
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

**For the Quarterly Period Ended
June 30, 2001**

**Commission File
No. 1-13653**

AMERICAN FINANCIAL GROUP, INC.

**Incorporated under
the Laws of Ohio**

**IRS Employer I.D.
No. 31-1544320**

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

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes X No

As of August 1, 2001, there were 68,018,269 shares of the Registrant's Common Stock outstanding, excluding 18,666,614 shares owned by subsidiaries.

AMERICAN FINANCIAL GROUP, INC. 10-Q

PART I

FINANCIAL INFORMATION

AMERICAN FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

(Dollars In Thousands)

| | June 30, 2001 | December 31, 2000 |
|--|---------------------|----------------------|
| Assets: | | |
| Cash and short-term investments | \$ 288,412 | \$ 438,670 |
| Investments: | | |
| Fixed maturities - at market (amortized cost - \$10,424,266 and \$10,148,348) | 10,513,266 | 10,164,648 |
| Other stocks - at market (cost - \$195,896 and \$174,959) | 365,696 | 385,359 |
| Investment in investee corporations | - | 23,996 |
| Policy loans | 210,721 | 213,469 |
| Real estate and other investments | 249,292 | 273,994 |
| Total investments | 11,338,975 | 11,061,466 |
| Recoverables from reinsurers and prepaid reinsurance premiums | 1,971,791 | 1,845,171 |
| Agents' balances and premiums receivable | 743,162 | 700,215 |
| Deferred acquisition costs | 801,543 | 763,097 |
| Other receivables | 267,951 | 240,731 |
| Variable annuity assets (separate accounts) | 530,710 | 533,655 |
| Prepaid expenses, deferred charges and other assets | 489,967 | 513,616 |
| Cost in excess of net assets acquired | 321,014 | 318,920 |
| | <u>\$16,753,525</u> | <u>\$16,415,541</u> |
| Liabilities and Capital: | | |
| Unpaid losses and loss adjustment expenses | \$ 4,576,306 | \$ 4,515,561 |
| Unearned premiums | 1,501,957 | 1,414,492 |
| Annuity benefits accumulated | 5,603,648 | 5,543,683 |
| Life, accident and health reserves | 601,951 | 599,360 |
| Long-term debt: | | |
| Holding companies | 603,491 | 584,869 |
| Subsidiaries | 172,655 | 195,087 |
| Variable annuity liabilities (separate accounts) | 530,710 | 533,655 |
| Accounts payable, accrued expenses and other liabilities | 1,083,729 | 972,271 |
| Total liabilities | 14,674,447 | 14,358,978 |
| Minority interest | 516,910 | 508,033 |
| Shareholders' Equity: | | |
| Common Stock, no par value | | |
| - 200,000,000 shares authorized | | |
| - 68,012,391 and 67,410,091 shares outstanding | 68,012 | 67,410 |
| Capital surplus | 909,166 | 898,066 |
| Retained earnings | 427,990 | 442,454 |
| Unrealized gain on marketable securities, net | 157,000 | 140,600 |
| Total shareholders' equity | 1,562,168 | 1,548,530 |
| | <u>\$16,753,525</u> | <u>\$16,415,541</u> |

AMERICAN FINANCIAL GROUP, INC. 10-Q

**AMERICAN FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF EARNINGS
(In Thousands, Except Per Share Data)**

| | Three months ended June 30, | | Six months ended June 30, | |
|--|--------------------------------|------------------|------------------------------|------------------|
| | <u>2001</u> | <u>2000</u> | <u>2001</u> | <u>2000</u> |
| Income: | | | | |
| Property and casualty insurance premiums | \$679,563 | \$623,721 | \$1,324,286 | \$1,195,858 |
| Life, accident and health premiums | 70,533 | 49,704 | 139,691 | 99,623 |
| Investment income | 215,764 | 209,425 | 424,316 | 418,315 |
| Realized gains (losses) on: | | | | |
| Securities | (26,425) | (3,907) | (33,306) | (5,340) |
| Subsidiaries | - | 25,000 | (1,586) | 25,000 |
| Other income | 53,804 | 55,187 | 112,088 | 109,819 |
| | <u>993,239</u> | <u>959,130</u> | <u>1,965,489</u> | <u>1,843,275</u> |
| Costs and Expenses: | | | | |
| Property and casualty insurance: | | | | |
| Losses and loss adjustment expenses | 526,411 | 483,497 | 1,022,627 | 901,148 |
| Commissions and other underwriting expenses | 192,902 | 182,573 | 377,876 | 361,005 |
| Annuity benefits | 70,716 | 79,727 | 139,980 | 145,888 |
| Life, accident and health benefits | 52,211 | 36,885 | 106,294 | 73,609 |
| Interest charges on borrowed money | 14,159 | 16,799 | 30,959 | 32,825 |
| Other operating and general expenses | 116,718 | 132,186 | 226,783 | 230,730 |
| | <u>973,117</u> | <u>931,667</u> | <u>1,904,519</u> | <u>1,745,205</u> |
| Operating earnings before income taxes | 20,122 | 27,463 | 60,970 | 98,070 |
| Provision for income taxes | 3,173 | 7,201 | 17,605 | 30,362 |
| Net operating earnings | 16,949 | 20,262 | 43,365 | 67,708 |
| Minority interest expense, net of tax | (8,366) | (5,964) | (18,318) | (15,860) |
| Equity in net earnings (losses) of investees, net of tax | (2,313) | 2,027 | (5,647) | 9,202 |
| Net Earnings | <u>\$ 6,270</u> | <u>\$ 16,325</u> | <u>\$ 19,400</u> | <u>\$ 61,050</u> |
| Earnings per Common Share: | | | | |
| Basic | \$.09 | \$.28 | \$.29 | \$1.04 |
| Diluted | \$.09 | \$.28 | \$.28 | \$1.04 |
| Average number of Common Shares: | | | | |
| Basic | 67,854 | 58,547 | 67,683 | 58,507 |
| Diluted | 68,491 | 58,944 | 68,217 | 58,698 |
| Cash dividends per Common Share | \$.25 | \$.25 | \$.50 | \$.50 |

