	\$1.13	\$0.79	\$1.00
Accounting changes	<u>-</u>	<u>(0.41)</u>	<u>(0.13)</u>
))	
Net income	<u>\$1.13</u>	<u>\$0.38</u>	<u>\$0.87</u>
Average number of common shares:			
Basic	43.7	42.4	42.3
Diluted	43.8	42.7	42.7
Cash dividends per common share	\$0.10	\$0.10	\$0.10

See Notes to Consolidated Financial Statements.

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(In millions)

	<u>Year ended December 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>2001</u>
Common Stock:			
Balance at beginning of year	\$ 42.4	\$ 42.3	\$ 42.3
Common Stock issued	4.6	0.2	0.1
Common Stock retired	<u>—</u>	<u>(0.1)</u>	<u>(0.1)</u>
))	
Balance at end of year	<u>\$ 47.0</u>	<u>\$ 42.4</u>	<u>\$ 42.3</u>
Capital Surplus:			
Balance at beginning of year	\$347.6	\$346.7	\$348.5
Common Stock issued	58.9	2.4	1.3
Common Stock retired	(0.5)	(1.5)	(0.7)
Capital transaction of subsidiary	<u>—</u>	<u>—</u>	<u>(2.4)</u>
)	
Balance at end of year	<u>\$406.0</u>	<u>\$347.6</u>	<u>\$346.7</u>
Retained Earnings:			
Balance at beginning of year	\$281.9	\$270.0	\$237.0
Net income	49.7	16.2	37.2
Common dividends declared	<u>(4.7)</u>	<u>(4.3)</u>	<u>(4.2)</u>
))	
Balance at end of year	<u>\$326.9</u>	<u>\$281.9</u>	<u>\$270.0</u>

Unrealized Gains, Net:			
Balance at beginning of year	\$180.0	\$ 89.8	\$ 43.9
Change during year	<u>(17.4)</u>	<u>90.2</u>	<u>45.9</u>
)		
Balance at end of year	<u>\$162.6</u>	<u>\$180.0</u>	<u>\$ 89.8</u>
<hr/>			
Comprehensive Income:			
Net Income	\$ 49.7	\$ 16.2	\$ 37.2
Other comprehensive income (loss) - change in net unrealized gains on marketable securities	<u>(17.4)</u>	<u>90.2</u>	<u>45.9</u>
)		
Comprehensive income	<u>\$ 32.3</u>	<u>\$106.4</u>	<u>\$ 83.1</u>

See Notes to Consolidated Financial Statements.

F-4

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

(In millions)

	<u>Year ended December 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>2001</u>
Cash Flows from Operating Activities:			
Net income	\$ 49.7	\$ 16.2	\$ 37.2
Adjustments:			
Cumulative effect of accounting changes	-	17.7	5.5

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-K

Increase in life, accident and health reserves	118.8	70.0	58.0
Benefits to annuity policyholders	295.0	301.0	294.7
Amortization of insurance acquisition costs	90.5	114.5	79.3
Depreciation and amortization	19.9	16.8	12.4
Realized losses on investments	9.2	45.7	51.6
Increase in insurance acquisition costs	(148.2)	(170.2)	(137.7)
Increase in reinsurance recoverable	(72.6)	(24.4)	(43.1)
Decrease in other assets	16.7	0.1	4.3
Decrease in other liabilities	(14.2)	(49.2)	(9.7)
Increase (decrease) in payable to affiliates, net	31.8	(29.8)	13.4
Other, net	<u>11.8</u>	<u>6.0</u>	<u>(15.8)</u>
)	
	<u>408.4</u>	<u>314.4</u>	<u>350.1</u>

Cash Flows from Investing Activities:

Purchases of and additional investments in:

Fixed maturity investments	(5,537.7)	(3,880.2)	(1,721.3)
Equity securities	(17.4)	(7.4)	(3.3)
Real estate, mortgage loans and other assets	(8.4)	(17.6)	(13.2)
Purchase of subsidiary	-	(48.5)	-
Cash and short-term investments of subsidiary acquired	-	4.9	-
Maturities and redemptions of fixed maturity investments	1,190.8	1,289.3	582.0
Sales of:			
Fixed maturity investments	3,449.0	2,191.4	873.4
Equity securities	27.5	4.1	1.2
Real estate, mortgage loans and other assets	3.5	7.0	26.1
Decrease (increase) in policy loans	<u>(0.7)</u>	<u>4.5</u>	<u>2.2</u>

)

(893.4) (452.5) (252.9)

)

)

)

Cash Flows from Financing Activities:

Fixed annuity receipts	788.2	874.5	616.6
Annuity surrenders, benefits and withdrawals	(572.0)	(549.9)	(622.5)
Net transfers (to) from variable annuity assets	1.0	20.8	(0.4)
Additions to notes payable	116.7	27.5	87.5

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-K

Reductions of notes payable	(156.8)	(0.2)	(16.4)
Issuance of Common Stock	63.0	2.6	1.4
Retirement of Common Stock	-	(1.6)	(0.8)
Issuance of trust preferred securities	19.4	-	-
Repurchase of trust preferred securities	(8.0)	-	(75.0)
Cash dividends paid	<u>(4.7)</u>	<u>(4.3)</u>	<u>(4.2)</u>
)))
	<u>246.8</u>	<u>369.4</u>	<u>(13.8)</u>
))
Net increase (decrease) in cash and short-term investments	(238.2)	231.3	83.4
Beginning cash and short-term investments	<u>402.2</u>	<u>170.9</u>	<u>87.5</u>
Ending cash and short-term investments	<u>\$ 164.0</u>	<u>\$ 402.2</u>	<u>\$ 170.9</u>

See Notes to Consolidated Financial Statements.

F-5

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SOP 03-1

In July 2003, the American Institute of Certified Public Accountants ("AICPA") issued Statement of Position ("SOP") 03-1, "Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts."

The most significant accounting implications to GAFRI of the SOP are as follows: (1) changing GAFRI's method of accounting for assets and liabilities related to two-tier annuities and persistency bonuses; (2) amortizing DPAC over the life of deferred annuity contracts excluding the annuitization phase; and (3) establishing an additional liability for guaranteed minimum death benefits for variable annuity contracts.

The Company will adopt the SOP effective January 1, 2004. Although interpretation of accounting for certain items covered by the SOP has not been finalized, the effect of initially adopting this SOP is expected to be less than 2% of stockholders' equity and will be reported as a cumulative effect of a change in accounting principle in the 2004 results of operations. This effect results primarily from the change in accounting for persistency bonuses and the Company's two-tier annuities. GAFRI does not expect that the final amount will have a material adverse impact on the Company.

INDEX TO NOTES

- | | |
|---|--|
| A. Description of the Company | K. Income Taxes |
| B. Summary of Significant Accounting Policies | L. Leases |
| C. Acquisition | M. Earnings Per Share |
| D. Segments of Operations | N. Contingencies |
| E. Investments | O. Statutory Information |
| F. Goodwill | P. Additional Information |
| G. Unamortized Insurance Acquisition Costs | Q. Quarterly Financial Data
(Unaudited) |
| H. Notes Payable | R. Subsequent Events (Unaudited) |
| I. Payable to Subsidiary Trusts | |
| J. Stockholders' Equity | |

A. DESCRIPTION OF THE COMPANY

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

American Financial Group, Inc. ("AFG") and its subsidiaries owned 82% of GAFRI's Common Stock at December 31, 2003.

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying consolidated financial statements include the accounts of GAFRI and its subsidiaries. Certain reclassifications have been made to prior years to conform to the current year's presentation. Acquisitions and sales of subsidiaries have resulted in certain differences in the financial statements and have affected comparability between years. 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 in conformity with generally accepted accounting principles 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

Fixed maturity securities classified as "available-for-sale" are reported at fair value with unrealized gains and losses reported as a separate component of stockholders' equity. Fixed maturity securities classified as "trading" are reported at fair value with changes in unrealized gains or losses during the period included in investment income. Short-term investments are carried at cost; mortgage loans on real estate are generally carried at amortized cost; policy loans are carried at the aggregate unpaid balance. Premiums and discounts on mortgage-backed securities are amortized over a period based on estimated future principal payments, including prepayments. Prepayment assumptions are reviewed periodically and adjusted to reflect actual prepayments and changes in expectations. The most significant determinants of prepayments are the differences between interest rates of the underlying mortgages and current mortgage loan rates and the structure of the security. Other factors affecting prepayments include the size, type and age of underlying mortgages, the geographic location of the mortgaged properties and the creditworthiness of the borrowers. Variations from anticipated prepayments will affect the life and yield of these securities.

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

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 (included in realized gains) and the cost basis of that investment is reduced.

Derivatives

Derivatives included in GAFRI's balance sheet consist primarily of (i) the interest component of certain life reinsurance contracts (included in other liabilities), (ii) an interest rate swap (included in Notes Payable), (iii) the equity-based component of certain annuity products (included in annuity benefits accumulated) and (iv) related call options (included in other assets) designed to be consistent with the characteristics of the liabilities and used to mitigate the risk embedded in those annuity products. Changes in the fair value of derivatives are included in current earnings.

In December 2003, GAFRI entered into an interest rate swap, effectively converting the interest rate on \$40 million of its 6-7/8% fixed rate Senior Notes to a floating rate based on LIBOR. The swap realigns GAFRI's mix of floating and fixed rate debt and has been designated a fair value hedge. The terms of the swap match those of the debt; therefore, the swap is considered to be (and is accounted for as) a 100% effective hedge. Both the swap and the hedged debt are adjusted for changes in fair value by offsetting amounts. Accordingly, since the swap is included with notes payable in the Balance Sheet, the only effect on GAFRI's financial statements is that the interest expense on the hedged debt is recorded based on the variable rate.

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, "Goodwill and Other Intangible Assets", under which goodwill is no longer amortized but is subject to an impairment test at least annually. As required under SFAS No. 142, GAFRI completed the transitional test for goodwill impairment (as of January 1, 2002) during the fourth quarter of 2002. The resulting write-down was reported by restating first quarter 2002 results for the cumulative effect of a change in accounting principle.

Reinsurance

In the normal course of business, GAFRI's insurance subsidiaries cede reinsurance to other companies under various coinsurance agreements to diversify risk and limit maximum exposure. These transactions may also provide a source of additional capital and liquidity. GAFRI reviews the financial condition of its reinsurers and monitors the amount of reinsurance it has with each company.

