Annual Report for 2004

American Financial Group, Inc. ("AFG" or the "Company") is engaged in property and casualty insurance, focusing on specialized commercial products for businesses, and in the sale of retirement annuities, supplemental insurance and life products.

__Our property and casualty__ ("P&C") operations emphasize underwriting profitability, entrepreneurship and specialization based on a common operating philosophy.

__Our annuity, supplemental insurance and life__ businesses focus on profitable, innovative products and services to provide customers with more choices in planning for lifestyle security.

With record earnings in 2004, the strongest capital in its history, a stronger debt-to-total capital ratio, and a stock market price which rose nearly 20% in 2004, AFG expects to take advantage of its expertise in niche markets in the upcoming years.

Contents

Financial Highlights	1
A Message to Our Shareholders	2
American Financial Group at a Glance	4
Business Summary	6
Financial Review for 2004	11
Corporate and Investor Information	56

Please refer to "Forward-Looking Statements" on the inside back cover.

Financial Highlights

(In millions, except per share data)	**2004**	2003	2002	2001	2000
Balance Sheet Data:					
Cash and investments	**$15,637**	$13,828	$13,651	$12,084	$11,500
Total assets	**22,560**	20,312	19,628	17,538	16,558
Long-term debt:					
Parent holding companies	**685**	575	637	597	573
Subsidiaries	**344**	262	308	282	207
Shareholders' equity	**2,431**	2,076	1,726	1,498	1,549
Ratio of debt to total capital (a)	**31%**	35%	43%	43%	41%
Cash dividends per share	**$0.50**	$0.50	$0.50	$1.00	$1.00
Book value per share (b)	**$29.35**	$25.97	$21.42	$20.71	$22.85
Shares outstanding	**76.6**	73.1	69.1	68.5	67.4

Summary of Operations:					
Total revenues	**$3,906**	$3,360	$3,745	$3,919	$3,816
Net earnings (loss) – GAAP	**$359.9**	$293.8	$ 84.6	$(14.8)	$ (56.0)
After tax income (expense) items included in net earnings (c):					
Litigation settlements and A&E reserve increase	**(33.8)**	(23.1)	(19.5)	(44.8)	—
Special tax benefits (d)	**—**	141.5	31.0	—	—
Net losses from non-financial investee corporations	**(3.2)**	(3.1)	(9.0)	(16.5)	(91.4)
Realized investment gains (losses)	**192.2**	50.8	(44.7)	(13.1)	2.1
Discontinued operations (e)	**(2.4)**	(33.6)	1.4	(19.9)	(0.4)
World Trade Center loss	**—**	—	—	(16.3)	—
Accounting changes and extraordinary items	**(5.6)**	6.3	(40.4)	(10.0)	(9.1)
Other	**(2.7)**	(0.8)	—	—	—
Net earnings from insurance businesses – Non-GAAP	**$215.4**	$155.8	$165.8	$105.8	$ 42.8
Diluted earnings (loss) per share amounts:					
Net earnings (loss) available to Common Shares – GAAP	**$4.81**	$4.12	$1.22	$(0.22)	$(0.95)
Litigation settlements and A&E reserve increase	**(0.45)**	(0.33)	(0.28)	(0.66)	—
Special tax benefits (d)	**—**	2.01	0.44	—	—
Net losses from non-financial investee corporations	**(0.04)**	(0.04)	(0.13)	(0.24)	(1.55)
Realized investment gains (losses)	**2.57**	0.73	(0.64)	(0.19)	0.04
Discontinued operations (e)	**(0.03)**	(0.48)	0.02	(0.29)	(0.01)
World Trade Center loss	**—**	—	—	(0.24)	—
Accounting changes and extraordinary items	**(0.08)**	0.09	(0.59)	(0.15)	(0.15)
Other	**(0.04)**	(0.08)	—	—	—
Net earnings from insurance businesses – Non-GAAP	**$2.88**	$2.22	$2.40	$1.55	$0.72

(a) For this calculation, debt and capital both include payable to subsidiary trusts and subsidiary preferred stock; capital also includes minority interest and shareholders' equity (excluding unrealized gains on fixed maturity investments).

(b) Excludes unrealized gains on fixed maturity investments.

(c) These items are excluded in deriving our "core" earnings from insurance operations for discussion and analytical purposes. Though core earnings is not a generally accepted accounting principles ("GAAP") measure, it is a key performance measure used by analysts and rating agencies.

(d) Reflects tax benefits in 2003 related to AFG's merger with AFC and its basis in Infinity stock. Tax benefits in 2002 relate to the resolution of certain tax matters.

(e) Reflects the results related to Transport Insurance Company which was sold in the fourth quarter of 2004.

To Our Shareholders

Last year we wrote about our specialized commercial insurance products group and our retirement annuity, supplemental insurance and life products group. We are pleased to report that both groups were profitable and grew in line with our expectations during 2004. Notwithstanding a few surprises, we were able to achieve record results.

Financial Results

Net earnings for 2004 reached a record $359.9 million ($4.81 per share) due in large part to a $134 million gain on the sale of Provident Financial Group shares to National City Corporation. "Core earnings" from insurance operations were $215.4 million ($2.88 per share) in 2004 compared to $155.8 million ($2.22 per share) in 2003.

The Property and Casualty Group continued to benefit from prior year rate increases as its ongoing insurance operations generated an underwriting profit in 2004, fully 78% greater than in 2003, despite one of the worst hurricane seasons in history. Rate increases moderated to about 6% in 2004. After three years of strong growth, market conditions have softened and we expect rates to remain relatively flat throughout the rest of this year. At the same time, we expect our underwriting discipline and balance sheet strength will enable us to continue our long tradition of outperforming industry averages.

The Annuity, Supplemental Insurance and Life Group reported strong operating earnings, 28% above those of 2003. Despite the continued low interest rate environment, each line of business in this group reported improved results in 2004.

Financial Strength

We ended 2004 with the strongest capital position in our history. Shareholders' equity is at an all time high. Book value per share increased 13% to $29.35. The record earnings along with the sale of common stock enabled us to improve our debt-to-total-capital ratio by 4 percentage points to 31%. We expect to trim another few points, with the ratio settling in below 30%, over the next 18 months. Our financial flexibility is strong as the parent company currently holds in excess of $100 million in cash and has no borrowings under its bank line.

Our strong financial performance and balance sheet strength were recognized by the stock market as AFG's stock price rose 18% during the year, more than twice the increase of the Standard & Poor's 500 Index.

Despite gradual increases in short-term interest rates in 2004, yield curves have flattened and long-term rates remain near 40-year lows. Consequently, AFG's yield on investments (based on amortized cost) fell to 5.7%. Investment income increased moderately, however, as cash and investments grew 13% to over $15.6 billion. Our investment portfolio, also at its highest quality ever, had a market value $450 million greater than its cost. Over the past 10 years, we have taken over $850 million in gains on sales of investments. We intend to continue to harvest gains opportunistically in the future.

Corporate Governance

Regulatory requirements associated with the Sarbanes-Oxley Act proved to be one of the more significant challenges of 2004. In response to this legislation, we reviewed, documented and tested a comprehensive set of internal controls. To ensure compliance, we tested all these processes company-wide. As of year-end, AFG was able to claim, and clearly demonstrate to our auditors, an effective system of internal controls.

In December of last year, we received a subpoena from the New York Attorney General's office, as did other insurance companies, requesting information about our legal malpractice insurance. We are cooperating fully with this investigation and continue to reconfirm with our employees the importance of maintaining high ethical standards. Our Board of Directors is comprised of a majority of independent directors who are highly qualified, experienced individuals who share our operating philosophy and professional commitment.