AMERICAN FINANCIAL GROUP, INC. 10-Q

**AMERICAN FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
(Dollars in Thousands)**

| | Common Shares | Common Stock and Capital Surplus | Retained Earnings | Unrealized Gain (Loss) on Securities | Total |
|---|-------------------|--|----------------------|--|--------------------|
| Balance at January 1, 2001 | <u>67,410,091</u> | <u>\$965,476</u> | <u>\$442,454</u> | <u>\$140,600</u> | <u>\$1,548,530</u> |
| Net earnings | - | - | 19,400 | - | 19,400 |
| Change in unrealized Comprehensive income | - | - | - | 16,400 | <u>16,400</u> |
| | | | | | 35,800 |
| Dividends on Common Stock | - | - | (33,815) | - | (33,815) |
| Shares issued: | | | | | |
| Exercise of stock options | 54,115 | 1,283 | - | - | 1,283 |
| Employee stock purchase plan | 27,576 | 714 | - | - | 714 |
| Retirement plan contributions | 521,777 | 13,032 | - | - | 13,032 |
| Directors fees paid in stock | 2,034 | 48 | - | - | 48 |
| Shares repurchased | (3,533) | (51) | (49) | - | (100) |
| Tax effect of intercompany dividends | - | (3,200) | - | - | (3,200) |
| Other | <u>331</u> | <u>(124)</u> | <u>-</u> | <u>-</u> | <u>(124)</u> |
| Balance at June 30, 2001 | <u>68,012,391</u> | <u>\$977,178</u> | <u>\$427,990</u> | <u>\$157,000</u> | <u>\$1,562,168</u> |
| | | | | | |
| Balance at January 1, 2000 | 58,419,952 | \$800,640 | \$557,538 | (\$ 18,200) | \$1,339,978 |
| Net earnings | - | - | 61,050 | - | 61,050 |
| Change in unrealized Comprehensive income (loss) | - | - | - | (93,300) | <u>(93,300)</u> |
| | | | | | (32,250) |
| Dividends on Common Stock | - | - | (29,245) | - | (29,245) |
| Shares issued: | | | | | |
| Exercise of stock options | 14,682 | 331 | - | - | 331 |
| Employee stock purchase plan | 38,270 | 940 | - | - | 940 |
| Retirement plan contributions | 99,716 | 2,119 | - | - | 2,119 |
| Directors fees paid in stock | 1,914 | 48 | - | - | 48 |
| Shares repurchased | (41,044) | (562) | (579) | - | (1,141) |
| Tax effect of intercompany dividends | - | (3,200) | - | - | (3,200) |
| Repurchase of trust preferred securities | - | - | 178 | - | 178 |
| Other | <u>-</u> | <u>(81)</u> | <u>-</u> | <u>-</u> | <u>(81)</u> |
| Balance at June 30, 2000 | <u>58,533,490</u> | <u>\$800,235</u> | <u>\$588,942</u> | <u>(\$111,500)</u> | <u>\$1,277,677</u> |