Under these agreements, GAFRI's insurance subsidiaries cede life insurance policies to a third party on a funds withheld basis where GAFRI retains the assets (securities) associated with the reinsurance contracts. Interest is credited to the reinsurer based on the actual investment performance (including realized gains and losses) of the retained assets. Effective October 1, 2003, the Company implemented SFAS No. 133 Implementation Issue B36 ("B36") "Embedded Derivatives in Reinsurance Contracts." Under B36, these reinsurance contracts are considered to

contain embedded derivatives (that must be marked to market) because the yield on the payables is based on specific blocks of the ceding companies' assets, rather than the overall creditworthiness of the ceding company. GAFRI determined that changes in the fair value of the underlying portfolios of fixed maturity securities is an appropriate measure of the value of the embedded derivative. As permitted under B36, the Company reclassified the securities related to these transactions from "available-for-sale" to "trading." The \$16.1 million cumulative effect of marking to market the derivatives embedded in the payables at October 1, 2003, was offset by the initial effect of transferring the related securities from available-for-sale to trading. Beginning in the fourth quarter of 2003, the mark to market on the embedded derivatives offsets the investment income recorded on the mark to market of the related trading portfolios.

F-7

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

Insurance Acquisition Costs and Expenses

Unamortized insurance acquisition costs consist of deferred policy acquisition costs ("DPAC"), net of unearned revenues, and the present value of future profits on business in force ("VOBA") of acquired insurance companies.

Insurance acquisition expenses in the income statement reflect primarily the amortization of DPAC and VOBA. In addition, certain commission costs are expensed as paid and included in insurance acquisition expenses. All other uncanceled acquisition costs such as marketing and underwriting expenses are included in "Other expenses."

Deferred Policy Acquisition Costs ("DPAC")

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

DPAC related to annuities and universal life insurance products is deferred to the extent deemed recoverable and 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 life and variable annuity 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 on marketable securities, net" in the stockholders' equity section of the Balance Sheet.

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.

Life and health insurance contracts are reviewed periodically using actuarial assumptions revised based on actual and anticipated experience, to determine if there is a potential premium deficiency. If any such deficiency exists, it is recognized by a charge to income and a reduction in unamortized acquisition costs.

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 in relation to expected gross profits of the acquired policies for annuities and universal life products and in relation to the 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.

F-8

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

Reserves for two-tier annuities (annuities with different stated account values depending on whether a policyholder annuitizes, dies or surrenders) are generally recorded at the lower-tier value plus an additional reserve for expected deaths and annuitizations ("EDAR") that require payment of the upper-tier value. The liability for EDAR is accrued for and modified using the same assumptions as used in determining DPAC and DPAC amortization.

Reserves for traditional single-tier fixed annuities are generally recorded at the stated annuitization value.

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 the original projections of 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 investment risk.

Life, Accident and Health Premiums and Benefits

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-K

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 that 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.

Payable to Subsidiary Trusts (Issuers of Preferred Securities)

Under revised Interpretation ("FIN") No. 46, "Consolidation of Variable Interest Entities" ("VIEs") issued by the Financial Accounting Standards Board in December 2003, GAFRI is required to deconsolidate two wholly-owned subsidiary trusts because they are VIEs in which GAFRI is not considered to be the primary beneficiary. These subsidiary trusts were formed to issue preferred securities and, in turn, purchase a like amount of subordinated debt from their parent company, which provides interest and principal payments to fund the respective trust obligations. Accordingly, the subordinated debt due to the trusts is shown as a liability in the Balance Sheet beginning December 31, 2003, and the related interest expense will be shown in the Income Statement as "Interest on subsidiary trust obligations" beginning in the first quarter of 2004. Prior to these dates, these items were included in the Balance Sheet as "Mandatorily redeemable preferred securities of subsidiary trusts" and in the Income Statement as "Trust preferred distribution requirement." Implementation of FIN 46 with respect to the preferred securities had no effect on earnings.

Income Taxes

GAFRI and Great American Life Insurance Company ("GALIC") have separate tax allocation agreements with American Financial Group ("AFG"), which designate how tax payments are shared by members of the tax group. In general, both companies

F-9

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

compute taxes on a separate return basis. GALIC is obligated to make payments to (or receive benefits from) AFG 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 AFG. If the AFG tax group utilizes any of GAFRI's net operating losses or deductions that originated prior to GAFRI's entering AFG's consolidated tax group, AFG will pay to GAFRI an amount equal to the benefit received. The tax allocation agreements with AFG 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 AFG's consolidated tax group are aggregated with other amounts receivable from or payable to affiliates.

Stock-Based Compensation

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-K

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 plans, 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.

The following table illustrates the effect on net income and earnings per share had compensation cost been recognized and determined for stock option awards based on the fair values at grant dates consistent with the method prescribed by SFAS No. 123. See Note J "Stockholders' Equity" for further information on stock options.

For SFAS No. 123 purposes, the "fair value" of \$3.69 per option granted in 2003, \$6.09 in 2002 and \$6.21 in 2001 was calculated using the Black-Scholes option pricing model and the following assumptions: dividend yield of less than 1%; expected volatility of 20% for 2003, 2002 and 2001; risk-free interest rate of 3% for 2003 and 5% for 2002 and 2001; and expected option life of 7.5 years. There is no single reliable method to determine the actual value of options at grant date. Accordingly, actual value of the option grants may be higher or lower than the SFAS No. 123 "fair value."

	<u>2003</u>	<u>2002</u>	<u>2001</u>
Net income, as reported	\$49.7	\$16.2	\$37.2
Pro forma stock option expense, net of tax	<u>(1.6)</u>	<u>(1.3)</u>	<u>(2.0)</u>
)))
Adjusted net income	<u>\$48.1</u>	<u>\$14.9</u>	<u>\$35.2</u>
Earnings per share (as reported):			
Basic	\$1.14	\$0.38	\$0.88
Diluted	\$1.13	\$0.38	\$0.87
Earning per share (adjusted):			
Basic	\$1.10	\$0.35	\$0.83
Diluted	\$1.10	\$0.35	\$0.82

Benefit Plans

GAFRI provides retirement benefits to qualified employees of participating companies through the GAFRI Retirement and Savings Plan. Under the retirement fund portion of the Plan, contributions are at the discretion of the GAFRI Board of Directors and are invested primarily in GAFRI Common Stock.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

Under the savings fund portion of the Plan, GAFRI matches a percentage of employee contributions. Employees have been permitted to direct the investment of their contributions to independently managed investment funds. Matching contributions to the savings fund portion of the Plan are also invested in accordance with participant elections. Company contributions to the Plan 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.

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.

Fair Value of Financial Instruments

Methods and assumptions used in estimating fair values are described in Note P to the financial statements. These fair values represent point-in-time estimates of value that might not be particularly relevant in predicting GAFRI's future earnings or cash flows.

C. ACQUISITION

On June 28, 2002, GAFRI's principal insurance subsidiary acquired Manhattan National Life Insurance Company ("MNL") from a subsidiary of Consec, Inc. for \$48.5 million in cash. While MNL is no longer writing new policies, as of December 31, 2003, it had approximately 80,000 policies in force (primarily term life). GAFRI has reinsured 90% of the business in force.

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 and universal life insurance products had been marketed through national marketing organizations. In May 2004, GAFRI will suspend new sales of these life insurance products due to inadequate volume and returns. The Company will continue to service its in-force block of over 200,000 policies and \$37 billion gross (\$12 billion, net) of life insurance in force. The Company continues to sell life products through its supplemental insurance operations and GA Life of Puerto Rico (see below.)

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. In 2001, Loyal reinsured a substantial portion of its life insurance business and has

reduced its marketing efforts in that line of business.

F-11

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

GA Life of Puerto Rico ("GAPR") sells in-home life and supplemental health products through a network of company-employed agents. Sales in Puerto Rico accounted for nearly 20% of GAFRI's life, accident and health premiums in 2003.

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

The following tables show (in millions) GAFRI's assets, revenues and operating profit by significant business segment.

<u>Assets</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Life and annuity products	\$ 9,039.8	\$8,283.5	\$7,396.1
Supplemental insurance products	862.7	801.4	731.5
GA Life of Puerto Rico	288.6	265.3	234.0
Corporate and other	<u>3.2</u>	<u>12.4</u>	<u>38.8</u>
Total assets per balance sheet	<u>\$10,194.3</u>	<u>\$9,362.6</u>	<u>\$8,400.4</u>
<u>Revenues</u>			
Life and annuity products	\$582.8	\$616.9	\$574.1
Supplemental insurance products	265.0	234.6	234.0
GA Life of Puerto Rico	76.7	71.6	64.3
Corporate and other	<u>5.3</u>	<u>5.8</u>	<u>9.3</u>
Total operating revenues	929.8	928.9	881.7
Realized losses	<u>(9.2)</u>	<u>(45.7)</u>	<u>(51.6)</u>
)))
Total revenues per income statement	<u>\$920.6</u>	<u>\$883.2</u>	<u>\$830.1</u>

<u>Operating profit - pretax</u>				
Life and annuity products		\$ 77.4	\$ 96.8	\$134.2
Supplemental insurance products		23.7	11.5	2.8
GA Life of Puerto Rico		12.5	11.7	10.7
Corporate and other		<u>(34.8)</u>	<u>(35.4)</u>	<u>(36.2)</u>
)))	
Pretax earnings from operations		78.8	84.6	111.5
Realized losses		<u>(9.2)</u>	<u>(45.7)</u>	<u>(51.6)</u>
)))	
Total pretax income per income statement		<u>\$ 69.6</u>	<u>\$ 38.9</u>	<u>\$ 59.9</u>

F-12

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

E. INVESTMENTS

Fixed maturity investments classified as available-for-sale at December 31, consisted of the following (in millions):

	2003				2002			
	Amortized	Market	<u>Gross Unrealized</u>		Amortized	Market	<u>Gross Unrealized</u>	
	<u>Cost</u>	<u>Value</u>	<u>Gains</u>	<u>Losses</u>	<u>Cost</u>	<u>Value</u>	<u>Gains</u>	<u>Losses</u>
Fixed maturities:								
United States								
Government								
and government								
agencies								
and authorities	\$ 710.1	\$ 726.4	\$ 18.7	(\$ 2.4)	\$ 742.9	\$ 770.3	\$ 28.5	(\$ 1.1)

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-K

States, municipalities and political subdivisions	200.8	214.6	14.7	(0.9)	181.3	198.3	19.5	(2.5)
Foreign governments	28.8	29.6	1.1	(0.3)	43.0	45.4	2.4	-
Public utilities	747.3	790.8	46.7	(3.2)	573.7	583.2	23.2	(13.7)
Mortgage-backed securities	2,277.7	2,277.3	32.2	(32.6)	2,245.8	2,339.1	100.9	(7.6)
All other corporate	3,582.9	3,782.6	209.6	(9.9)	3,086.8	3,223.4	191.0	(54.4)
Redeemable preferred stocks	<u>20.7</u>	<u>23.9</u>	<u>3.2</u>	<u>-</u>	<u>20.6</u>	<u>21.4</u>	<u>1.8</u>	<u>(1.0)</u>
	<u>\$7,568.3</u>	<u>\$7,845.2</u>	<u>\$326.2</u>	<u>(\$49.3)</u>	<u>\$6,894.1</u>	<u>\$7,181.1</u>	<u>\$367.3</u>	<u>(\$80.3)</u>

The following table shows gross unrealized losses on fixed maturities by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2003.