Strategic Focus

We are pleased with AFG's strong performance in 2004 and believe that the strategies we have been following have contributed to improvements and profitability in nearly all aspects of our business. Key aspects of our strategic focus include:

- improving and refining our diversified mix of specialty products and businesses,
- maintaining underwriting discipline through adequate pricing and astute risk selection,
- competing responsibly and ethically in the marketplace,
- delivering world class claims handling and customer service,
- identifying and developing future business leaders who will enhance our intellectual capital,
- capitalizing on our strong investment capabilities, and
- managing expenses diligently,

all with the purpose of enhancing shareholder value. By focusing on these long-term business goals, we believe we can continue to generate solid financial performance, both in profitability and balance sheet strength.

An important part of our strategy is making sure we have people in place to lead our company. As previously announced, Carl H. Lindner, the Company's founder, has stepped down as Chief Executive Officer, although he remains Chairman of the Board. For more than 40 years Carl has provided the insight, energy and leadership that built American Financial Group as a strong, successful business. He has been a leader in the community and has provided opportunities for people in all walks of life. We cherish his legacy of service to others. We look forward to continuing in that tradition in our new roles as co-Chief Executive Officers. In March, Fred J. Runk retired as chief financial officer. We thank Fred for his many years of dedicated service, insight and counsel. Keith Jensen has assumed the responsibilities of chief financial officer.

A Promising Future

We would like to thank the entire AFG team—employees, customers, providers of goods and services—for their efforts in making 2004 one of our most successful years ever. We would also like to thank you, our shareholders, for your continued interest and support.

We're positioned well for continued growth and profitability. We look forward to reporting to you again on our progress. The best is yet to come.

Carl H. Lindner III
Co-Chief Executive Officer

S. Craig Lindner
Co-Chief Executive Officer

March 31, 2005

American Financial Group at a Glance

Segment/Operating Unit	Description and Developments
Specialty Property & Casualty Insurance Group (A.M. Best Rating) Great American Insurance Company (A) American Empire Surplus Lines Insurance Company (A) Mid-Continent Casualty Company (A) National Interstate Insurance Company (A) Republic Indemnity Company of America (A–)	■ This group offers a wide array of specialized commercial insurance coverages and services through many business units and subsidiaries. ■ Net written premiums grew 20% in 2004 reflecting volume growth and rate increases in certain of our commercial casualty businesses, coupled with a reduction in reinsurance. Rate increases averaged about 6% for 2004. ■ National Interstate, the second largest writer in the U.S. of insurance for the passenger transportation industry, continued its excellent track record of profitability and premium growth while positioning itself for a successful initial public offering completed in January 2005. ■ American Empire Surplus Lines has experienced 20 consecutive years of underwriting profitability.
Specialty Group Components: **Property and Transportation** Includes physical and damage and liability coverage for buses, trucks and recreational vehicles, inland and ocean marine, agricultural-related products and other property coverages. **Specialty Casualty** Includes excess and surplus, general liability, executive and professional liability and customized programs for small to mid-sized businesses. **Specialty Financial** Includes risk management insurance programs for lending and leasing institutions, surety and fidelity bonds and foreign credit insurance. **California Workers' Compensation** Consists of a subsidiary that writes workers' compensation insurance primarily in the state of California. **Other** Includes an internal reinsurance facility.	■ 2004 was a record earnings year for our Crop Division, the third largest writer of crop insurance in the U.S. and a recognized leader in the industry. ■ Our equine mortality operation achieved record premium in 2004 and continues to be the market leader. ■ Our property and inland marine operations had another extraordinary year, a continuation of the growth and profitability it has enjoyed since its formation in 1990. ■ Our excess and surplus, general liability and targeted markets businesses generated solid underwriting profits in 2004. ■ Mid-Continent, largely a writer of general liability insurance, had a turnaround year in 2004 and the largest premium production in its history. ■ Our Fidelity & Crime unit has been opportunistic in offering unique programs for casinos and armored car companies and added a kidnap and ransom coverage. ■ Our trade credit insurance business is a significant market leader in the credit insurance segment and has produced an underwriting profit every year since being acquired in 1991. ■ Our California workers' compensation subsidiary, Republic Indemnity, has taken advantage of the improved market conditions that began in 2001. Its operating results reflect significant price increases and meaningful regulatory reform during the past several years.
Annuity, Supplemental Insurance and Life Group (A.M. Best Rating) Great American Financial Resources, Inc. (GAFRI) Great American Life Insurance Company (A) Annuity Investors Life Insurance Company (A) United Teacher Associates Insurance Company (A–) Loyal American Life Insurance Company (A) Great American Life Assurance Company of Puerto Rico (A)	■ We believe GAFRI is one of the top five fixed annuity companies for independent agents in the kindergarten through 12th grade school market. GAFRI also offers a variety of supplemental insurance products, including coverage for cancer, long-term care, Medicare supplement and disability. ■ In 2004, GAFRI reached record levels in almost every key measure of financial strength, including stockholders' equity, book value per share, revenues, net earnings, and assets; its debt-to-capital ratio is at its lowest level ever. ■ GAFRI's supplemental insurance lines and Puerto Rico subsidiary each reported record operating earnings, premiums and assets. ■ Operating earnings increased in every line of business, leading to an overall increase of 28 percent.

Segment Data *(dollars in millions)*
for years ended December 31

Specialty Property & Casualty Insurance Group	**2004**	2003	2002
Gross Written Premiums	**$3,639**	$3,243	$2,713
Net Written Premiums	**2,224**	1,854	1,577
Net Earned Premiums	**2,097**	1,746	1,497
GAAP Ratios:			
Loss & LAE	**66.7%**	67.4%	67.5%
Underwriting Expense	**27.4%**	28.6%	30.9%
Combined Ratio	**94.1%**	96.0%	98.4%

Specialty Group Components	**2004**	2003	2002
Gross Written Premiums:			
Property and Transportation	**$1,337**	$1,142	$ 886
Specialty Casualty	**1,453**	1,413	1,235
Specialty Financial	**468**	396	332
California Workers' Compensation	**380**	290	229
Other	**1**	2	31
	$3,639	$3,243	$2,713
Net Written Premiums:			
Property and Transportation	**$ 683**	$ 515	$ 413
Specialty Casualty	**740**	679	609
Specialty Financial	**395**	302	255
California Workers' Compensation	**339**	271	219
Other	**67**	87	81
	$2,224	$1,854	$1,577
GAAP Combined Ratio:			
Property and Transportation	**80.7%**	87.8%	90.1%
Specialty Casualty	**99.8%**	98.2%	106.6%
Specialty Financial	**108.9%**	108.4%	101.4%
California Workers' Compensation	**89.5%**	92.0%	96.4%

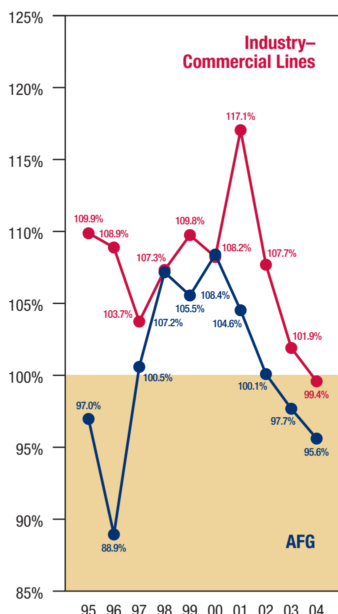
Annuity, Supplemental Insurance and Life Group	**2004**	2003	2002
Statutory Premiums:			
Annuities:			
Fixed	**$ 663**	$ 747	$ 819
Variable	**105**	122	182
Total Annuities	**768**	869	1,001
Supplemental Health and Life Premiums	**348**	335	313
Total Premiums	**$1,116**	$1,204	$1,314
Gross Investment Income	**$ 538**	$ 517	$ 532

Business Summary

Specialty Group

Profitability vs. Industry
(Calendar Year)

Statutory Combined Ratio
(Total Insurance Losses + Costs)



In all our insurance businesses, we sell promises—significant promises. Our foundations for delivery on those promises are expertise, integrity, and financial strength. Success can be defined in many ways; ultimately, for us it is (i) delivering solutions for the financial risks and challenges faced by our customers and (ii) generating returns that deliver long-term value to our investors and our employees.