AMERICAN FINANCIAL GROUP, INC. 10-Q

AMERICAN FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS
(In Thousands)

| | Six months ended June 30, | |
|---|------------------------------|------------------|
| | 2001 | 2000 |
| Operating Activities: | | |
| Net earnings | \$19,400 | \$ 61,050 |
| Adjustments: | | |
| Equity in net (earnings) losses of investees | 5,647 | (9,202) |
| Depreciation and amortization | 71,680 | 64,026 |
| Annuity benefits | 139,980 | 145,888 |
| Realized (gains) losses on investing activities | 10,167 | (33,330) |
| Deferred annuity and life policy acquisition costs | (73,530) | (70,617) |
| Increase in reinsurance and other receivables | (77,271) | (34,508) |
| Increase in other assets | (27,385) | (58,323) |
| Increase in insurance claims and reserves | 169,679 | 170,303 |
| Increase (decrease) in other liabilities | 71,156 | (23,170) |
| Increase (decrease) in minority interest | 6,186 | (1,629) |
| Other, net | 9,421 | (2,591) |
| | <u>325,130</u> | <u>207,897</u> |
| Investing Activities: | | |
| Purchases of and additional investments in: | | |
| Fixed maturity investments | (981,049) | (942,929) |
| Equity securities | (2,907) | (20,126) |
| Real estate, property and equipment | (31,090) | (39,819) |
| Maturities and redemptions of fixed maturity investments | 337,280 | 348,447 |
| Sales of: | | |
| Fixed maturity investments | 368,003 | 380,062 |
| Equity securities | 9,148 | 30,678 |
| Subsidiaries | 22,000 | - |
| Real estate, property and equipment | 43,456 | 4,810 |
| Cash and short-term investments of acquired (former) subsidiaries | (132,858) | 259 |
| Decrease (increase) in investments | (171) | 2,337 |
| | <u>(368,188)</u> | <u>(236,281)</u> |
| Financing Activities: | | |
| Fixed annuity receipts | 271,827 | 251,100 |
| Annuity surrenders, benefits and withdrawals | (341,310) | (387,667) |
| Net transfers to variable annuity assets | (1,368) | (34,150) |
| Additional long-term borrowings | 78,868 | 110,172 |
| Reductions of long-term debt | (83,192) | (26,981) |
| Issuances of Common Stock | 1,790 | 1,004 |
| Repurchases of trust preferred securities | - | (2,479) |
| Cash dividends paid | (33,815) | (29,245) |
| | <u>(107,200)</u> | <u>(118,246)</u> |
| Net Decrease in Cash and Short-term Investments | (150,258) | (146,630) |
| Cash and short-term investments at beginning of period | <u>438,670</u> | <u>390,630</u> |
| Cash and short-term investments at end of period | <u>\$288,412</u> | <u>\$244,000</u> |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A. Accounting Policies

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

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

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

Investments All fixed maturity securities are considered "available for sale" and reported at fair value with unrealized gains and losses reported as a separate component of shareholders' equity. Short-term investments are carried at cost; loans receivable are carried primarily at the aggregate unpaid balance. Premiums and discounts on mortgage-backed securities are amortized over a period based on estimated future principal prepayments and adjusted to reflect actual prepayments.

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

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

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

Cost in Excess of Net Assets Acquired The excess of cost of subsidiaries over AFG's equity in the underlying net assets ("goodwill") is being amortized over periods of 20 to 40 years.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

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

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

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

In response to a recent increase in asbestos and other environmental ("A&E") claims, AFG has begun a current review of such exposures. Any strengthening of reserves determined to be necessary will be recorded upon completion of the review. With the exception of the A&E claims, management believes that the liabilities for unpaid losses and loss adjustment expenses are adequate.

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

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

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

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

Minority Interest For balance sheet purposes, minority interest represents the interests of noncontrolling shareholders in AFG subsidiaries, including American Financial Corporation ("AFC") preferred stock and preferred securities issued by trust subsidiaries of AFG. For income statement purposes, minority interest expense represents those shareholders' interest in the earnings of AFG subsidiaries as well as AFC preferred dividends and accrued distributions on the trust preferred securities.

Income Taxes AFC files consolidated federal income tax returns which include all 80%-owned U.S. subsidiaries, except for certain life insurance subsidiaries and their subsidiaries. Because holders of AFC Preferred Stock hold in excess of 20% of AFC's voting rights, AFG (parent) and its direct subsidiary, AFC Holding Company ("AFC Holding" or "AFCH"), are not eligible to file consolidated returns with AFC, and therefore, file separately.

Deferred income taxes are calculated using the liability method. Under this method, deferred income tax assets and liabilities are determined based on differences between financial reporting and tax bases and are measured using enacted tax rates. Deferred tax assets are recognized if it is more likely than not that a benefit will be realized.

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

Benefit Plans AFG provides retirement benefits to qualified employees of participating companies through contributory and noncontributory defined contribution plans contained in AFG's Retirement and Savings Plan. Under the retirement portion of the plan, company contributions are invested primarily in

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

securities of AFG and affiliates. Under the savings portion of the plan, AFG matches a specific portion of employee contributions. Contributions to benefit plans are charged against earnings in the year for which they are declared.