	<u>Twelve Months or Less</u>			<u>More than Twelve Months</u>		
	<u>Unrealized Loss</u>	<u>Market Value</u>	<u>Market as % of Cost</u>	<u>Unrealized Loss</u>	<u>Market Value</u>	<u>Market as % of Cost</u>
Fixed maturities:						
United States Government and government agencies and authorities	(\$ 2.4)	\$ 154.0	98%	\$ -	\$ 0.1	100%
States, municipalities and political subdivisions	-	14.2	100	(0.9)	14.1	94
Foreign government	(0.3)	12.1	98	-	-	-
Public utilities	(2.5)	58.5	96	(0.7)	14.4	95
Mortgage-backed securities	(32.0)	1,429.4	98	(0.6)	7.6	93

All other corporate	<u>(4.5)</u>	<u>309.3</u>	<u>99</u>	<u>(5.4)</u>	<u>72.3</u>	<u>93</u>
	<u>(\$41.7)</u>	<u>\$1,977.5</u>	<u>98</u>	<u>(\$7.6)</u>	<u>\$108.5</u>	<u>93</u>
			%			%

Gross gains and losses on fixed maturity transactions included in GAFRI's Consolidated Statement of Cash Flows consisted of the following (in millions):

	<u>2003</u>	<u>2002</u>	<u>2001</u>
Gross gains	\$59.1	\$ 74.0	\$46.3
Gross losses	(74.3)	(119.2)	(95.8)

F-13

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

The table below sets forth the scheduled maturities of GAFRI's fixed maturity investments based on market value as of December 31. Asset-backed securities and other securities with sinking funds are reported at average maturity. Data based on amortized cost is generally the same. Actual maturities may differ from contractual maturities because certain securities may be called or prepaid by the issuers. Mortgage-backed securities had an average life of approximately six and one-half years at December 31, 2003 compared to five and one-fourth years at December 31, 2002.

<u>Maturity</u>	<u>2003</u>	<u>2002</u>
One year or less	2%	6%
After one year through five years	20	21
After five years through ten years	33	28
After ten years	<u>16</u>	<u>13</u>

	71	68
Mortgage-backed securities	<u>29</u>	<u>32</u>
	<u>100</u>	<u>100</u>

% %

Certain risks are inherent in connection with fixed maturity securities, including loss upon default, price volatility in reaction to changes in interest rates, and general market factors and risks associated with reinvestment of proceeds due to prepayments or redemptions in a period of declining interest rates.

At December 31, 2003, GAFRI had no single investment in excess of 10% of stockholders' equity except for certain investments guaranteed by the U.S. Government or government agencies.

Realized gains (losses) and changes in unrealized appreciation (depreciation) on fixed maturity, equity security and other investments are summarized as follows (in millions):

	<u>Fixed</u> <u>Maturities</u>	<u>Equity</u> <u>Securities</u>	<u>Other</u>	<u>Tax</u> <u>Effects</u>	<u>Total</u>
<u>2003</u>					
Realized	(\$15.2)	\$5.7	\$0.3	\$ 3.3	(\$ 5.9)
Change in unrealized	(10.1)	11.0	-	(0.4)	0.5
<u>2002</u>					
Realized	(\$45.2)	(\$0.7)	\$0.2	\$16.0	(\$29.7)
Change in unrealized	158.0	5.3	-	(55.6)	107.7
<u>2001</u>					
Realized	(\$49.5)	(\$0.8)	(\$1.3)	\$18.1	(\$33.5)
Change in unrealized	99.9	(16.2)	-	(29.2)	54.5

F-14

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

Major categories of net investment income were as follows (in millions):

<u>2003</u>	<u>2002</u>	<u>2001</u>
-------------	-------------	-------------

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-K

Fixed maturities*	\$513.8	\$529.5	\$505.6
Other	<u>2.8</u>	<u>2.8</u>	<u>2.9</u>
Total investment income	516.6	532.3	508.5
Investment expenses	<u>(5.7)</u>	<u>(4.5)</u>	<u>(2.0)</u>
)))
Net investment income	<u>\$510.9</u>	<u>\$527.8</u>	<u>\$506.5</u>

* Includes income on fixed maturities, mortgage loans, policy loans and short-term investments.

GAFRI's investment portfolio is managed by a subsidiary of AFG. Investment expenses included investment management charges related to this subsidiary amounting to \$4.4 million in 2003, \$3.3 million in 2002 and \$1.4 million in 2001.

F. GOODWILL

Effective January 1, 2002, goodwill is no longer amortized but is subject to annual impairment testing. GAFRI completed its initial test in the fourth quarter of 2002, which resulted in a \$17.7 million after-tax (\$0.41 per share) impairment charge reported by restating first quarter 2002 results for the cumulative effect of a change in accounting principle. The impairment charge recorded was primarily related to a decrease in estimated future earnings based upon lower forecasted new business sales over the next few years.

If the goodwill amortization of \$1.8 million (\$0.04 per share) in 2001 had not been expensed, net earnings for the period would have been \$38.8 million (\$0.91 per share).

Changes in the carrying value of goodwill during 2002 and 2003, by reporting segment, are presented in the following table (in millions):

	Life and <u>Annuity</u>	Supplemental <u>Insurance</u>	<u>Total</u>
Balance December 31, 2001	\$26.9	\$13.5	\$40.4
Additions	1.5	-	1.5
Transitional impairment charge	<u>(12.1)</u>	<u>(9.1)</u>	<u>(21.2)</u>
)))

Balance December 31, 2002	16.3	4.4	20.7
Goodwill related to business sold	(0.7)	-	(0.7)
Other	<u>(1.9)</u>	<u>-</u>	<u>(1.9)</u>
)	(
Balance December 31, 2003	<u>\$13.7</u>	<u>\$ 4.4</u>	<u>\$18.1</u>

a. Relates primarily to wholly-owned insurance agency subsidiary.

b. Primarily relates to subsidiaries' lawsuit settlement and purchase accounting adjustment.

F-15

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

G. UNAMORTIZED INSURANCE ACQUISITION COSTS

Unamortized insurance acquisition costs consisted of the following at December 31, (in millions):

	<u>2003</u>	<u>2002</u>
Deferred policy acquisition costs	\$671.1	\$647.8
Present value of future profits acquired	57.9	66.8
Unearned revenues	<u>(114.8)</u>	<u>(123.6)</u>
)	(
	<u>\$614.2</u>	<u>\$591.0</u>

A progression of GAFRI's present value of future profits acquired ("PVFP") is as follows (in millions):

	<u>2003</u>	<u>2002</u>	<u>2001</u>
Beginning balance	\$ 66.8	\$71.2	\$93.4
Addition due to acquisitions	-	15.2	-
Interest accrued	4.7	5.2	6.7
Amortization	(13.2)	(17.0)	(15.9)

Other (a)	<u>(0.4)</u>	<u>(7.8)</u>	<u>(13.0)</u>
)))
	<u>\$ 57.9</u>	<u>\$66.8</u>	<u>\$71.2</u>
PVFP gross (original) carrying amount	\$123.7	\$124.1	
Accumulated amortization, net of interest accrued	<u>(65.8)</u>	<u>(57.3)</u>	
))	
	<u>\$ 57.9</u>	<u>\$ 66.8</u>	

a. 2003 amount relates to purchase accounting adjustment for subsidiary acquired; 2002 amount primarily reflects reinsurance ceding of 90% of Manhattan's life business; 2001 amount primarily reflects reinsurance ceding of 80% of Loyal's life business.

The interest accrual rates used range primarily from 5% to 7%. During each of the next five years, the PVFP is expected to decrease at a rate of approximately 14% of the balance at the beginning of each respective year.

H. NOTES PAYABLE

Notes payable consisted of the following at December 31 (in millions):

	<u>2003</u>	<u>2002</u>
Direct obligations of GAFRI	\$ 1.5	\$ 1.7
Obligations of AAG Holding (guaranteed by GAFRI):		
6-7/8% Senior Notes due 2008	100.0	100.0
7-1/2% Senior Debentures due 2033	112.5	-
Bank Credit Line	<u>-</u>	<u>148.6</u>
Total	<u>\$214.0</u>	<u>\$250.3</u>

AAG Holding has a floating rate \$155 million unsecured credit agreement. Loans under the credit agreement mature on December 31, 2004. At December 31, 2003, there were no borrowings outstanding under the agreement. At December 31, 2002, the weighted-average interest rate on amounts borrowed under its credit line was 2.18%.

In November 2003, the Company issued \$112.5 million principal amount of 7-1/2%, 30 year Senior Debentures and used the majority of the proceeds to pay down all of the remaining amounts borrowed under the bank credit line.

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

In December 2003, GAFRI entered into an interest rate swap agreement under which it effectively converted the interest rate on \$40 million principal amount of its 6-7/8% Senior Notes due 2008 from fixed to floating rate interest. At December 31, 2003, the effective interest rate on this debt was approximately 4.1%. The Company expects to enter into similar swap agreements in 2004 covering up to an additional \$60 million principal amount of these notes.

In January 2004, the Company issued additional Senior Debentures, using the proceeds to redeem its 9-1/4% trust preferred securities at face value and to repurchase a portion of its outstanding 8-7/8% preferred securities. (See Note R)

At December 31, 2003, scheduled principal payments on debt for the subsequent five years were as follows (in millions):

<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
\$0.2	\$0.2	\$0.2	\$0.1	\$100.1

Cash interest payments were \$10.7 million in 2003, \$10.2 million in 2002 and \$9.9 million in 2001.

I. PAYABLE TO SUBSIDIARY TRUSTS (ISSUERS OF PREFERRED SECURITIES)

Wholly-owned subsidiary trusts of GAFRI have issued preferred securities and, in turn, purchased from their parent company 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.