There will always be obstacles in our path—after all, our business is to take on the potential obstacles of our insureds in exchange for payment of a premium—but many, such as asbestos and environmental issues, a litigious climate with many generous jury awards, interest rates at historically low levels, and the threat of terrorism—cannot be anticipated with any precision. Consistent adherence to our strict fundamentals in underwriting, risk selection, pricing, claims handling and communication is essential to minimize the risks associated with the unknown. Strong relationships with our customers and an understanding of their needs and wants are also key.

Proper execution of our strategy begins with a talented, experienced team of people. Our management team strives to not only make good operating decisions, but also to attract and develop future leaders of our organization. Proper execution will also enable us to be successful and to have the financial strength to continue to fulfill the promises we make.

Property and Casualty Insurance Operations

Our property and casualty operations consist primarily of a specialty insurance group composed of multiple business units operating in areas where we can have an advantage based on our expertise, unique products or distribution. Senior management allows each of the units operating autonomy, yet retains certain strong central controls through capital allocation and periodic strategic reviews. This entrepreneurial approach has proven successful as the individual units can be opportunistic and are able to quickly react to changing market conditions, while being held fully accountable for their results.

Through a variety of business units, we offer a wide array of insurance products including, but not limited to, the following major lines of business within four classifications:

Property and Transportation

- **Inland and Ocean Marine.** Coverage primarily for marine cargo, boat dealers, marina operators/dealers, excursion vessels, builders' risk, contractors' equipment, excess property and motor truck cargo.

- **Agricultural-related.** Federally reinsured multi-peril crop (allied lines) insurance covering most perils as well as crop hail, equine mortality and other coverages for full-time operating farms/ranches and agribusiness operations on a nationwide basis.
- **Commercial Automobile.** Customized insurance programs for various transportation operations and a specialized physical damage product for the trucking industry.

Specialty Casualty

- **Executive and Professional Liability.** Liability coverage for attorneys, and for directors and officers of businesses and not-for-profit organizations.
- **Umbrella and Excess Liability.** Higher layer liability coverage in excess of primary layers.
- **Excess and Surplus.** Specially designed insurance products for those who can't find coverage in standard markets.

Specialty Financial

- **Fidelity and Surety Bonds.** Fidelity and crime coverage for government, mercantile and financial institutions. Surety coverage for various types of contractors and public and private corporations.
- **Collateral Protection.** Coverage for insurance risk management programs for lending and leasing institutions.

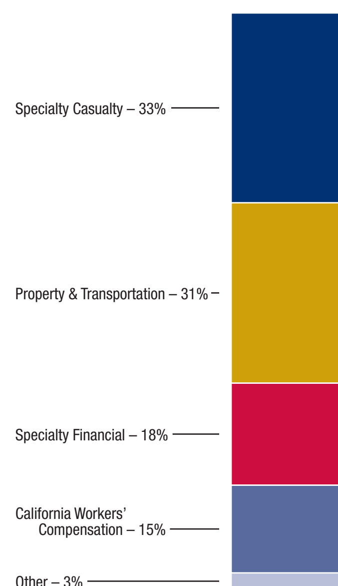
California Workers' Compensation

- **Workers' Compensation.** Coverage for prescribed benefits payable to employees (principally in California) who are injured on the job.

Our focus on underwriting performance has enabled our property and casualty group to outperform the industry in 2004 and for eighteen of the last nineteen years. We believe that our product line diversification and stringent underwriting discipline have contributed to our ability to consistently outperform the industry. Our goal is to earn underwriting profits while providing exceptional service to our policyholders. Management's philosophy has been to refrain from writing business that is not expected to be profitable even if it is necessary to limit premium growth to do so.

Specialty Group

2004 Premium Distribution

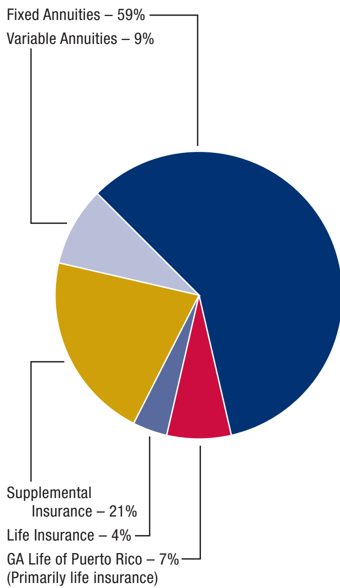


We try to react quickly to take advantage of changing market conditions. Management is continually analyzing markets to identify new risks and new opportunities within our businesses. This helps us to quickly determine any necessary course of action—whether a change in price or perhaps a shift of capital to more profitable lines of business.

In 2004, our gross written premiums totaled $3.6 billion, an increase of almost $400 million or 12% over 2003. After reinsurance, net written premiums increased about $370 million or 20% to $2.2 billion. The increase in premiums reflects volume growth in crop, California workers' compensation, collateral protection and other product lines as well as the impact of rate increases averaging about 6% during the year. Due primarily to more competitive market conditions, we anticipate little increase in overall rates for 2005.

Our combined ratio improved 1.9 points to 94.1% despite $37 million in losses (1.8 points) due to the hurricanes that ravaged the Southeastern U.S. The Specialty Group has now generated underwriting profits for thirteen consecutive quarters.

Annuity, Supplemental Insurance and Life Group
2004 Premium Distribution



Annuity, Supplemental Insurance and Life Operations

Our annuity, supplemental insurance and life operations are conducted through Great American Financial Resources (GAFRI). This part of our organization has been built on the fixed annuity business, which remains its core line of business. Over the years we have diversified our offerings with supplemental insurance and life products designed to meet market needs while achieving our premium and profitability targets.

Annuities make up our largest product group, accounting for more than 80% of GAFRI's assets and approximately two-thirds of its premiums. We continue to update our traditional fixed annuity offerings to meet the needs of our target markets and attract quality agents. As a result, GAFRI's sales of fixed annuities in the school segment climbed for the fourth straight year. In the non-school segment, GAFRI's sales of fixed annuities fell in 2004 as we maintained our commission and interest crediting discipline during a period of historically low interest rates.

Through United Teacher Associates Insurance Company (UTA) and Loyal American Life Insurance Company, both with operations in Austin, Texas, we sell insurance policies to supplement primary health and other insurance coverage as well as long-term care insurance. These limited benefit products provide coverage for critical illness, short-term disability, cancer, intensive care, accidents, hospital stays, and long-term care for individuals and groups. Gross premiums of Loyal and UTA increased nearly 14% in 2004.