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

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

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

Earnings Per Share Basic earnings per share is calculated using the weighted average number of shares of common stock outstanding during the period. The calculation of diluted earnings per share includes the following dilutive effect of common stock options: second quarter of 2001 and 2000 - 637,000 shares and 397,000 shares; six months of 2001 and 2000 - 534,000 shares and 191,000 shares, respectively.

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

B. Sale of Subsidiaries

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

Commercial lines division In 1998, AFG sold its Commercial lines division to Ohio Casualty Corporation. In August 2000, AFG received an additional payment of \$25 million from Ohio Casualty based on retention and growth through May 2000 of the businesses sold. This earn-out was recognized as additional "gain on sale of subsidiary" in the second quarter of 2000.

- C. **Segments of Operations** AFG's property and casualty group is engaged primarily in private passenger automobile and specialty insurance businesses. The Specialty group includes a highly diversified group of specialty business units. Some of the more significant areas are inland and ocean marine, California workers' compensation, agricultural-related coverages, executive and professional liability, fidelity and surety bonds, collateral protection, and umbrella and excess coverages. The Personal group writes nonstandard and preferred/standard private passenger auto and other personal insurance coverage. AFG's annuity, life and health business markets primarily retirement products as well as life and supplemental health insurance.

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

| | Three months ended June 30, | | Six months ended June 30, | |
|--------------------------------------|--------------------------------|------------------|------------------------------|--------------------|
| | 2001 | 2000 | 2001 | 2000 |
| Revenues (a) | | | | |
| Property and casualty insurance: | | | | |
| Premiums earned: | | | | |
| Specialty | \$356,188 | \$307,388 | \$ 672,495 | \$ 582,211 |
| Personal | 322,629 | 316,333 | 650,261 | 613,646 |
| Other lines - primarily discontinued | 746 | - | 1,530 | 1 |
| | <u>679,563</u> | <u>623,721</u> | <u>1,324,286</u> | <u>1,195,858</u> |
| Investment and other income | 106,440 | 129,311 | 213,775 | 250,478 |
| | <u>786,003</u> | <u>753,032</u> | <u>1,538,061</u> | <u>1,446,336</u> |
| Annuities, life and health (b) | 202,562 | 195,945 | 419,592 | 383,282 |
| Other | 4,674 | 10,153 | 7,836 | 13,657 |
| | <u>\$993,239</u> | <u>\$959,130</u> | <u>\$1,965,489</u> | <u>\$1,843,275</u> |
| Operating Profit (Loss) | | | | |
| Property and casualty insurance: | | | | |
| Underwriting: | | | | |
| Specialty | (\$ 4,609) | (\$ 14,680) | (\$ 6,839) | (\$ 25,178) |
| Personal | (35,795) | (26,392) | (63,577) | (37,325) |
| Other lines - primarily discontinued | 654 | (1,277) | (5,801) | (3,792) |
| | <u>(39,750)</u> | <u>(42,349)</u> | <u>(76,217)</u> | <u>(66,295)</u> |
| Investment and other income | 69,147 | 93,482 | 144,349 | 178,007 |
| | <u>29,397</u> | <u>51,133</u> | <u>68,132</u> | <u>111,712</u> |
| Annuities, life and health | 17,335 | (2,209) | 47,458 | 25,305 |
| Other (c) | (26,610) | (21,461) | (54,620) | (38,947) |
| | <u>\$ 20,122</u> | <u>\$ 27,463</u> | <u>\$ 60,970</u> | <u>\$ 98,070</u> |

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

- D. **Investee Corporations** Investment in investee corporations reflects AFG's ownership of 24 million shares (33%) of Chiquita common stock. The market value of this investment was \$24 million at December 31, 2000. Chiquita is a leading international marketer, producer and distributor of quality fresh fruits and vegetables and processed foods. Summarized financial information for Chiquita for the six months ended June 30, 2000, follows (in millions):

| | |
|--|---------|
| Net Sales | \$1,260 |
| Operating Income | 112 |
| Income before Extraordinary Item | 46 |
| Extraordinary Gain on Debt Prepayment | 2 |
| Net Income | 48 |
| Net Income Attributed to Common Shares | 39 |

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

Start-up manufacturing businesses Since 1998, AFG subsidiaries have made loans to two start-up manufacturing businesses which were previously owned by unrelated third-parties. During 2000, the former owners chose to forfeit their equity interests to AFG rather than invest additional capital. In the fourth quarter of 2000, AFG sold the equity interests to a group of employees for nominal cash consideration plus warrants to repurchase a significant ownership interest. Due to the absence of significant financial investment by the buyers relative to the amount of debt owed to AFG subsidiaries, the sale was not recognized as a divestiture for accounting purposes. Assets of the businesses transferred (approximately \$55 million at June 30, 2001 and December 31, 2000) are included in other assets; liabilities of the businesses transferred (approximately \$7 million at June 30, 2001 and December 31, 2000, after elimination of loans from AFG subsidiaries) are included in other liabilities. AFG's equity in the losses of these two companies (\$2.3 million in the second quarter and \$5.6 million in the first six months of 2001) is included in investee losses in the statement of earnings.