In accordance with FIN 46, VIEs that issued preferred securities subsequent to January 31, 2003, are not consolidated for reporting purposes. Beginning December 31, 2003, previously consolidated subsidiary trusts were deconsolidated for reporting purposes under FIN 46. Accordingly, the subordinated debt due the trusts is shown as a liability in GAFRI's balance sheet instead of the preferred securities, which were previously reported as "Mandatorily redeemable preferred securities of subsidiary trusts." The preferred securities supported by the payable to subsidiary trusts consisted of the following at December 31, 2003:

<u>Date of Issuance</u>	<u>Issue (Maturity Date)</u>	<u>Amount Outstanding</u>	<u>Optional Redemption Dates</u>
November 1996	9-1/4% TOPrS (2026)	\$65,012,500	Redeemed in March 2004
March 1997	8-7/8% Pfd (2027)	70,000,000	On or after 3/1/2007
May 2003	7.35% Pfd (2033)	20,000,000	On or after 5/15/2008

In May 2003, a newly formed wholly-owned subsidiary trust of GAFRI issued \$20 million of trust preferred securities for proceeds of \$20 million before issue costs of approximately \$600,000. Until May 2008, these securities pay interest quarterly at an annual rate of 7.35%, after which the interest rate will reset quarterly to an annual rate of Libor plus 4.1%. The proceeds from this transaction were used primarily to pay down bank debt.

In the first quarter of 2004, GAFRI redeemed all of its 9-1/4% trust preferred securities at face value and repurchased a portion of its 8-7/8% preferred securities. (See Note R)

Cash payments with respect to the preferred securities were \$13.7 million, \$13.0 million and \$18.4 million in 2003, 2002 and 2001, respectively.

F-17

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

J. STOCKHOLDERS' EQUITY

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

GAFRI's dividend paying capability is limited by certain customary debt covenants to amounts based on cumulative earnings and losses, debt ratios and other items.

The change in net unrealized gains on marketable securities included the following (in millions):

	<u>2003</u>			<u>2002</u>			<u>2001</u>		
	<u>Pretax</u>	<u>Taxes</u>	<u>Net</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	(\$20.0)	\$ 6.9	(\$13.1)	\$ 90.6	(\$30.1)	\$60.5	\$ 12.3	(\$ 4.2)	\$ 8.1
Transfer to trading securities	(16.1)	5.6	(10.5)	-	-	-	-	-	-
Adoption of EITF 99-20	-	-	-	-	-	-	8.4	(2.9)	5.5
Realized losses on securities	<u>9.6</u>	<u>(3.4)</u>	<u>6.2</u>	<u>45.7</u>	<u>(16.0)</u>	<u>29.7</u>	<u>49.8</u>	<u>(17.5)</u>	<u>32.3</u>
)))		
Change in net unrealized gains (losses) on marketable securities		<u>\$ 9.1</u>	<u>(\$17.4)</u>	<u>\$136.3</u>	<u>(\$46.1)</u>	<u>\$90.2</u>	<u>\$ 70.5</u>	<u>(\$24.6)</u>	<u>\$45.9</u>
	<u>(\$26.5)</u>								

In September 2003, GAFRI raised approximately \$60 million through the sale of 4.3 million common shares in a rights offering. In the offering, AFG purchased 3.5 million shares and Carl H. Lindner, the Company's Chairman of the Board, purchased 0.4 million shares.

At December 31, 2003, there were 5.3 million shares of GAFRI Common Stock reserved for issuance under GAFRI's stock option plans for employees and directors. Under these 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.

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-K

Data for GAFRI's Stock Option Plan is presented below:

	<u>2003</u>		<u>2002</u>		<u>2001</u>	
	<u>Shares</u>	<u>Average Exercise Price</u>	<u>Shares</u>	<u>Average Exercise Price</u>	<u>Shares</u>	<u>Average Exercise Price</u>
Outstanding at beginning of year	3,265,185	\$17.06	3,139,159	\$16.83	2,869,462	\$16.56
Granted	439,273	\$13.60	487,752	\$17.47	576,500	\$17.96
Forfeited	(228,100)	\$17.33	(149,200)	\$18.76	(237,477)	\$17.34
Exercised	<u>(151,956)</u>	\$13.45	<u>(212,526)</u>	\$13.37	<u>(69,326)</u>	\$13.51
)			
Outstanding at end of year	<u>3,324,402</u>	\$16.75	<u>3,265,185</u>	\$17.06	<u>3,139,159</u>	\$16.83
Options exercisable at year-end	<u>2,095,833</u>	\$17.19	<u>1,952,654</u>	\$16.72	<u>1,821,727</u>	\$16.03
Options available for grant at year-end	<u>1,364,065</u>		<u>825,238</u>		<u>1,163,790</u>	

The following table summarizes information about stock options outstanding at December 31, 2003:

	<u>Options Outstanding</u>			<u>Options Exercisable</u>		
	<u>Shares</u>	<u>Average Exercise Price</u>	<u>Average Remaining Life</u>	<u>Shares</u>	<u>Average Exercise Price</u>	
\$13.25 - \$15.00	1,688,826	\$13.87	5.4 years	1,092,713	\$13.82	
\$15.01 - \$18.00	867,299	\$17.65	7.7 years	276,460	\$17.69	
\$18.01 - \$21.00	37,203	\$19.74	5.8 years	25,081	\$20.17	

\$21.01 - 731,074 \$22.19 4.7 years 701,579 \$22.14
 \$24.38

F-18

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

K. INCOME TAXES

The following is a reconciliation of income taxes at the statutory rate of 35% and income taxes as shown in the Consolidated Income Statement (in millions).

	<u>2003</u>	<u>2002</u>	<u>2001</u>
Earnings before income taxes:			
Operating			
Domestic	\$57.4	\$27.0	\$48.9
Foreign	12.2	11.9	11.0
Cumulative effect of accounting changes	<u>-</u>	<u>(21.2)</u>	<u>(8.4)</u>
))	
Earnings before income taxes	<u>\$69.6</u>	<u>\$17.7</u>	<u>\$51.5</u>
Tax computed at statutory rate	\$24.4	\$ 6.2	\$18.0
Effect of:			
NOL utilization	-	(3.3)	-
Foreign operations	(4.5)	(4.6)	(3.3)
Goodwill	-	3.9	-
Other, net	<u>-</u>	<u>(0.7)</u>	<u>(0.4)</u>
))	
Total provision (all current)	19.9	1.5	14.3
Amounts applicable to accounting changes	<u>-</u>	<u>3.5</u>	<u>2.9</u>
Provision for income tax as shown in Consolidated Income Statement	<u>\$19.9</u>	<u>\$ 5.0</u>	<u>\$17.2</u>

Included in its consolidated tax provision is tax expense of \$0.6 million in 2003, zero in 2002 and \$0.4 million in 2001 related to GAFRI's operations in Puerto Rico.

The significant components of deferred tax assets and liabilities, excluding the effects of unrealized gains and losses on marketable securities, included in the Consolidated Balance Sheet were as follows (in millions):

	<u>December 31.</u>	
	<u>2003</u>	<u>2002</u>
Deferred tax assets:		
Net operating/capital loss carryforwards	\$ 3.3	\$ 4.0
Accrued expenses	17.8	16.7
Investment securities	35.9	74.2
Policyholder liabilities	38.2	12.7
Capitalized assets	13.1	9.2
Deferred tax liabilities:		
Unamortized insurance acquisition costs	(159.3)	(172.3)

At December 31, 2003, GAFRI had net operating loss carryforwards for federal income tax purposes of approximately \$4 million, which are scheduled to expire primarily in 2005 and 2006. In addition, GAFRI had net capital loss carryforwards for federal income tax purposes of approximately \$5.3 million, which are scheduled to expire in 2006 and 2008.

F-19

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

L. LEASES

Future minimum lease payments, net of sublease revenues, under operating leases having initial or remaining non-cancelable lease terms in excess of one year at December 31, 2003 are payable as follows: 2004 - \$7.9 million; 2005 - \$4.1 million; 2006 - \$3.2 million; 2007 - \$1.9 million; 2008 - \$0.4 million; 2009 and beyond - \$0.2 million. In addition, GAFRI has 99-year land leases (approximately 93 years remaining) at one of its real estate properties. Minimum lease payments under these leases are expected to be approximately \$90,000 in 2004 and are adjusted annually for inflation.

Rental expense for operating leases, net of sublease revenues, was \$7.0 million in 2003 and 2002 and \$5.5 million in 2001.

M. EARNINGS PER SHARE

The number of common shares outstanding used in calculating diluted earnings per share in 2003, 2002 and 2001 include 0.1 million shares, 0.3 million shares and 0.4 million shares, respectively, for the effect of the assumed exercise of GAFRI's stock options.

N. CONTINGENCIES

The Company is continuing its clean-up activities at certain of its former manufacturing operations and third-party sites, in some cases in accordance with consent agreements with federal and state environmental agencies. Changes in regulatory standards, the number and financial resources of other potentially responsible parties, further investigations, the range of costs for remediation alternatives, changing technology and the time period over which these matters develop may affect estimated costs in the future. At December 31, 2003, based on prior costs and discussions with independent environmental consultants, the Company believes the remaining aggregate cost of environmental work at all sites for which it has responsibility will range from \$5.8 million to \$25.7 million. A significant portion of the known environmental costs are associated with long term remediation and monitoring. Management believes that reserves recorded are sufficient to satisfy the known liabilities and that the ultimate cost will not, individually, or in the aggregate, have a material adverse effect on the financial condition or results of operations of GAFRI. The Company's reserve for environmental costs was \$5.9 million at December 31, 2003 and \$6.6 million at December 31, 2002.

O. STATUTORY INFORMATION; RESTRICTIONS ON TRANSFERS OF FUNDS AND ASSETS OF SUBSIDIARIES

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):

	<u>2003</u>	<u>2002</u>	<u>2001</u>
Capital and surplus	\$515.4	\$418.6	\$388.4
Asset valuation reserve	52.5	61.2	76.9
Interest maintenance reserve	21.5	26.0	11.0
Pretax income from operations	\$ 84.5	\$ 60.3	\$131.5
Net income (loss)	56.5	(23.6)	25.2

F-20

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

Dividends that 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 these restrictions, GALIC and GAPR may pay \$56.5 million and \$32.9 million, respectively, in dividends in 2004 without prior approval. In 2003, GALIC paid \$11.0 million in dividends and GAPR paid \$1.2 million in dividends to GAFRI. Also in 2003, GAFRI made capital contributions to GALIC of \$47.2 million.