Great American Life Assurance Company of Puerto Rico is the largest in-home service life insurance provider in Puerto Rico. Through this company, we sell life and supplemental health insurance products through a network of company-employed agents and ordinary life, cancer, and other products through independent agents and banks.

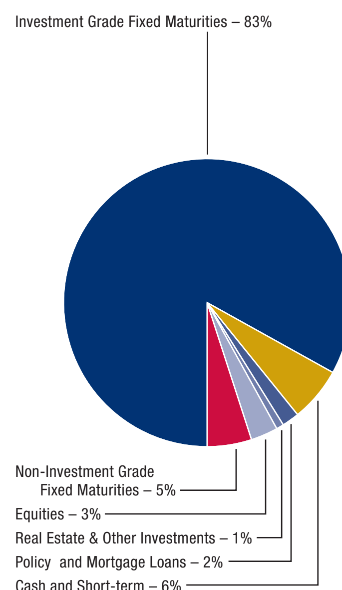
Investments

Our primary investment objective is to maximize return on an ongoing basis rather than focus on short-term performance. Our talented team of analysts and investment managers has built a high quality investment portfolio that produces a relatively predictable, steady stream of income, mitigating the uncertainties of our insurance operations. Over the years our conservatively invested, low-risk portfolio has generated solid returns and provided asset growth. In 2004, investment income, consisting primarily of interest and dividends received on bonds and stocks held, totaled about $800 million. This is a slight increase over 2003, reflecting a $1.4 billion increase in average cash and investments, offset by lower average yields on fixed maturity investments.

At December 31, 2004, our fixed maturity portfolio had an aggregate market value of $13.7 billion, which was $375 million in excess of its cost. Approximately 94% of these investments were rated “investment grade” (credit rating of AAA to BBB) by nationally recognized rating agencies. The average life of our fixed maturity investments is less than five years for our property and casualty companies and about seven and one-half years for our annuity, supplemental insurance and life group, reflecting the relative longevity of each group’s insurance liabilities and in each case allowing flexibility to react to changes in market conditions. Our fixed income portfolio is also diversified to limit our exposure to any one issuer or industry—the largest investment in securities of any single issuer (other than U.S. Treasury Notes) amounted to less than one percent of total investments at December 31, 2004.

Investment Portfolio

Composition at December 31, 2004



Stocks, real estate, policy loans and other investments make up the remainder of our investments. At December 31, 2004, our stock portfolio had an aggregate market value of about $540 million which was $80 million in excess of cost. In July, 2004, we received shares of National City Corporation in exchange for our ownership interest in Provident Financial Group and realized a $214 million pretax gain on the transaction.

Other investments include classic European style hotels in Cincinnati (The Cincinnatian) and New Orleans (Le Pavillon); the Driskill Hotel in Austin; the Chatham Bars Inn on Cape Cod; the Skipjack Cove Yachting Resort on Chesapeake Bay; the Charleston Harbor Resort and Marina; the Sailfish Marina and Resort in Palm Beach Shores; apartment developments in several states; and potentially valuable air rights in New York City. We believe that the market value of our real estate is significantly in excess of its $200 million carrying value.

Play Ball!

We are proud to have our name displayed prominently on the home of the oldest franchise in professional baseball as the Cincinnati Reds' Great American Ball Park hosts fans for its third season. The complex now also includes the Cincinnati Reds Hall of Fame which was opened last fall.

AMERICAN FINANCIAL GROUP, INC.®

Financial Review for 2004

Contents

Selected Financial Data 12

Management's Discussion and Analysis of Financial Condition and Results of Operations 13

Consolidated Financial Statements and Notes
- Consolidated Balance Sheet 30
- Consolidated Statement of Earnings 31
- Consolidated Statement of Changes in Shareholders' Equity 32
- Consolidated Statement of Cash Flows 33
- Notes to Consolidated Financial Statements
  - A. Accounting Policies 34
  - B. Acquisitions and Sales of Subsidiaries 38
  - C. Segments of Operations 39
  - D. Investments 40
  - E. Deferred Acquisition Costs 42
  - F. Managed Investment Entity 42
  - G. Goodwill 42
  - H. Long-term Debt 43
  - I. Payable to Subsidiary Trusts (Issuers of Preferred Securities) 44
  - J. Minority Interest 44
  - K. Shareholders' Equity 44
  - L. Income Taxes 46
  - M. Discontinued Operation 47
  - N. Equity in Net Earnings (Losses) of Investees 47
  - O. Commitments and Contingencies 48
  - P. Quarterly Operating Results (Unaudited) 48
  - Q. Insurance 50
  - R. Additional Information 51
  - S. Subsequent Event (Unaudited) 52

Report of Management on Internal Control Over Financial Reporting 53

Reports of Independent Registered Public Accounting Firm 54

Selected Financial Data — GAAP

(dollars in millions, except per share data)	2004	2003	2002	2001	2000
Earnings Statement Data:					
Total Revenues	**$3,906**	$3,360	$3,745	$3,919	$3,816
Operating Earnings Before Income Taxes	**590**	301	176	86	110
Earnings (Loss) from Continuing Operations	**368**	321	124	15	(47)
Discontinued Operations (a)	**(2)**	(33)	1	(20)	—
Cumulative Effect of Accounting Changes (b)	**(6)**	6	(40)	(10)	(9)
Net Earnings (Loss)	**360**	294	85	(15)	(56)
Basic Earnings (Loss) Per Common Share:					
Earnings (Loss) from Continuing Operations	**$5.00**	$4.53	$1.80	$.22	($.79)
Discontinued Operations	**(.03)**	(.48)	.02	(.29)	(.01)
Cumulative Effect of Accounting Change	**(.08)**	.09	(.59)	(.15)	(.15)
Net Earnings (Loss) Available to Common Shares	**4.89**	4.14	1.23	(.22)	(.95)
Diluted Earnings (Loss) Per Common Share:					
Earnings (Loss) from Continuing Operations	**$4.92**	$4.51	$1.79	$.22	($.79)
Discontinued Operations	**(.03)**	(.48)	.02	(.29)	(.01)
Cumulative Effect of Accounting Change	**(.08)**	.09	(.59)	(.15)	(.15)
Net Earnings (Loss) Available to Common Shares	**4.81**	4.12	1.22	(.22)	(.95)
Cash Dividends Paid Per Share of Common Stock	**$.50**	$.50	$.50	$1.00	$1.00
Ratio of Earnings to Fixed Charges (c):					
Including Annuity Benefits	**2.43**	1.69	1.36	1.13	1.18
Excluding Annuity Benefits	**7.07**	3.71	2.40	1.49	1.63
Balance Sheet Data:					
Total Assets	**$22,560**	$20,312	$19,628	$17,538	$16,558
Long-term Debt:					
Holding Companies	**685**	575	637	597	573
Subsidiaries	**344**	262	308	282	207
Minority Interest	**220**	188	471	455	508
Shareholders' Equity	**2,431**	2,076	1,726	1,498	1,549

(a) Reflects the results related to Transport Insurance Company which was sold in the fourth quarter of 2004.

(b) Reflects the implementation of accounting changes mandated by recently enacted accounting standards.

(c) Fixed charges are computed on a "total enterprise" basis. For purposes of calculating the ratios, "earnings" have been computed by adding to pretax earnings the fixed charges and the minority interest in earnings of subsidiaries having fixed charges and the undistributed equity in losses of investees. Fixed charges include interest (including or excluding interest credited to annuity policyholders' accounts as indicated), amortization of debt premium/discount and expense, preferred dividend and distribution requirements of subsidiaries and a portion of rental expense deemed to be representative of the interest factor.