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

| | June 30, 2001 | December 31, 2000 |
|--|------------------|----------------------|
| Holding Companies: | | |
| AFG 7-1/8% Senior Debentures due April 2009 | \$301,020 | \$300,931 |
| AFG 7-1/8% Senior Debentures due December 2007 | 79,600 | 79,600 |
| AFC notes payable under bank line | 197,000 | 178,000 |
| APU 10-7/8% Subordinated Notes due May 2011 | 11,584 | 11,611 |
| Other | 14,287 | 14,727 |
| | <u>\$603,491</u> | <u>\$584,869</u> |
| Subsidiaries: | | |
| GAFRI 6-7/8% Senior Notes due June 2008 | \$100,000 | \$100,000 |
| GAFRI notes payable under bank line | 41,300 | 48,500 |
| Notes payable secured by real estate | 16,569 | 31,201 |
| Other | 14,786 | 15,386 |
| | <u>\$172,655</u> | <u>\$195,087</u> |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

At June 30, 2001, sinking fund and other scheduled principal payments on debt for the balance of 2001 and the subsequent five years were as follows (in millions):

| | <u>Holding Companies</u> | <u>Subsidiaries</u> | <u>Total</u> |
|------|------------------------------|---------------------|--------------|
| 2001 | \$.9 | \$.6 | \$ 1.5 |
| 2002 | 207.3 | 1.3 | 208.6 |
| 2003 | - | 1.3 | 1.3 |
| 2004 | - | 42.3 | 42.3 |
| 2005 | - | 10.0 | 10.0 |
| 2006 | - | .7 | .7 |

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

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

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

| | <u>June 30, 2001</u> | <u>December 31, 2000</u> |
|--|--------------------------|------------------------------|
| Interest of noncontrolling shareholders in subsidiaries' common stock | \$128,093 | \$119,216 |
| Preferred securities issued by subsidiary trusts | 316,663 | 316,663 |
| AFC preferred stock | <u>72,154</u> | <u>72,154</u> |
| | <u>\$516,910</u> | <u>\$508,033</u> |

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

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

| <u>Date of Issuance</u> | <u>Issue (Maturity Date)</u> | <u>June 30, 2001</u> | <u>December 31, 2000</u> | <u>Optional Redemption Dates</u> |
|-----------------------------|------------------------------|--------------------------|------------------------------|--------------------------------------|
| October 1996 | AFCH 9-1/8% TOPRS (2026) | \$98,750 | \$98,750 | On or after 10/22/2001 |
| November 1996 | GAFRI 9-1/4% TOPRS (2026) | 72,913 | 72,913 | On or after 11/7/2001 |
| March 1997 | GAFRI 8-7/8% Pfd (2027) | 70,000 | 70,000 | On or after 3/1/2007 |
| May 1997 | GAFRI 7-1/4% ROPES (2041) | 75,000 | 75,000 | After 9/28/2001 |

Until September 28, 2001, GAFRI's ROPES are senior unsecured obligations of GAFRI. On that date, the distribution rate on the ROPES will be reset to current market rates (not to exceed 8.8%) and the ROPES will become subordinate to GAFRI's senior indebtedness. Given the current interest rate environment for these types of securities, GAFRI expects to redeem its ROPES in September 2001 using borrowings under its bank line.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

AFC Preferred Stock AFC's Preferred Stock is voting, cumulative, and consists of the following:

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

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

| | Six months ended June 30, | |
|--|------------------------------|-----------------|
| | 2001 | 2000 |
| Interest of noncontrolling shareholders in earnings of subsidiaries | \$ 6,524 | \$ 4,063 |
| Accrued distributions by subsidiaries on preferred securities: | | |
| Trust issued securities, net of tax | 8,908 | 8,911 |
| AFC preferred stock | 2,886 | 2,886 |
| | <u>\$18,318</u> | <u>\$15,860</u> |

- G. Shareholders' Equity** At June 30, 2001, there were 68,012,391 shares of AFG Common Stock outstanding, including 1,363,027 shares held by American Premier for possible distribution to certain creditors and other claimants upon proper claim presentation and settlement pursuant to the 1978 plan of reorganization of American Premier's predecessor, The Penn Central Corporation. Shares being held for distribution are not eligible to vote but otherwise are accounted for as issued and outstanding. AFG is authorized to issue 12.5 million shares of Voting Preferred Stock and 12.5 million shares of Nonvoting Preferred Stock, each without par value.

At June 30, 2001, there were 9.7 million shares of AFG Common Stock reserved for issuance upon exercise of stock options. As of that date, options for 6.3 million shares were outstanding. Options generally become exercisable at the rate of 20% per year commencing one year after grant; those granted to non-employee directors of AFG are fully exercisable upon grant. All options expire ten years after the date of grant.