Securities owned by insurance subsidiaries having a carrying value of \$43 million at December 31, 2003 were on deposit as required by regulatory authorities.

P. ADDITIONAL INFORMATION

Related Party Transactions

GAFRI had extended a line of credit in 1996 to a company owned by AFG and brothers of GAFRI's Chairman. Under the agreement, this company could borrow up to \$8 million at 13%. At December 31, 2001, \$6.4 million was due under the credit line. In September 2002, the company was sold to a third party and GAFRI's line of credit was repaid and terminated.

In 2000, GAFRI received an \$18.9 million subordinated note in connection with the sale of its minority ownership interest in an ethanol company back to that company. Following the sale, GAFRI's Chairman beneficially owned 100% of the ethanol company. The note bore interest at 12-1/4% and was repaid as follows: \$6 million in 2001, \$1 million in 2002 and the remaining \$11.9 million in 2003. The ethanol company also owed GAFRI \$4.0 million under a subordinated note bearing interest at 14%, which was repaid in December 2003.

Other income includes approximately \$0.4 million in 2001 of payments from a subsidiary of AFG for the rental of an office building owned by GALIC. This building was sold in 2001 to an unaffiliated party.

In order to take advantage of operational efficiencies, GAFRI shares certain information technology services with AFG. GAFRI made approximately \$3 million in payments to AFG for such services in 2003 and 2002 and \$7 million in 2001.

During 2003, GAFRI invested \$12 million (and another AFG subsidiary invested \$8 million) in preferred stock and warrants of an unrelated party who utilized the proceeds to repay bank loans, including \$3.4 million in loans and fees to the Provident Bank. GAFRI's Chairman and members of his immediate family own approximately one-fourth of Provident's parent company.

F-21

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

Fair Value of Financial Instruments

The following table shows the carrying value and estimated fair value of GAFRI's financial instruments at December 31 (in millions):

	<u>2003</u>		<u>2002</u>	
	Carrying <u>Value</u>	Estimated <u>Fair Value</u>	Carrying <u>Value</u>	Estimated <u>Fair Value</u>
<u>Assets</u>				
Fixed maturity investments	\$8,040.6	\$8,040.6	\$7,181.1	\$7,181.1
Equity securities	83.4	83.4	73.5	73.5
<u>Liabilities</u>				
Annuity benefits accumulated	\$6,974.6	\$6,780.6	\$6,453.9	\$6,284.4

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-K

Notes payable	214.0	220.4	250.3	240.3
Payable to subsidiary trusts	155.0	160.2	N/A	N/A
Trust preferred securities	N/A	N/A	\$ 142.9	\$ 140.6
Stockholders' equity	\$ 942.5	\$ 762.0	\$ 851.9	\$ 730.3

When available, fair values are based on prices quoted in the most active market for each security. If quoted prices are not available, fair value is estimated based on present values, discounted cash flows, fair value of comparable securities or similar methods. The fair value of the liability for annuities in the payout phase is assumed to be the present value of the anticipated cash flows, discounted at current interest rates. Fair value of annuities in the accumulation phase is assumed to be the policyholders' cash surrender amount. Fair value of stockholders' equity is based on the quoted market price of GAFRI's Common Stock.

F-22

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

Unrealized Gains on Marketable Securities, Net

In addition to adjusting equity securities considered available-for-sale to fair value, SFAS 115, "Accounting for Certain Investments in Debt and Equity Securities", requires that certain other balance sheet amounts be adjusted to the extent that unrealized gains and losses from securities would result in adjustments had these gains or losses actually been realized. The components of the Consolidated Balance Sheet caption "Unrealized gains on marketable securities, net" in stockholders' equity are summarized as follows (in millions):

	Unadjusted Asset (Liability)	Effect of SFAS 115	Adjusted Asset (Liability)
<u>2003</u>			
Fixed maturities	\$7,568.3	\$276.9	\$7,845.2
Equity securities	45.9	37.5	83.4
Unamortized insurance acquisition costs, net	672.9	(58.7)	614.2
Annuity benefits accumulated	(6,965.7)	(8.9)	(6,974.6)
Deferred taxes on unrealized gains	-	<u>(84.2)</u>	(84.2)
)	
Unrealized gains		<u>\$162.6</u>	

2002

Fixed maturities	\$6,894.1	\$287.0	\$7,181.1
Equity securities	47.0	26.5	73.5
Unamortized insurance acquisition costs, net	622.0	(31.0)	591.0
Annuity benefits accumulated	(6,444.7)	(9.2)	(6,453.9)
Deferred taxes on unrealized losses	-	<u>(93.3)</u>	(93.3)
)	
Unrealized gains		<u>\$180.0</u>	

Pension Plan

The Company has a defined benefit pension plan (the "Plan") covering former U.S. employees of its discontinued manufacturing operations. Amounts included in GAFRI's financial statements related to the Plan are immaterial. Pension benefits are based upon past service with the Company and compensation levels. Contributions are made by the Company in amounts necessary to satisfy requirements of the Employee Retirement Income Security Act.

F-23

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

Accident and Health Reserves

The following table provides an analysis of changes in the liability for unpaid claims included in GAFRI's accident and health reserves over the past three years on a GAAP basis (in millions):

	<u>2003</u>	<u>2002</u>	<u>2001</u>
Balance at beginning of period	\$ 89.4	\$ 96.6	\$110.2
Provision for benefits occurring in the current year	137.3	134.1	134.7
Net increase (decrease) in provision for benefits of prior years (a)	<u>(6.5)</u>	<u>(5.2)</u>	<u>0.9</u>
))	
Total benefits incurred	130.8	128.9	135.6

Payments for losses of:			
Current year	(92.5)	(90.6)	(91.3)
Prior years	<u>(39.4)</u>	<u>(45.6)</u>	<u>(61.3)</u>
)))
Total payments	(131.9)	(136.2)	(152.6)
Reserves of businesses acquired	<u>-</u>	<u>0.1</u>	<u>3.4</u>
Gross unpaid accident and health claims included in life, accident and health reserves in the Balance Sheet	<u>\$ 88.3</u>	<u>\$ 89.4</u>	<u>\$ 96.6</u>

- a. The decrease in the provision for benefits of prior years for 2003 and 2002 is due primarily to better than expected results in the medicare supplement line of business.

Reinsurance

The Company has reinsured approximately \$28 billion and \$29 billion in face amount of life insurance as of December 31, 2003 and 2002, respectively. Life premiums ceded were \$85 million, \$61 million and \$49 million for 2003, 2002 and 2001, respectively.

F-24

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

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)

	AAG	CONS	ALL OTHER	CONS		
<u>DECEMBER 31, 2003</u>	<u>GAFRI</u>	<u>HOLDING</u>	<u>TRUSTS</u>	<u>SUBS</u>	<u>ENTRIES</u>	<u>CONS</u>

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-K

Assets

Cash and investments	\$ 0.7	\$ -	\$ -	\$ 8,599.3	(\$ 1.2)	\$ 8,598.8
Investment in subsidiaries	893.7	1,273.1	-	15.1	(2,181.9)	-
Notes receivable from AAG Holding	102.8	-	-	-	(102.8)	-
Unamortized insurance acquisition costs, net	-	-	-	614.2	-	614.2
Other assets	19.5	4.8	-	346.6	42.0	412.9
Variable annuity assets (separate accounts)	<u>-</u>	<u>-</u>	<u>-</u>	<u>568.4</u>	<u>-</u>	<u>568.4</u>
	<u>\$1,016.7</u>	<u>\$1,277.9</u>	<u>\$ -</u>	<u>\$10,143.6</u>	<u>(\$2,243.9)</u>	<u>\$10,194.3</u>

Liabilities and Capital

Insurance liabilities	\$ -	\$ -	\$ -	\$ 7,999.2	(\$ 5.7)	\$ 7,993.5
Notes payable to GAFRI	-	102.4	-	0.4	(102.8)	-
Other notes payable	1.5	212.5	-	-	-	214.0
Payable to subsidiary trusts	-	175.3	-	-	(20.3)	155.0
Other liabilities	72.7	18.3	-	232.7	(2.8)	320.9
Variable annuity liabilities (separate accounts)	<u>-</u>	<u>-</u>	<u>-</u>	<u>568.4</u>	<u>-</u>	<u>568.4</u>
	74.2	508.5	-	8,800.7	(131.6)	9,251.8
Total stockholders' equity	<u>942.5</u>	<u>769.4</u>	<u>-</u>	<u>1,342.9</u>	<u>(2,112.3)</u>	<u>942.5</u>
	<u>\$1,016.7</u>	<u>\$1,277.9</u>	<u>\$ -</u>	<u>\$10,143.6</u>	<u>(\$2,243.9)</u>	<u>\$10,194.3</u>

DECEMBER 31, 2002

Assets

Cash and investments	\$ 3.5	\$ -	\$ -	\$ 7,967.3	(\$ 1.6)	\$ 7,969.2
Investment in subsidiaries	801.1	1,193.4	-	0.9	(1,995.4)	-

<u>DECEMBER 31, 2003</u>	<u>GAFRI HOLDING TRUSTS</u>			<u>ALL OTHER SUBS ENTRIES</u>		<u>CONS</u>
Revenues						
:						
Life, accident and health premiums	\$ -	\$ -	\$ -	\$331.9	\$ -	\$331.9
Net investment income and other revenue	19.3	-	-	580.5	(11.1)	588.7
Interest income on AAG Holding notes	-	-	14.0	-	(14.0)	-
Equity in earnings of subsidiaries	<u>60.4</u>	<u>91.4</u>	<u>-</u>	<u>-</u>	<u>(151.8)</u>	<u>-</u>
)		
	79.7	91.4	14.0	912.4	(176.9)	920.6
Costs and Expenses:						
Insurance benefits and expenses	-	-	-	667.0	-	667.0
Interest expense on AAG Holding notes	-	14.0	-	-	(14.0)	-
Other interest and debt expenses	0.1	21.7	-	-	3.1	24.9
Other expenses	<u>10.0</u>	<u>7.3</u>	<u>-</u>	<u>143.6</u>	<u>(1.8)</u>	<u>159.1</u>
)		
	10.1	43.0	-	810.6	(12.7)	851.0
Earnings before income taxes	69.6	48.4	14.0	101.8	(164.2)	69.6
Provision for income taxes	<u>19.9</u>	<u>16.3</u>	<u>-</u>	<u>30.2</u>	<u>(46.5)</u>	<u>19.9</u>
)		
Net income	<u>\$49.7</u>	<u>\$32.1</u>	<u>\$14.0</u>	<u>\$ 71.6</u>	<u>(\$117.7)</u>	<u>\$ 49.7</u>