Although the ratio of earnings to fixed charges *excluding* interest on annuities is not required or encouraged to be disclosed under Securities and Exchange Commission rules, some investors and lenders may not consider interest credited to annuity policyholders' accounts a borrowing cost for an insurance company, and accordingly, believe this ratio is meaningful.

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

General

Following is a discussion and analysis of the financial statements and other statistical data that management believes will enhance the understanding of AFG's financial condition and results of operations. This discussion should be read in conjunction with the financial statements beginning on page 30.

Overview

Financial Condition

AFG is organized as a holding company with almost all of its operations being conducted by subsidiaries. AFG, however, has 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.

The following items highlight improvements in AFG's financial condition during 2004:

- AFG and GAFRI issued just over $200 million in senior debentures in the first quarter of 2004, and used approximately $189 million of the proceeds to retire higher coupon debt due unconsolidated subsidiary trusts that, in turn, retired preferred securities.
- In 2004, AFG and GAFRI replaced their existing bank credit lines with four-year lines of $300 million and $150 million, respectively. No amounts were borrowed under these facilities at December 31, 2004.
- AFG received $82 million in cash during the fourth quarter of 2004 from the issuance of 2.7 million shares of Common Stock.
- At December 31, 2004, AFG (parent) had over $100 million in cash and short-term investments.

Results of Operations

Through the operations of its subsidiaries, AFG is engaged primarily in property and casualty insurance and in the sale of retirement annuities and supplemental insurance and life products. With the sale of Infinity in 2003, AFG narrowed the focus of its property and casualty business to its specialized commercial products for businesses.

The property and casualty business is cyclical in nature with periods of high competition resulting in low premium rates, sometimes referred to as a "soft market" or "downcycle" followed by periods of reduced competition and higher premium rates, referred to as a "hard market" or "upcycle." The 1990's were a soft market period; prices started to harden in 2000 and accelerated significantly following the terrorist attacks in 2001. Rate increases moderated during the latter part of 2003 and continued that trend during 2004.

As discussed in the following pages under "Results of Operations," the profitability of AFG's property and casualty business improved during the hard market despite the negative impact of adverse development on prior year claims and lower yields on newly invested funds.

AFG's net earnings for 2004 were $360 million ($4.81 per share). Included in net earnings were the following items, net of tax and minority interest:

- Net realized gain of $134.4 million on the sale of Provident Financial Group securities.
- Charge of $33.8 million related to the settlement of environmental litigation.
- Underwriting losses of $24.1 million from four hurricanes.

Critical Accounting Policies

Significant accounting policies are summarized in Note A 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, especially asbestos and environmental-related reserves, the recoverability of deferred acquisition costs, and the determination of "other than temporary" impairment on investments are the areas where the degree of judgment required to determine amounts recorded in the financial statements make the accounting policies critical. See *"Liquidity and Capital Resources – Investments"* for discussion of impairments on investments and *"Liquidity and Capital Resources – Uncertainties"* for a discussion of insurance reserves.

Recoverability of Deferred Acquisition Costs

Deferred acquisition costs ("DAC") related to annuities and universal life insurance products are amortized in relation to the present value of expected gross profits on the policies. Assumptions considered in determining expected gross profits involve significant judgment and include management's estimates of assumed interest rates and investment spreads, surrenders, annuitizations, renewal premiums and mortality. Should actual experience require management to change its assumptions regarding the emergence of future revenues and profits (commonly referred to as "unlocking"), a charge or credit would be recorded to adjust DAC to the level it would have been if the new assumptions had been used from the inception date of each policy.

Liquidity and Capital Resources

Ratios

AFG's debt to total capital ratio (at the parent holding company level) was approximately 22% at December 31, 2004, compared to 21% at December 31, 2003.

AFG's ratio of earnings to fixed charges, including annuity benefits as a fixed charge, was 2.43 (1.91 excluding the Provident gain) for the year ended December 31, 2004. Excluding annuity benefits, this ratio was 7.07 (4.85 excluding the Provident gain) for 2004. Although the ratio excluding interest on annuities is not required or encouraged to be disclosed under Securities and Exchange Commission rules, it is presented because interest credited to annuity policyholder accounts is not always considered a borrowing cost for an insurance company.

The NAIC's model law for risk based capital ("RBC") applies to both life and property and casualty companies. RBC formulas determine the amount of capital that an insurance company needs to ensure that it has an acceptable expectation of not becoming financially impaired. At December 31, 2004, the capital ratios of all AFG insurance companies substantially exceeded the RBC requirements. The lowest capital ratio of any operating AFG subsidiary was over 3 times its authorized control level RBC.

Sources of Funds

Parent Holding Company Liquidity

Management believes AFG has sufficient resources to meet its liquidity requirements. If funds generated from operations, including dividends and tax payments from subsidiaries, are insufficient to meet fixed charges in any period, AFG would be required to utilize parent company cash ($107 million at December 31, 2004) or to generate cash through borrowings, sales of securities or other assets, or similar transactions.

In November 2004, AFG replaced its existing credit line with a $300 million, four-year credit facility. No amounts have been borrowed under this credit facility through December 31, 2004. Amounts borrowed bear interest at rates ranging from 1% to 2% over LIBOR based on AFG's credit rating. This credit agreement provides ample liquidity and can be used to obtain funds for operating subsidiaries or, if necessary, for the parent company.

Through public offerings in the fourth quarter of 2004, AFG sold 2.7 million shares of Common Stock at an average price of $30.56 per share, net of commissions and fees. Net proceeds from the sales of $81.9 million will be used to support the growth of its subsidiaries. In addition, AFG's wholly-owned subsidiary, American Premier Underwriters ("APU"), sold an additional 1.3 million previously issued and outstanding AFG common shares. These shares were held for the benefit of certain Class M creditors of APU's predecessor, The Penn Central Transportation Company. Proceeds from that sale ($41.5 million) were placed in escrow to be used to pay APU environmental claims related to its former railroad operations.

All debentures issued by AFG (and GAFRI) are rated investment grade by three nationally recognized rating agencies. In February 2004, AFG issued $115 million in 7-1/8% Debentures due 2034 under a shelf registration statement and called for redemption $95.5 million in 9-1/8% trust preferred securities. Under a currently effective shelf registration statement, AFG can issue up to an aggregate of $517 million in additional equity or debt securities. The shelf registration provides AFG with greater flexibility to access the capital markets from time to time as market and other conditions permit.

For statutory accounting purposes, equity securities of non-affiliates are generally carried at market value. At December 31, 2004, AFG's insurance companies owned publicly traded equity securities with a market value of $537 million. In addition, Great American Insurance Company owns GAFRI common stock with a market value of $670 million and a statutory carrying value of $469 million. Decreases in market prices could adversely affect the insurance group's capital, potentially impacting the amount of dividends available or necessitating a capital contribution. Conversely, increases in market prices could have a favorable impact on the group's dividend-paying capability.

Under tax allocation agreements with AFG, its 80%-owned U.S. subsidiaries generally compute tax provisions as if filing separate returns based on book

taxable income computed in accordance with generally accepted accounting principles. The resulting provision (or credit) is currently payable to (or receivable from) AFG.