The change in unrealized gain (loss) on marketable securities for the six months ended June 30 included the following (in millions):

| | Pretax | Taxes | Minority Interest | Net |
|--|------------------|-----------------|----------------------|-----------------|
| <u>2001</u> | | | | |
| Unrealized holding losses on securities arising during the period | (\$ 3.4) | \$ 1.0 | (\$0.7) | (\$ 3.1) |
| Realized losses included in net income | <u>33.3</u> | <u>(11.7)</u> | <u>(2.1)</u> | <u>19.5</u> |
| Change in unrealized gain on marketable securities, net | <u>\$29.9</u> | <u>(\$10.7)</u> | <u>(\$2.8)</u> | <u>\$16.4</u> |
| <u>2000</u> | | | | |
| Unrealized holding losses on securities arising during the period | (\$157.3) | \$55.4 | \$5.6 | (\$96.3) |
| Realized losses included in net income | <u>5.3</u> | <u>(1.9)</u> | <u>(.4)</u> | <u>3.0</u> |
| Change in unrealized gain (loss) on marketable securities, net | <u>(\$152.0)</u> | <u>\$53.5</u> | <u>\$5.2</u> | <u>(\$93.3)</u> |

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

ITEM 2

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

GENERAL

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

Asbestos and Environmental Reserves Study Throughout the property and casualty insurance industry, estimating ultimate liability for asbestos claims has become increasingly uncertain due to inconsistent court decisions, recent bankruptcy filings, novel theories of coverage, and judicial interpretations that often expand theories of recovery and broaden the scope of coverage. The casualty insurance industry as a whole is engaged in extensive litigation over these coverage and liability issues as the volume and severity of claims against asbestos defendants continue to increase. During the second quarter of 2001, AFG experienced an increase in the number and severity of these claims, which claims carry with them a likelihood for higher than previously established reserves for expected claim payments and settlement costs. While management presently does not have sufficient information to accurately quantify the level or range of any additional exposure, the additional costs of adjudicating or settling pending and future claims may materially exceed amounts currently established and may be material to the period in which they are recorded. Accordingly, AFG is undertaking a current review for asbestos and environmental exposures. Any resulting strengthening will be recorded upon completion of the review which is expected to take several months. At June 30, 2001, AFG had recorded \$430 million (before reinsurance recoverables of \$83 million) for various liability coverages related to these environmental, asbestos and other mass tort claims.

IT Initiative In 1999, AFG initiated an enterprise-wide project to study its information technology ("IT") resources, needs and opportunities. The initiative, involving improvements in physical infrastructure and business support systems, entails extensive effort and costs over a period of several years. While the costs precede the expected savings, management believes the benefits in efficiencies and effectiveness will exceed the costs incurred, all of which have been and will be funded through available working capital.

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

- changes in economic conditions, including interest rates, performance of securities markets, and the availability of capital;
- regulatory actions;
- changes in legal environment;

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

- judicial decisions and rulings;
- tax law changes;
- levels of catastrophes and other major losses;
- the actual amount of liabilities associated with certain environmental and asbestos-related insurance claims;
- adequacy of loss reserves;
- availability of reinsurance; and
- competitive pressures, including the ability to obtain rate increases.

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

LIQUIDITY AND CAPITAL RESOURCES

Ratios AFG's debt to total capital ratio (at the parent holding company level) was approximately 26% at June 30, 2001 and 25% at December 31, 2000. AFG's ratio of earnings to fixed charges (on a total enterprise basis) was 1.76 for the first six months of 2001 and 1.63 for the entire year of 2000.

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

AFG has a revolving credit agreement with several banks under which it can borrow up to \$300 million. This credit line provides liquidity and can be used to obtain funds for operating subsidiaries or, if necessary, for the parent companies. At June 30, 2001, there was \$197 million borrowed under the line.

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

Investments Approximately 92% of the fixed maturities held by AFG were rated "investment grade" (credit rating of AAA to BBB) by nationally recognized rating agencies at June 30, 2001. Investment grade securities generally bear lower yields and lower degrees of risk than those that are unrated and noninvestment grade. Management believes that the high quality investment portfolio should generate a stable and predictable investment return.

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

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

RESULTS OF OPERATIONS

General Pretax operating earnings for the three months and six months ended June 30, 2001 were \$20.1 million and \$61.0 million, respectively, compared to \$27.5 million and \$98.1 million in the comparable 2000 periods. Results for the second quarter of 2000 include special litigation charges of \$41.3 million, partially offset by a \$25 million gain on the sale of a subsidiary. Excluding these items, pretax operating earnings declined as increased realized losses on securities and a decline in the Personal group's underwriting results more than offset improved Specialty group underwriting results.