YEAR ENDED
DECEMBER 31, 2002

Revenues

:

Life, accident and health premiums	\$ -	\$ -	\$ -	\$305.7	\$ -	\$305.7
------------------------------------	------	------	------	---------	------	---------

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-K

Net investment income and other revenue	21.1	-	-	575.4	(19.0)	577.5
Interest income on AAG Holding notes	-	-	14.0	-	(14.0)	-
Equity in earnings of subsidiaries	<u>27.4</u>	<u>61.7</u>	<u>-</u>	<u>-</u>	<u>(89.1)</u>	<u>-</u>
)		
	48.5	61.7	14.0	881.1	(122.1)	883.2
Costs and Expenses:						
Insurance benefits and expenses	-	-	-	660.8	-	660.8
Interest expense on AAG Holding notes	-	14.0	-	-	(14.0)	-
Other interest and debt expenses	0.1	20.4	-	-	3.3	23.8
Other expenses	<u>9.5</u>	<u>9.7</u>	<u>-</u>	<u>148.9</u>	<u>(8.4)</u>	<u>159.7</u>
)		
	9.6	44.1	-	809.7	(19.1)	844.3
Earnings before income taxes	38.9	17.6	14.0	71.4	(103.0)	38.9
Provision for income taxes	<u>5.0</u>	<u>5.5</u>	<u>-</u>	<u>18.3</u>	<u>(23.8)</u>	<u>5.0</u>
)		
Net operating earnings	33.9	12.1	14.0	53.1	(79.2)	33.9
Accounting change, net	<u>(17.7)</u>	<u>-</u>	<u>-</u>	<u>(17.7)</u>	<u>17.7</u>	<u>(17.7)</u>
)))	
Net income	<u>\$16.2</u>	<u>\$12.1</u>	<u>\$14.0</u>	<u>\$ 35.4</u>	<u>(\$ 61.5)</u>	<u>\$ 16.2</u>

F-26

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

CONDENSED CONSOLIDATING INCOME STATEMENT

(In millions)

YEAR ENDED	AAG	CONS	ALL	CONS		
			OTHER	ENTRIES		
<u>DECEMBER 31, 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	\$ -	\$ -	\$ -	\$280.1	\$ -	\$280.1
Net investment income and other revenue	25.6	-	-	544.6	(20.2)	550.0
Interest income on AAG Holding notes	-	-	18.2	-	(18.2)	-
Equity in earnings of subsidiaries	<u>51.7</u>	<u>89.0</u>	<u>-</u>	<u>-</u>	<u>(140.7)</u>	<u>-</u>
)		
	77.3	89.0	18.2	824.7	(179.1)	830.1
Costs and Expenses:						
Insurance benefits and expenses	-	-	-	587.0	-	587.0
Interest expense on AAG Holding notes	-	18.2	-	-	(18.2)	-
Other interest and debt expenses	0.1	20.4	-	0.1	7.3	27.9
Other expenses	<u>17.3</u>	<u>8.8</u>	<u>-</u>	<u>139.0</u>	<u>(9.8)</u>	<u>155.3</u>
)		
	17.4	47.4	-	726.1	(20.7)	770.2
Earnings before income taxes	59.9	41.6	18.2	98.6	(158.4)	59.9
Provision for income taxes	<u>17.2</u>	<u>13.9</u>	<u>-</u>	<u>28.8</u>	<u>(42.7)</u>	<u>17.2</u>
)		
Net operating earnings	42.7	27.7	18.2	69.8	(115.7)	42.7
Accounting change, net	<u>(5.5)</u>	<u>-</u>	<u>-</u>	<u>(5.5)</u>	<u>5.5</u>	<u>(5.5)</u>
)))	
Net income	<u>\$ 37.2</u>	<u>\$27.7</u>	<u>\$18.2</u>	<u>\$ 64.3</u>	<u>(\$110.2)</u>	<u>\$ 37.2</u>

F-27

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

YEAR ENDED DECEMBER 31, 2003

(In millions)

	AAG	CONS	ALL	CONS		
	GAFRI	HOLDING	TRUSTS	OTHER	ENTRIES	CONS
				SUBS		
Cash Flows from Operating Activities:						
Net income	\$49.7	\$ 32.1	\$14.0	\$ 71.6	(\$117.7)	\$ 49.7
Adjustments:						
Equity in net earnings of subsidiaries	(43.8)	(61.1)	-	-	104.9	-
Increase in life, accident and health reserves	-	-	-	118.8	-	118.8
Benefits to annuity policyholders	-	-	-	295.0	-	295.0
Amortization of insurance acquisition costs	-	-	-	90.5	-	90.5
Depreciation and amortization	-	3.5	-	16.4	-	19.9
Realized losses on investments	-	-	-	9.2	-	9.2
Increase in insurance acquisition costs	-	-	-	(148.2)	-	(148.2)
Increase in reinsurance recoverable	-	-	-	(72.6)	-	(72.6)
Decrease in other assets	2.8	-	-	13.9	-	16.7
Decrease in other liabilities	(2.8)	-	-	(11.4)	-	(14.2)
Increase in payable to affiliates, net	3.8	-	-	28.0	-	31.8
Capital contribution from parent (to subsidiary)	(213.1)	165.9	-	47.2	-	-
Dividends from subsidiaries (to parent)	142.5	(130.3)	-	(12.2)	-	-
Other, net	<u>0.1</u>	<u>18.4</u>	<u>-</u>	<u>(5.5)</u>	<u>(1.2)</u>	<u>11.8</u>
	<u>(60.8)</u>	<u>28.5</u>	<u>14.0</u>	<u>440.7</u>	<u>(14.0)</u>	<u>408.4</u>
))))))
Cash Flows from Investing Activities:						
Purchases of investments and other assets	-	-	-	(5,563.5)	-	(5,563.5)
Maturities and redemptions of fixed maturity investments	-	-	-	1,190.8	-	1,190.8
Sales of investments and other assets	1.2	-	-	3,478.8	-	3,480.0

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-K

Increase in policy loans	<u>-</u>	<u>-</u>	<u>-</u>	<u>(0.7)</u>	<u>-</u>	<u>(0.7)</u>
))	
	<u>1.2</u>	<u>-</u>	<u>-</u>	<u>(894.6)</u>	<u>-</u>	<u>(893.4)</u>
))	
Cash Flows from Financing Activities:						
Fixed annuity receipts	-	-	-	788.2	-	788.2
Annuity surrenders, benefits and withdrawals	-	-	-	(572.0)	-	(572.0)
Net transfers from variable annuity assets	-	-	-	1.0	-	1.0
Additions to notes payable	-	116.7	-	-	-	116.7
Reductions of notes payable	(0.2)	(156.6)	-	-	-	(156.8)
Issuance of Common Stock	63.0	-	-	-	-	63.0
Trust dividend requirements	-	-	(14.0)	-	14.0	-
Issuance of trust preferred securities	-	19.4	-	-	-	19.4
Repurchase of trust preferred securities	-	(8.0)	-	-	-	(8.0)
Cash dividends paid	<u>(4.7)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(4.7)</u>
))))))
	<u>58.1</u>	<u>(28.5)</u>	<u>(14.0)</u>	<u>217.2</u>	<u>14.0</u>	<u>246.8</u>
))))))
Net decrease in cash and short-term investments	(1.5)	-	-	(236.7)	-	(238.2)
Beginning cash and short-term investments	<u>1.9</u>	<u>-</u>	<u>-</u>	<u>400.3</u>	<u>-</u>	<u>402.2</u>
Ending cash and short-term investments	<u>\$ 0.4</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 163.6</u>	<u>\$ -</u>	<u>\$ 164.0</u>

F-28

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

YEAR ENDED DECEMBER 31, 2002

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-K

(In millions)

	AAG	CONS	ALL	CONS		
	<u>GAFRI</u>	<u>HOLDING</u>	<u>TRUSTS</u>	<u>OTHER</u>	<u>ENTRIES</u>	<u>CONS</u>
				<u>SUBS</u>		
Cash Flows from Operating Activities:						
Net income	\$ 16.2	\$ 12.1	\$ 14.0	\$ 35.4	(\$ 61.5)	\$ 16.2
Adjustments:						
Cumulative effect of accounting change	17.7	-	-	17.7	(17.7)	17.7
Equity in net earnings of subsidiaries	(29.0)	(42.2)	-	-	71.2	-
Increase in life, accident and health reserves	-	-	-	70.0	-	70.0
Benefits to annuity policyholders	-	-	-	301.0	-	301.0
Amortization of insurance acquisition costs	-	-	-	114.5	-	114.5
Depreciation and amortization	0.1	0.3	-	16.4	-	16.8
Realized losses on investments	0.1	-	-	45.6	-	45.7
Increase in insurance acquisition costs	-	-	-	(170.2)	-	(170.2)
Increase in reinsurance recoverable	-	-	-	(24.4)	-	(24.4)
Decrease (increase) in other assets	(1.0)	-	-	1.1	-	0.1
Increase (decrease) in other liabilities	5.1	-	-	(54.3)	-	(49.2)
Increase (decrease) in payable to affiliates, net	(2.7)	-	-	(27.1)	-	(29.8)
Capital contribution from parent (to subsidiary)	(59.0)	25.0	-	34.0	-	-
Dividends from subsidiaries (to parent)	47.7	(22.2)	-	(25.5)	-	-
Other, net	<u>0.9</u>	<u>(0.5)</u>	<u>-</u>	<u>11.6</u>	<u>(6.0)</u>	<u>6.0</u>
))		
	<u>(3.9)</u>	<u>(27.5)</u>	<u>14.0</u>	<u>345.8</u>	<u>(14.0)</u>	<u>314.4</u>
))		
Cash Flows from Investing Activities:						
Purchases of investments and other assets	(0.3)	-	-	(3,904.9)	-	(3,905.2)
Purchase of subsidiary, net	-	-	-	(43.6)	-	(43.6)
Maturities and redemptions of fixed maturity investments	6.4	-	-	1,282.9	-	1,289.3
Sales of investments and other assets	2.3	-	-	2,200.2	-	2,202.5
Decrease in policy loans	<u>-</u>	<u>-</u>	<u>-</u>	<u>4.5</u>	<u>-</u>	<u>4.5</u>