Subsidiary Liquidity

In August 2004, GAFRI replaced its existing credit agreement with a $150 million four-year credit facility. Amounts borrowed bear interest at rates ranging from 1% to 2% over LIBOR based on GAFRI's credit rating. There were no amounts borrowed under this agreement at December 31, 2004. In addition, GAFRI can issue approximately $250 million in additional equity or debt securities under a currently effective shelf registration.

The liquidity requirements of AFG's insurance subsidiaries relate primarily to the liabilities associated with their products as well as operating costs and expenses, payments of dividends and taxes to AFG and contributions of capital to their subsidiaries. Historically, cash flows from premiums and investment income have provided more than sufficient funds to meet these requirements without requiring a sale of investments or contributions from AFG. Funds received in excess of cash requirements are generally invested in additional marketable securities. In addition, the insurance subsidiaries generally hold a significant amount of highly liquid, short-term investments.

The excess cash flow of AFG's property and casualty group allows it to extend the duration of its investment portfolio somewhat beyond that of its claim reserves.

In January 2005, National Interstate Corporation ("NIC"), a majority-owned subsidiary that specializes in property and casualty insurance for the passenger transportation industry, issued 3,350,000 shares of its common stock in an initial public offering. A portion of the $40.6 million of net proceeds from this offering were used to repay NIC's $15 million promissory note to another AFG subsidiary. The remainder will be used for other general corporate purposes. After the offering, AFG owns approximately 54% of NIC.

In GAFRI's annuity business, where profitability is largely dependent on earning a "spread" between invested assets and annuity liabilities, the duration of investments is generally maintained close to that of liabilities. In a rising interest rate environment, significant protection from withdrawals exists in the form of temporary and permanent surrender charges on GAFRI's annuity products. With declining rates, GAFRI receives some protection (from spread compression) due to the ability to lower crediting rates, subject to guaranteed minimums.

AFG believes its insurance subsidiaries maintain sufficient liquidity to pay claims and benefits and operating expenses, as well as meet commitments in the event of unforeseen events such as reserve deficiencies, inadequate premium rates or reinsurer insolvencies.

Contractual Obligations

The following table shows an estimate (based on historical patterns and expected trends) of payments to be made for insurance reserve liabilities, as well as scheduled payments for major contractual obligations (in millions).

	Total	Within One Year	2–3 Years	4–5 Years	More than 5 Years
Annuity, Life, Accident & Health Liabilities (a)	$ 9,154	$1,066	$2,401	$1,685	$4,002
Property and Casualty Unpaid Losses and Loss Adjustment Expenses (b)	5,337	1,800	1,700	700	1,137
Long-Term Debt	1,029	10	100	588	331
Payable to Subsidiary Trusts	78	—	—	—	78
Operating Leases	149	35	57	28	29
Total	$15,747	$2,911	$4,258	$3,001	$5,577

(a) Reserve projections for insurance liabilities include anticipated cash benefit payments only. Projections do not include any impact for future earnings or additional premiums.

(b) Dollar amounts and time periods are estimates based on historical net payment patterns applied to the gross reserves and do not represent actual contractual obligations. Based on the same assumptions, AFG projects reinsurance recoveries related to these reserves totaling $2.2 billion as follows: Within 1 year – $800 million; 2-3 years – $700 million; 4-5 years – $300 million; and thereafter – $434 million. Actual payments and their timing could differ significantly from these estimates.

The AFG Convertible Debentures due in 2033 are included in the above table at the first put date (2008). AFG has no material contractual purchase obligations or other long-term liabilities at December 31, 2004.

Investments

AFG attempts to optimize investment income while building the value of its portfolio, placing emphasis upon long-term performance.

Approximately two-thirds of AFG's consolidated assets are invested in marketable securities. AFG's investment portfolio at December 31, 2004, contained $13 billion in "Fixed maturities" classified as available for sale and $537 million in "Other stocks", all carried at market value with unrealized gains and losses reported as a separate component of shareholders' equity on an after-tax basis. At December 31, 2004, AFG had pretax net unrealized gains of $376.2 million on fixed maturities and $81.1 million on other stocks.

Fixed income investment funds are generally invested in securities with intermediate-term maturities with an objective of optimizing total return while allowing flexibility to react to changes in market conditions. At December 31, 2004, the average life of AFG's fixed maturities was about 6-1/2 years.

Approximately 94% of the fixed maturities held by AFG were rated "investment grade" (credit rating of AAA to BBB) by nationally recognized rating agencies at December 31, 2004. Investment grade securities generally bear lower yields and lower degrees of risk than those that are unrated or noninvestment grade. Management believes that the high quality investment portfolio should generate a stable and predictable investment return.

Investments in mortgage backed securities ("MBSs") represented approximately one-fourth of AFG's fixed maturities at December 31, 2004. 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 lower rates. Due to the significant decline in the general level of interest rates in recent years, AFG has experienced an increase in the level of prepayments on its MBSs; these prepayments have not been reinvested at interest rates comparable to the rates earned on the prepaid MBSs. Substantially all of AFG's MBSs are investment grade quality, with over 95% rated "AAA" at December 31, 2004.

Summarized information for the unrealized gains and losses recorded in AFG's Balance Sheet at December 31, 2004, is shown in the following table (dollars in millions). Approximately $66 million of available for sale "Fixed maturities" and $23 million of "Other stocks" had no unrealized gains or losses at December 31, 2004.

	Securities With Unrealized Gains	Securities With Unrealized Losses
Available for sale Fixed Maturities		
Market value of securities	$9,943	$3,402
Amortized cost of securities	$9,521	$3,448
Gross unrealized gain (loss)	$ 422	($ 46)
Market value as % of amortized cost	104%	99%
Number of security positions	1,759	397
Number individually exceeding $2 million gain or loss	12	—
Concentration of gains (losses) by type or industry (exceeding 5% of unrealized):		
Gas and electric services	$ 54.3	($ 2.3)
Banks, savings and credit institutions	67.0	(0.9)
Mortgage-backed securities	40.4	(22.3)
State and municipal	22.7	(1.6)
Telephone communications	21.1	(0.9)
U.S. government and government agencies	18.3	(8.6)
Percentage rated investment grade	93%	97%
Other Stocks		
Market value of securities	$ 464	$ 50
Cost of securities	$ 380	$ 53
Gross unrealized gain (loss)	$ 84	($ 3)
Market value as % of cost	122%	94%
Number individually exceeding $2 million gain or loss	5	—

The table below sets forth the scheduled maturities of AFG's available for sale fixed maturity securities at December 31, 2004, 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.

Maturity	Securities With Unrealized Gains	Securities With Unrealized Losses
One year or less	3%	2%
After one year through five years	23	35
After five years through ten years	39	16
After ten years	13	8
	78	61
Mortgage-backed securities	22	39
	100%	100%

AFG realized aggregate losses of $3.9 million during 2004 on $180.2 million in sales of fixed maturity securities (7 issues; 6 issuers) that had individual unrealized losses greater than $500,000 at December 31, 2003. Market values of six of the securities increased an aggregate of $3.1 million from year-end 2003 to date of sale. The market value of the remaining security decreased $428,000 from year-end 2003 to the sale date.

Although AFG 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.