Many investors and analysts focus on "core earnings" of companies, setting aside certain items included in net earnings. Such "core earnings" for AFG, consisting of net earnings adjusted to exclude (i) realized gains (losses), (ii) equity in investee earnings (losses), and (iii) special litigation charges in 2000, were \$23.9 million (\$.35 per share, diluted) and \$45.7 million (\$.67 per share) in the second quarter and six months of 2001 compared to \$23.8 million (\$.40 per share) and \$62.2 million (\$1.06 per share) in the second quarter and six months of 2000.

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

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

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

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

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

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

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

| | Three months ended June 30, | | Six months ended June 30, | |
|--|--------------------------------|----------------|------------------------------|------------------|
| | 2001 | 2000 | 2001 | 2000 |
| <u>Net Written Premiums (GAAP)</u> | | | | |
| Specialty | \$393.8 | \$335.5 | \$ 750.4(a) | \$ 633.2 |
| Personal | 252.0 | 348.1 | 622.5 | 697.9 |
| | <u>\$645.8</u> | <u>\$683.6</u> | <u>\$1,372.9</u> | <u>\$1,331.1</u> |
| <u>Combined Ratios (GAAP) (b)</u> | | | | |
| Specialty | 101.3% | 104.7% | 101.0% | 104.2% |
| Personal | 111.1 | 108.4 | 109.8 | 106.0 |
| Aggregate (including discontinued lines) | 105.9 | 106.8 | 105.7 | 105.5 |

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

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

Specialty The Specialty group's increase in net written premiums reflects the impact of rate increases implemented in 2000 and 2001 and the realization of growth opportunities in certain commercial markets. In its California workers' compensation business, AFG implemented rate increases in excess of 35% on renewals in the first half 2001. Rate increases implemented in the other specialty operations averaged 15% for the first six months of 2001. AFG expects these levels of rate increases to continue for the remainder of 2001. The improvement in the combined ratio compared to the 2000 periods reflects the impact of these rate increases. Excluding the California workers' compensation business, the Specialty group's combined ratio was 99.7% for the second quarter and 98.8% for the first six months of 2001.

Personal The Personal group's decline in net written premiums reflects a reinsurance agreement, effective April 1, 2001, under which AFG cedes 80% of the automobile physical damage business written by three of its insurance subsidiaries. This agreement enabled AFG to reallocate some of its capital to the more profitable specialty operations. Excluding the effect of this agreement, the Personal group's net written premiums declined approximately 11% for the second quarter and 3% for the six months as lower business volume more than offset the impact of significant rate increases. The increase in the combined ratio compared to the 2000 periods reflects unexpected loss development due to inadequate rates on policies written during 2000 and \$4.1 million in second quarter 2001 storm losses, principally from Hurricane Allison and Midwest hailstorms. To further improve underwriting results, AFG implemented rate increases averaging 9% in the first six months of 2001 and expects rate increases to be at least 15% by the end of 2001.

Life, Accident and Health Premiums and Benefits The increase in life, accident and health premiums and benefits is due primarily to the acquisition of blocks of supplemental health insurance business.

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

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

| | Three months ended June 30, | | Six months ended June 30, | |
|--------------------------------------|--------------------------------|--------|------------------------------|--------|
| | 2001 | 2000 | 2001 | 2000 |
| Other income | \$29.4 | \$26.5 | \$61.4 | \$44.4 |
| Other operating and general expenses | 16.6 | 17.0 | 31.6 | 31.3 |
| Interest charges on borrowed money | .6 | .6 | 1.3 | 1.3 |
| Minority interest expense, net | 1.4 | .5 | 3.3 | .7 |

Other income includes net pretax gains on the sale of real estate assets of \$9.3 million in the second quarter and \$24.6 million in the first six months of 2001 compared to \$4.6 million and \$6.7 million for the 2000 periods.

Other Income Excluding gains on the sale of real estate assets (discussed above), other income decreased \$15.6 million (15%) in the first six months of 2001 due primarily to income from the sale of operating assets and lease residuals in the first quarter of 2000.

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

Realized losses on securities includes the following provisions for other than temporary impairment: second quarter of 2001 and 2000 - \$29.2 million and \$2.5 million; six months of 2001 and 2000 - \$37.2 million and \$3.3 million, respectively.

Under SFAS No. 133, which was adopted as of October 1, 2000, warrants to purchase common stock of publicly traded companies are generally considered derivatives and marked to market through current earnings as realized gains and losses. Realized losses on securities in 2001 includes gains of \$3.2 million in the second quarter and \$2.3 million in the first six months to adjust the carrying value of AFG's investment in warrants to market value.

Gain (Loss) on Sales of Subsidiaries In the first quarter of 2001, AFG recognized a \$1.6 million pretax loss representing an adjustment to the fourth quarter 2000 loss recorded on the sale of its Japanese division. In the second quarter of 2000, AFG recognized a \$25 million gain representing an earn-out related to the 1998 sale of its Commercial lines division.