	<u>8.4</u>	<u>-</u>	<u>-</u>	<u>(460.9)</u>	<u>-</u>	<u>(452.5)</u>
))	
Cash Flows from Financing Activities:						
Fixed annuity receipts	-	-	-	874.5	-	874.5
Annuity surrenders, benefits and withdrawals	-	-	-	(549.9)	-	(549.9)
Net transfers from variable annuity assets	-	-	-	20.8	-	20.8
Additions to notes payable	-	27.5	-	-	-	27.5
Reductions of notes payable	(0.2)	-	-	-	-	(0.2)
Issuance of Common Stock	2.6	-	-	-	-	2.6
Retirement of Common Stock	(1.6)	-	-	-	-	(1.6)
Trust dividend requirements	-	-	(14.0)	-	14.0	-
Cash dividends paid	<u>(4.3)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(4.3)</u>
))	
	<u>(3.5)</u>	<u>27.5</u>	<u>(14.0)</u>	<u>345.4</u>	<u>14.0</u>	<u>369.4</u>
))				
Net increase in cash and short-term investments	1.0	-	-	230.3	-	231.3
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>\$ 1.9</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 400.3</u>	<u>\$ -</u>	<u>\$ 402.2</u>

F-29

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

YEAR ENDED DECEMBER 31, 2001

(In millions)

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-K

	AAG	CONS	ALL	CONS		
			OTHER			
	<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	\$ 37.2	\$ 27.7	\$18.2	\$ 64.3	(\$110.2)	\$ 37.2
Adjustments:						
Cumulative effect of accounting change	5.5	-	-	5.5	(5.5)	5.5
Equity in net earnings of subsidiaries	(37.5)	(60.2)	-	-	97.7	-
Increase in life, accident and health reserves	-	-	-	58.0	-	58.0
Benefits to annuity policyholders	-	-	-	294.7	-	294.7
Amortization of insurance acquisition costs	-	-	-	79.3	-	79.3
Depreciation and amortization	0.7	4.9	-	6.8	-	12.4
Realized losses on investments	3.3	-	-	48.3	-	51.6
Increase in insurance acquisition costs	-	-	-	(137.7)	-	(137.7)
Increase in reinsurance recoverable	-	-	-	(43.1)	-	(43.1)
Decrease (increase) in other assets	9.3	-	-	(5.0)	-	4.3
Increase (decrease) in other liabilities	1.5	-	-	(11.2)	-	(9.7)
Increase (decrease) in payable to affiliates, net	(1.6)	-	-	15.0	-	13.4
Capital contribution from parent (to subsidiary)	(150.6)	123.1	-	27.5	-	-
Dividends from subsidiaries (to parent)	129.9	(111.9)	-	(18.0)	-	-
Other, net	<u>0.9</u>	<u>18.8</u>	<u>-</u>	<u>(36.8)</u>	<u>1.3</u>	<u>(15.8)</u>
))	
	<u>(1.4)</u>	<u>2.4</u>	<u>18.2</u>	<u>347.6</u>	<u>(16.7)</u>	<u>350.1</u>
))		
Cash Flows from Investing Activities:						
Purchases of investments and other assets	(6.4)	-	-	(1,731.4)	-	(1,737.8)
Maturities and redemptions of fixed maturity investments	-	-	-	582.0	-	582.0
Sales of investments and other assets	7.7	-	-	893.0	-	900.7
Decrease in intercompany notes receivable	1.5	-	-	-	(1.5)	-
Decrease in policy loans	<u>-</u>	<u>-</u>	<u>-</u>	<u>2.2</u>	<u>-</u>	<u>2.2</u>

	<u>2.8</u>	<u>-</u>	<u>-</u>	<u>(254.2)</u>	<u>(1.5)</u>	<u>(252.9)</u>
)))	
Cash Flows from Financing Activities:						
Fixed annuity receipts	-	-	-	616.6	-	616.6
Annuity surrenders, benefits and withdrawals	-	-	-	(622.5)	-	(622.5)
Net transfers to variable annuity assets	-	-	-	(0.4)	-	(0.4)
Additions to notes payable	0.1	87.4	-	-	-	87.5
Reductions of notes payable	(0.2)	(14.8)	-	(1.4)	-	(16.4)
Issuance of Common Stock	1.4	-	-	-	-	1.4
Retirement of Common Stock	(0.8)	-	-	-	-	(0.8)
Trust dividend requirements	-	-	(18.2)	-	18.2	-
Repurchase of trust preferred securities	-	(75.0)	-	-	-	(75.0)
Cash dividends paid	<u>(4.2)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(4.2)</u>
))))))
	<u>(3.7)</u>	<u>(2.4)</u>	<u>(18.2)</u>	<u>(7.7)</u>	<u>18.2)</u>	<u>(13.8)</u>
))))))
Net increase (decrease) in cash and short-term investments	(2.3)	-	-	85.7	-	83.4
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>\$ 0.9</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$170.0</u>	<u>\$ -</u>	<u>\$170.9</u>

F-30

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

Q. QUARTERLY FINANCIAL DATA (Unaudited)

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-K

Quarterly results necessarily rely heavily on estimates. These estimates and certain other factors, such as the seasonal nature of the Company's hotel operations and the discretionary sales of assets, cause the quarterly results not to be necessarily indicative of results for longer periods of time. The following table represents quarterly results of operations for the years ended December 31, 2003 and 2002 (in millions, except per share data).

<u>2003</u>	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>	<u>Total Year</u>
Realized gains (losses)	(\$ 8.3)	(\$ 3.6)	\$ 0.7	\$ 2.0	(\$ 9.2)
Total revenues	215.8	226.3	238.6	239.9	920.6
Net income	8.3	7.0	19.9	14.5	49.7
Basic earnings per common share:					
Net income	\$ 0.20	\$ 0.16	\$ 0.46	\$ 0.31	\$ 1.14
Diluted earnings per common share:					
Net income	\$ 0.20	\$ 0.16	\$ 0.46	\$ 0.31	\$ 1.13
Average common shares outstanding					
Basic	42.5	42.5	43.0	46.9	43.7
Diluted	42.6	42.6	43.0	47.1	43.8
<u>2002</u>					
Realized gains (losses)	(\$ 9.6)	(\$ 20.6)	(\$ 21.4)	\$ 5.9	(\$ 45.7)
Total revenues	213.6	204.2	221.7	243.7	883.2
Income before accounting changes	11.4	7.9	2.0	12.6	33.9
Accounting changes	(17.7)	-	-	-	(17.7)
Net income (loss)	(6.3)	7.9	2.0	12.6	16.2
Basic earnings (loss) per common share:					
Income before accounting changes	\$ 0.27	\$ 0.19	\$ 0.05	\$ 0.30	\$ 0.80
Accounting changes	<u>(0.42)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(0.42)</u>
Net income (loss)	<u>(\$ 0.15)</u>	<u>\$ 0.19</u>	<u>\$ 0.05</u>	<u>\$ 0.30</u>	<u>\$ 0.38</u>
Diluted earnings (loss) per common share:					
Income before accounting changes	\$ 0.27	\$ 0.18	\$ 0.05	\$ 0.29	\$ 0.79
Accounting changes	<u>(0.41)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(0.41)</u>

))	
Net income (loss)	(\$ 0.14)	\$ 0.18	\$ 0.05	\$ 0.29	\$ 0.38
Average common shares outstanding					
Basic	42.4	42.4	42.4	42.4	42.4
Diluted	42.8	42.8	42.6	42.6	42.7

Quarterly earnings per share may not add to year-to-date amounts due to changes in shares outstanding.

F-31

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

R. SUBSEQUENT EVENTS (Unaudited)

In January 2004, AAG Holding raised approximately \$83.5 million through the sale of \$86.3 million principal amount of senior debentures. The debentures carry a stated coupon rate of 7-1/4%, mature in 2034, and are non-callable for five years. The offering was made under the Company's effective shelf registration statement filed with the Securities and Exchange Commission covering the issuance of up to \$250 million of various securities of the Company.

Also in January 2004, GAFRI announced its call for redemption of all the 9-1/4% TOPrS issued by one of its wholly-owned subsidiary trusts. The TOPrS were redeemed on March 8, 2004 at a price of \$25.34, which included accrued and unpaid dividends of \$0.34 per security. The funds used for this redemption were part of the net proceeds from the debt offering mentioned above.

In February 2004, the remaining proceeds from the 7-1/4% debt offering, together with cash on hand, were used to repurchase \$27.2 million principal amount of the Company's 8-7/8% preferred securities for \$28.7 million in cash, including accrued interest.

In February 2004, GAFRI announced that the proposed merger of Provident Financial Group, Inc. with National City Corporation is expected to result in an after-tax realized gain of between \$25 million and \$30 million, depending on market prices at closing. GAFRI owns approximately 1.5 million Provident common and common equivalent shares. Upon completion of the merger, GAFRI expects to receive approximately 1.7 million National City common and common equivalent shares. This transaction would give rise to an incremental increase in stockholders' equity of between \$5 million and \$10 million, again depending on market prices at closing.

F-32

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) Documents filed as part of this Report:

1. Financial Statements are Included in Part II, Item 8.

2. Financial Statement Schedules:

Selected Quarterly Financial Data is included in Note Q to the Consolidated Financial Statements.

Schedules filed herewith:

<u>For 2003, 2002 and 2001</u>	<u>Page</u>
II - Condensed Financial Information of Registrant	S-2
III - Supplementary Insurance Information	S-4

All other schedules for which provisions are made in the applicable regulation of the Securities and Exchange Commission have been omitted as they are not applicable, not required, or the information required thereby is set forth in the Financial Statements or the notes thereto.