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

		Aggregate Market Value	Aggregate Unrealized Gain (Loss)	Market Value as % of Cost Basis
Fixed Maturities				
Securities with unrealized gains:				
Exceeding $500,000	(252 issues)	$3,086	$240	108%
Less than $500,000	(1,507 issues)	6,857	182	103
		$9,943	$422	104%
Securities with unrealized losses:				
Exceeding $500,000	(25 issues)	$1,007	($ 21)	98%
Less than $500,000	(372 issues)	2,395	(25)	99
		$3,402	($ 46)	99%

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

	Aggregate Market Value	Aggregate Unrealized Gain (Loss)	Market Value as % of Cost Basis
Fixed Maturities with Unrealized Losses at December 31, 2004			
Investment grade with losses for:			
One year or less (318 issues)	$2,751	($26)	99%
Greater than one year (52 issues)	559	(17)	97
	$3,310	($43)	99%
Non-investment grade with losses for:			
One year or less (14 issues)	$ 63	($ 2)	97%
Greater than one year (13 issues)	29	(1)	97
	$ 92	($ 3)	97%

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

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

	Net Realized Gains on Sales	Charges for Impairment	Other(a)	Total
2004	$320.0	($ 16.7)	($ 1.3)	$302.0
2003	117.1	(58.4)	0.2	58.9
2002	112.8	(179.4)	(12.4)	(79.0)

(a) Includes adjustments to reflect the impact of realized gains and losses on the amortization of deferred policy acquisition costs and to carry derivatives at market.

Higher impairment charges in 2002 reflect a rise in corporate defaults in the marketplace resulting from the weakened economy and other factors.

Uncertainties

As more fully explained in the following paragraphs, management believes that the areas posing the greatest risk of material loss are the adequacy of its insurance reserves and American Premier's contingencies arising out of its former operations.

Property and Casualty Insurance Reserves

The liability for unpaid losses and loss adjustment expenses ("LAE") was as follows (in millions):

	December 31, 2004	December 31, 2003
Specialty	**$4,797**	$4,105
Personal	**—**	243
Other lines (including asbestos and environmental)	**540**	561
	$5,337	$4,909

The liabilities 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 periods on direct business written ("case reserves"); (b) estimates received from ceding reinsurers and insurance pools and associations; (c) estimates of unreported losses (including possible development on known claims) based on past experience ("IBNR"); (d) estimates based on experience of expense for investigating and adjusting claims; and (e) the current state of law and coverage litigation. Using these items as well as historical trends adjusted for changes in underwriting standards, policy provisions, product mix and other factors, management, including company actuaries, determines a single or "point" estimate which it records as its best estimate of the liabilities. Recorded amounts are analyzed and tested on a quarterly basis by company actuaries. Ranges of loss reserves are not developed by company actuaries.

Estimating the liability for unpaid losses and LAE is inherently judgmental and is influenced by factors which are subject to significant variation. Through the use of analytical reserve development techniques, management considers items such as the effect of inflation on medical, hospitalization, material, repair and replacement costs, general economic trends and the legal environment.

While current factors and reasonably likely changes in variable factors are considered in estimating the liability for unpaid losses, there is no method or system which can eliminate the risk of actual ultimate results differing from such estimates. As shown in the reserve development table (loss triangle) on page 10 of AFG's 2004 10-K, the original estimates of AFG's liability for losses and loss adjustment expenses, net of reinsurance, over the past 10 years have developed through December 31, 2004, to be deficient (for seven years) by as much as 14.3% and redundant (for three years) by as much as 2.0% (excluding the effect of special charges for asbestos and environmental exposures). The average of such redundancies and deficiencies has been slightly (less than 4%) deficient. Management believes this development illustrates the variability in factors considered in estimating its insurance reserves.

Quarterly reviews of unpaid loss and LAE reserves are prepared using standard actuarial techniques. These may include (but may not be limited to):

- Case Incurred Development Method;
- Paid Development Method;
- Bornhuetter-Ferguson Method; and
- Incremental Paid LAE to Paid Loss Methods.

Supplementary statistical information is reviewed to determine which methods are most appropriate to use or if adjustments are needed to particular methods. Such information includes:

- Open and closed claim counts
- Average case reserves and average incurred on open claims
- Closure rates and statistics related to closed and open claim percentages
- Average closed claim severity
- Ultimate claim severity
- Reported loss ratios
- Projected ultimate loss ratios
- Loss payment patterns

Within each line, Company actuaries review the results of individual tests, supplementary statistical information, and input from underwriting, operating and claim management, to select their point estimate of the ultimate liability. This estimate may be one test, or a weighted average of several tests, or a judgmental selection as the actuaries determine is appropriate. The actuarial review is performed each quarter as a test of the reasonableness of management's point estimate.

The level of detail in which data is analyzed varies among the different lines of business. Data is generally analyzed by major product or by coverage within product, using countrywide data; however, in some situations, data may be reviewed by state for a few large volume states. Appropriate segmentation of the data is determined based on data volume, data credibility, mix of business, and other actuarial considerations. Overall, Company actuaries review over 500 identified line components. Best estimates are selected based on test indications and judgment.

The following table shows (in millions) the breakdown of AFG's property and casualty reserves between case reserves, IBNR reserves and LAE reserves (estimated amounts required to adjust, record and settle claims, other than the claim payments themselves).

	December 31, 2004 Gross Loss Reserves			
	Case	IBNR	LAE	Total Reserve
Statutory Line of Business				
Other liability – occurrence	$ 495	$1,074	$285	$1,854
Workers' Compensation	724	305	76	1,105
Other liability – claims-made	317	262	119	698
Commercial multiple peril	153	164	103	420
Commercial Auto/ Truck Liability/Medical	127	129	58	314
Private Passenger Auto Liability/ Medical	80	54	20	154
Special property (fire, allied lines, inland marine, earthquake)	191	88	71	350
Other lines	141	214	82	437
Total Statutory Reserves	2,228	2,290	814	5,332
Adjustments for GAAP:				
Loss reserve discounting	(17)	—	—	(17)
Reserves of foreign operations	10	11	1	22
Total Adjustments for GAAP	(7)	11	1	5
Total GAAP Reserves	$2,221	$2,301	$815	$5,337

Following is a discussion of certain variables affecting the estimation of the more significant lines of business (asbestos and environmental liabilities are separately discussed below). Many other variables may also impact ultimate claim costs.

An important assumption underlying reserve estimates is that the cost trends implicitly built into development patterns will continue into the future. To estimate the sensitivity of recorded reserves to an unexpected change in the trends, 1% was added to the trend that is embedded in the factors used to determine the reserves for ultimate liabilities. This unexpected change could arise from a variety of sources including a general increase in economic inflation, inflation from social programs, new medical technologies, or other factors such as those listed below in connection with our largest lines of business. Utilizing the effect of a 1% change in cost trends enables changes greater than 1% to be estimated by extrapolation. Each

additional 1% change in the cost trend would increase the effect on net earnings by an amount slightly (about 6%) greater than the effect of the previous 1%. For example, if a 1% change in cost trends would change net earnings by $20 million, a 2% change would change net earnings by $41 million. The estimated cumulative impact that a one percent change would have on our net earnings is shown below (in millions).

Line of business	
Other Liability – Occurrence	$20
Workers Compensation	18
Other Liability – Claims made	12
Commercial Multi-peril	6

Other Liability – Occurrence

This line of business consists of coverages protecting the insured against legal liability resulting from negligence, carelessness, or a failure to act causing property damage or personal injury to others. Some of the important variables affecting estimation of loss reserves for other liability – occurrence include:

- Litigious climate
- Unpredictability of judicial decisions regarding coverage issues
- Magnitude of jury awards
- Outside counsel costs
- Timing of claims reporting

The judicial climate in some states has had some effect on certain claims in recent years with more liberal coverage decisions, expanded concepts of liability and higher jury awards. Significant case reserve strengthening has occurred in several books of business within this line. Stronger case reserves will cause future development on known claims to be less than recent historical patterns. Also, for some business in run-off, there have been significant changes in the procedures for managing outside counsel costs which should result in a reduction in future loss adjustment expenses compared to prior experience for this line of business.