Annuity Benefits Annuity benefits reflect amounts accrued on annuity policyholders' funds accumulated. The majority of GAFRI's fixed rate annuity products permit GAFRI to change the crediting rate at any time (subject to minimum interest rate guarantees of 3% or 4% per annum). As a result, management has been able to react to changes in market interest rates and maintain a desired interest rate spread. In 2000, annuity benefits also includes a second quarter charge of \$14.2 million related to the settlement of a policyholder class action lawsuit.

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

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

Interest Expense Interest expense for the second quarter and six months of 2001 decreased compared to 2000 as lower average interest rates on AFG's variable rate debt and lower average subsidiary indebtedness more than offset higher average borrowings under the AFC bank line.

Other Operating and General Expenses Other operating and general expenses for 2000 include second quarter charges of \$18.3 million related to the settlement of the policyholder class action lawsuit against a GAFRI subsidiary and \$8.8 million for an adverse California Supreme Court ruling against an AFG property and casualty subsidiary. Excluding these litigation charges, other operating and general expenses increased \$11.6 million (11%) in the second quarter and \$23.1 million (11%) for the first six months of 2001 compared to 2000 due primarily to increased expenses associated with the IT initiative and slightly higher holding company expenses.

Investee Corporations For 2001, equity in earnings (losses) of investee corporations represents losses of two start-up manufacturing businesses. Equity in net earnings (losses) of investees in 2000 represents AFG's proportionate share of Chiquita's earnings. Due to Chiquita's restructuring plans, AFG suspended its use of equity accounting and reclassified its \$24 million investment to "Other stocks" in the balance sheet at June 30, 2001.

Recent Accounting Standards In July 2001, the Financial Accounting Standards Board issued SFAS No. 141, "Business Combinations", and No. 142, "Goodwill and Other Intangible Assets." Under SFAS No. 141, business combinations initiated after June 30, 2001 are required to be accounted for using the purchase method of accounting. Under SFAS No. 142, goodwill will no longer be required to be amortized beginning January 1, 2002, but will be subject to an impairment test at least annually. A transitional test for impairment is required to be completed in 2002 with any resulting writedown reported during the first quarter as a cumulative effect of a change in accounting principle. Based on goodwill recorded at June 30, 2001, management expects that goodwill amortization in 2002 would have been approximately \$15 million.

Item 3

Quantitative and Qualitative Disclosure of Market Risk

As of June 30, 2001, there were no material changes to the information provided in AFG's Form 10-K for 2000 under the caption "Exposure to Market Risk" in Management's Discussion and Analysis of Financial Condition and Results of Operations.

AMERICAN FINANCIAL GROUP, INC. 10-Q
PART II
OTHER INFORMATION

Item 1

Legal Proceedings

Reference is made to MD&A - Asbestos and Environmental Reserves Study.

Item 4

Submission of Matters to a Vote of Security Holders

AFG's Annual Meeting of Shareholders was held on May 24, 2001; there were two matters voted upon: (Item 1) election of eight directors, and (Item 2) approval of an amendment to the Stock Option Plan. Approximately 92% of the shares eligible to vote were represented at the meeting.

The votes cast for, against, withheld and the number of abstentions as to each matter voted on at the 2001 Annual Meeting is set forth below:

| <u>Name</u> | <u>For</u> | <u>Against</u> | <u>Withheld</u> | <u>Abstain</u> |
|----------------------|------------|----------------|-----------------|----------------|
| Item 1 | | | | |
| Theodore H. Emmerich | 59,205,777 | N/A | 1,914,774 | N/A |
| James E. Evans | 56,156,346 | N/A | 4,964,205 | N/A |
| Thomas M. Hunt | 59,200,338 | N/A | 1,920,213 | N/A |
| Carl H. Lindner | 55,919,822 | N/A | 5,200,729 | N/A |
| Carl H. Lindner III | 55,914,916 | N/A | 5,205,635 | N/A |
| Keith E. Lindner | 55,906,920 | N/A | 5,213,631 | N/A |
| S. Craig Lindner | 55,919,232 | N/A | 5,201,319 | N/A |
| William R. Martin | 59,204,776 | N/A | 1,915,775 | N/A |
| Item 2 | 52,800,463 | 8,246,768 | N/A | 73,320 |

N/A - Not Applicable

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PART II
OTHER INFORMATION - CONTINUED

Item 6

Exhibits and Reports on Form 8-K

(a) Exhibit 10 - 2001 Annual Bonus Plan.

(b) Reports on Form 8-K:

| <u>Date of Report</u> | <u>Item Reported</u> |
|-----------------------|---------------------------------------|
| August 2, 2001 | Second quarter 2001 Earnings Release. |

Signature

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

American Financial Group, Inc.

August 13, 2001

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