3. Exhibits - See Exhibit Index on Page E-1.

(b) Report on Form 8-K:

<u>Date of Report</u>	<u>Item Reported</u>
October 20, 2003	Third Quarter 2003 Earnings Release
November 3, 2003	Press Release regarding GAFRI's 7-1/2% Debt Offering
January 21, 2004	Press Release regarding GAFRI's 7-1/4% Debt Offering
February 12, 2004	Fourth Quarter and Full Year 2003 Earnings Release

GREAT AMERICAN FINANCIAL RESOURCES, INC. - PARENT ONLY

SCHEDULE II - CONDENSED FINANCIAL INFORMATION OF REGISTRANT

(In millions)

Condensed Balance Sheet

	<u>December 31,</u>	
Assets	<u>2003</u>	<u>2002</u>
:		
Investments:		
Fixed maturities - at market		
(amortized cost - \$0.0 and \$0.1)	\$ -	\$ 0.2
Equity securities - at market		
(cost - \$0.0 and \$1.4)	0.3	1.4
Cash and short-term investments	0.4	1.9
Investment in subsidiaries (a)	893.2	801.1
Note receivable from AAG Holding	102.4	102.4
Other assets	<u>20.4</u>	<u>18.3</u>
	<u>\$1,016.7</u>	<u>\$925.3</u>
 Liabilities and Capital:		
Accounts payable, accrued expenses and		
other liabilities	\$ 33.8	\$ 36.5
Payables to affiliates	38.9	35.2
Notes payable	1.5	1.7
Stockholders' equity (b)	<u>942.5</u>	<u>851.9</u>
	<u>\$1,016.7</u>	<u>\$925.3</u>

Condensed Income Statement

	<u>Year ended December 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>2001</u>

Revenues:

Net investment income and other income	\$19.3	\$21.2	\$28.9
Realized losses on investments	-	(0.1)	(3.3)
Equity in undistributed earnings of subsidiaries	48.2	1.9	32.8
Capital distributions from subsidiaries	<u>12.2</u>	<u>25.5</u>	<u>18.9</u>

79.7 48.5 77.3

Costs and Expenses:

Interest and other financing expenses	0.1	0.1	0.1
Other expenses	<u>10.0</u>	<u>9.5</u>	<u>17.3</u>

10.1 9.6 17.4

Operating earnings before income taxes	69.6	38.9	59.9
Provision for income taxes	<u>19.9</u>	<u>5.0</u>	<u>17.2</u>

Income before accounting changes	49.7	33.9	42.7
Cumulative effect of accounting changes, net of tax	<u>-</u>	<u>(17.7)</u>	<u>(5.5)</u>

))

Net Income	<u>\$49.7</u>	<u>\$16.2</u>	<u>\$37.2</u>
------------	---------------	---------------	---------------

(a) Includes net unrealized gains on marketable securities of \$162.6 million and \$179.9 million in 2003 and 2002, respectively.

(b) Includes net unrealized gains on marketable securities of \$162.6 million and \$180.0 million in 2003 and 2002, respectively.

S-2

GREAT AMERICAN FINANCIAL RESOURCES, INC. - PARENT ONLY

SCHEDULE II - CONDENSED FINANCIAL INFORMATION OF REGISTRANT

(In millions)

Condensed Statement of Cash Flows

	<u>Year Ended December 31.</u>		
	<u>2003</u>	<u>2002</u>	<u>2001</u>
Cash Flows from Operating Activities:			
Net income	\$ 49.7	\$16.2	\$ 37.2
Adjustments:			
Cumulative effect of accounting changes	-	17.7	5.5
Equity in net earnings of subsidiaries	(43.8)	(29.0)	(37.5)
Depreciation and amortization	-	0.1	0.7
Realized losses on investments	-	0.1	3.3
Decrease (increase) in other assets	2.8	(1.0)	9.3
Increase (decrease) in payable to affiliates, net	3.8	(2.7)	(1.6)
Increase (decrease) in other liabilities	(2.8)	5.1	1.5
Capital distributions from subsidiaries	142.5	47.7	129.9
Contributions to subsidiaries	(213.1)	(59.0)	(150.6)
Other, net	<u>0.1</u>	<u>0.9</u>	<u>0.9</u>
	<u>(60.8)</u>	<u>(3.9)</u>	<u>(1.4)</u>
)))
Cash Flows from Investing Activities:			
Purchase of investments	-	(0.3)	(6.4)
Decrease in intercompany notes receivable	-	-	1.5
Maturities and redemptions of fixed maturity investments	-	6.4	-
Sales of investments	<u>1.2</u>	<u>2.3</u>	<u>7.7</u>
	<u>1.2</u>	<u>8.4</u>	<u>2.8</u>
Cash Flows from Financing Activities:			
Additions to notes payable	-	-	0.1

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-K

Reductions of notes payable	(0.2)	(0.2)	(0.2)
Issuance of Common Stock	63.0	2.6	1.4
Retirement of Common Stock	-	(1.6)	(0.8)
Cash dividends paid	<u>(4.7)</u>	<u>(4.3)</u>	<u>(4.2)</u>
)))
	<u>58.1</u>	<u>(3.5)</u>	<u>(3.7)</u>
)))
Net increase (decrease) in cash and short-term investments	(1.5)	1.0	(2.3)
Beginning cash and short-term investments	<u>1.9</u>	<u>0.9</u>	<u>3.2</u>
Ending cash and short-term investments	<u>\$ 0.4</u>	<u>\$ 1.9</u>	<u>\$ 0.9</u>

S-3

GREAT AMERICAN FINANCIAL RESOURCES, INC. AND SUBSIDIARIES

SCHEDULE III - SUPPLEMENTARY INSURANCE INFORMATION

THREE YEARS ENDED DECEMBER 31, 2003

(In millions)

COLUMN A	COLUMN B	COLUMN C	COLUMN D	COLUMN E	COLUMN F	COLUMN G	COLUMN H	COLUMN I
Segment	Unamortized Insurance Acquisition Costs, Net	Future policy benefits, losses, claims and loss expenses	Unearned Premiums	Other policy claims and benefits payable	Premium Revenue	Net Investment Income (1)	Benefits, claims, losses and settlement expenses	Amortization of insurance acquisition expense

2003

S-4	Life & Annuity products	\$437	\$7,232	\$ 3	\$13	\$ 44	\$458	\$334	\$ 72	\$ 97	N/A
	Supplemental insurance	107	587	3	2	222	37	177	31	32	N/A

Edgar Filing: GREAT AMERICAN FINANCIAL RESOURCES INC - Form 10-K

products

GA Life of Puerto Rico	70	145	1	8	66	11	34	18	12	N/A
Corporate and other	-	-	-	-	-	<u>5</u>	-	-	<u>18</u>	N/A
Total	<u>\$614</u>	<u>\$7,964</u>	<u>\$ 7</u>	<u>\$23</u>	<u>\$332</u>	<u>\$511</u>	<u>\$545</u>	<u>\$121</u>	<u>\$159</u>	

2002

Life & Annuity products	\$435	\$6,659	\$ 1	\$15	\$ 54	\$474	\$353	\$ 68	\$ 97	N/A
Supplemental insurance products	94	538	2	2	191	38	162	29	31	N/A
GA Life of Puerto Rico	62	127	1	11	61	11	31	18	11	N/A
Corporate and other	-	-	-	-	-	<u>5</u>	-	-	<u>21</u>	N/A
Total	<u>\$591</u>	<u>\$7,324</u>	<u>\$ 4</u>	<u>\$28</u>	<u>\$306</u>	<u>\$528</u>	<u>\$546</u>	<u>\$115</u>	<u>\$160</u>	

2001

Life & Annuity products	\$416	\$5,835	\$ 2	\$12	\$ 36	\$451	\$319	\$36	\$ 85	N/A
Supplemental insurance products	85	490	2	-	190	38	161	27	42	N/A
GA Life of Puerto Rico	55	118	1	11	54	10	28	16	10	N/A
Corporate and other	-	-	-	-	-	<u>8</u>	-	-	<u>18</u>	N/A
Total	<u>\$556</u>	<u>\$6,443</u>	<u>\$ 5</u>	<u>\$23</u>	<u>\$280</u>	<u>\$507</u>	<u>\$508</u>	<u>\$79</u>	<u>\$155</u>	

1. Allocated by legal entity.

2. Life, accident and health premiums are shown Column F.

GREAT AMERICAN FINANCIAL RESOURCES, INC.

INDEX TO EXHIBITS

<u>Number</u>	<u>Exhibit Description</u>
3.1	Certificate of Incorporation of Registrant
3.2	By-laws of Registrant
4	Registrant has no outstanding debt issues exceeding 10% of the assets of Registrant and consolidated subsidiaries.
10.1	Agreement of Allocation of Payment of Federal Income Taxes ("Great American Financial Resources Tax Allocation Agreement"), dated December 31, 1992, between American Financial Corporation and the Registrant incorporated herein by reference to Exhibit 10.12 to the Registrant's Registration Statement on Form S-2 dated January 7, 1993.
10.2	Assignment of Tax Allocation Payments dated December 31, 1992, between American Financial Corporation and the Registrant incorporated herein by reference to Exhibit 10.15 to the Registrant's Registration Statement on Form S-2 dated January 7, 1993.
10.3	Agreement for the Allocation of Federal Income Taxes dated May 13, 1974, between American Financial Corporation and Great American Life Insurance Company, as supplemented on January 1, 1987 incorporated herein by reference to Exhibit 10.16 to the Registrant's Registration Statement on Form S-2 dated January 7, 1993.
10.4	Investment Services Agreement, dated December 31, 1992, between Great American Life Insurance Company and American Money Management Corporation incorporated herein by reference to Exhibit 10.17 to the Registrant's Registration Statement on Form S-2 dated January 7, 1993.
10.5	Common Stock Registration Agreement, dated December 31, 1992, between the Registrant and American Financial Corporation and its wholly-owned subsidiary Great American Insurance Company incorporated herein by reference to Exhibit 10.22 to the Registrant's Registration Statement on Form S-2 dated January 7, 1993.
21	Subsidiaries of the Registrant.
23	Consent of Independent Auditors.
31(a)	Sarbanes-Oxley Section 302(a) Certification of Chief Executive Officer
31(b)	Sarbanes-Oxley Section 302(a) Certification of Chief Financial Officer

32 Sarbanes-Oxley Section 906 Certification of Chief Executive Officer
and Chief Financial Officer

E-1

Signatures

Pursuant to the requirements of Section 13 of the Securities Exchange Act of 1934, Great American Financial Resources, Inc. has duly caused this Report to be signed on its behalf by the undersigned, duly authorized.

GREAT AMERICAN FINANCIAL RESOURCES,
INC.

Signed: March 12, 2004

BY: s/CARL H. LINDNER

Carl H. Lindner
Chairman of the Board

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

<u>Signature</u>	<u>Capacity</u>	<u>Date</u>
<u>s/CARL H. LINDNER</u> Carl H. Lindner	Chairman of the Board of Directors	March 12, 2004
<u>s/S. CRAIG LINDNER</u> S. Craig Lindner	Director and Chief Executive Officer	March 12, 2004
<u>s/WILLIAM R. MARTIN</u> William R. Martin	Director*	March 12, 2004
<u>s/JOHN T. LAWRENCE, III</u> John T. Lawrence, III	Director*	March 12, 2004
<u>s/RONALD W. TYSOE</u> Ronald W. Tysoe	Director*	March 12, 2004
<u>s/CHRISTOPHER P. MILIANO</u> Christopher P. Miliano	Chief Financial Officer (Principal Accounting Officer)	March 12, 2004

* Member of Audit Committee