Workers' Compensation

This line of business provides coverage to employees who may be injured in the course of employment. Some of the important variables affecting estimation of loss reserves for workers' compensation include:

- Legislative actions and regulatory interpretations
- Future medical cost inflation
- Timing of claims reporting

AFG's workers' compensation business is written primarily in California. There have been significant reforms passed by the California state legislature in 2003 and in 2004 that will impact future settlement payments for claims outstanding. The magnitude of these potential cost savings depends on the implementation and interpretation of the reforms throughout the California workers' compensation system over the next several years.

In addition, AFG's strengthening of case reserves during 2002 and 2003 should cause future development of known claims to be less than prior historical patterns.

Other Liability – Claims Made

This line of business consists mostly of directors and officers' liability, and professional liability, mostly for lawyers. Some of the important variables affecting estimation of loss reserves for other liability – claims made include:

- Litigious climate
- The economy
- Variability of the stock prices

The general state of the economy and the variability of the stock price of the insured can affect the frequency and severity of shareholder class action suits that trigger coverage under directors' and officers' liability policies. This has caused some adverse development in the past and is judgmentally considered in reserving for this line of business.

Commercial Multi-Peril

This line of business consists of two or more coverages protecting the insured from various property and liability risk exposures. The commercial multi-peril line of business includes coverage similar to other liability – occurrence, so in general, variables affecting estimation of loss reserves for commercial multi-peril include those mentioned above for other liability – occurrence. In addition, this line also includes reserves for a run-off book of homebuilders business. Variables unique to estimating the liabilities for this coverage include:

- Changing legal/regulatory interpretations of coverage
- Statutes of limitations and statutes of repose in filing claims
- Changes in policy forms and endorsements

Over the years, certain portions of the homebuilders business has experienced adverse interpretations of coverage, coupled with certain statutory changes relating to liability, that caused an increase in the emergence of claims from older years. Management believes that changes in policy forms and endorsements implemented in 1998 will reduce AFG's exposure to such adverse interpretations.

Recoverables from Reinsurers

AFG is subject to credit risk with respect to its reinsurers, as reinsurance contracts do not relieve AFG of its liability to policyholders. To mitigate this risk, substantially all reinsurance is ceded to companies with investment grade or better S&P ratings or is secured by "funds withheld" or other collateral.

In 2004, AFG recorded a loss of $28.9 million to commute $87.2 million of reinsurance recoverables with certain of its reinsurers who have experienced deteriorating financial condition. In the first quarter of 2005, AFG completed an additional agreement to help further mitigate its exposure to such reinsurers. AFG has recorded reserves for doubtful collection of reinsurance recoverables on a case by case and overall basis. These estimates are subject to significant judgment and may vary significantly depending upon the reinsurers continued willingness and ability to pay amounts due.

Asbestos and Environmental-related ("A&E") Reserves

Asbestos and environmental reserves consisted of the following (in millions):

	December 31,	
	2004	2003
Asbestos	**$259.4**	$278.7
Environmental	**71.2**	121.2
Other Mass Tort	**11.3**	23.4
A&E reserves, net of reinsurance recoverable	**341.9**	423.3
Reinsurance recoverable, net of allowance	**59.3**	92.0
Gross A&E reserves	**$401.2**	$515.3

Asbestos reserves include claims asserting alleged injuries and damages from exposure to asbestos. Environmental reserves include claims relating to polluted waste sites. Other mass tort claims include alleged injuries and damages from exposure to lead, silica and various chemical substances, as well as other toxic hazards.

Approximately one-half of AFG's asbestos reserves relate to policies written by AFG subsidiaries. Claims from these policies generally are product oriented claims with only a limited amount of non-product exposures, and are dominated by small to mid-sized commercial entities that are mostly regional policyholders with few national target defendants.

The remainder is assumed reinsurance business that includes exposures for the periods 1954 to 1983. The asbestos and environmental assumed claims are ceded by various insurance companies under reinsurance treaties. A majority of the individual assumed claims have exposures of less than $100,000 to AFG. Asbestos losses assumed include some of the industry known manufacturers, distributors and installers. Pollution losses include industry known insured names and sites.

Establishing reserves for A&E claims relating to policies and participations in reinsurance treaties and former operations is subject to uncertainties that are significantly greater than those presented by other types of claims. For this group of claims, traditional actuarial techniques that rely on historical loss development trends cannot be used and a meaningful range of loss cannot be estimated. Management makes its best estimate of these reserves based on prior ground up studies adjusted for payments and identifiable changes. Case reserves and expense reserves are established by the claims department as specific policies are identified. In addition to the case reserves established for known claims, management establishes additional reserves for claims not yet known or reported and for possible development on known claims. These additional reserves are management's best estimate based on its review of industry trends and other industry information about such claims, with due consideration to individual claim situations. Estimating ultimate liability for asbestos claims presents a unique and difficult challenge to the insurance industry due to, among other things, inconsistent court decisions, an increase in bankruptcy filings as a result of asbestos-related liabilities, novel theories of coverage, and judicial interpretations that often expand theories of recovery and broaden the scope of coverage. The casualty insurance industry is engaged in extensive litigation over these coverage and liability issues as the volume and severity of claims against asbestos defendants continue to increase.

Emerging trends, such as those named below, could impact AFG's reserves and payments:

- There is a growing interest at the state and federal level to attempt to legislatively address asbestos liabilities and the manner in which asbestos claims are resolved. These developments are fluid and could result in a comprehensive solution or piecemeal state by state solutions.
- The manner by which bankruptcy courts are addressing asbestos liabilities is in flux.
- Claimants' counsel continue to file claims based on emerging toxic exposures such as silica.

While management believes that AFG's reserves for A&E claims are a reasonable estimate of ultimate liability for such claims, actual results may vary materially from the amounts currently recorded due to the difficulty in predicting the number of future claims, the impact of recent

bankruptcy filings, and unresolved issues such as whether coverage exists, whether policies are subject to aggregate limits on coverage, whether claims are to be allocated among triggered policies and implicated years, and whether claimants who exhibit no signs of illness will be successful in pursuing their claims. A 1% variation in loss cost trends, caused by any of the factors previously described, would change net income by approximately $12 million.

From time to time, AFG has engaged independent firms to work closely with its claims staff to study the A&E reserves of its insurance company subsidiaries. The most recent study was completed in the third quarter of 2001 and resulted in AFG recording a pretax charge of $100 million to increase its A&E reserves. Management believes that current practice of the property and casualty insurance industry is to commission a comprehensive study every three or four years. Accordingly, absent legislative reforms which may alter the need for an independent review, management plans to conduct such a routine study during 2005.

In February 2003, Great American Insurance Company entered into an agreement for the settlement of asbestos related coverage litigation under insurance polices issued during the 1970's and 1980's to Bigelow-Liptak Corporation and related companies, subsequently known as A.P. Green Industries, Inc. Management believes that this settlement will enhance financial certainty and provides resolution to litigation that represents AFG's largest known asbestos-related claim and the only such claim that management believes to be material.

The settlement is for $123.5 million (Great American has the option to pay in cash or over time with 5.25% interest), all but $30 million of which was covered by reserves established prior to September 30, 2002, and anticipated reinsurance recoverables for this matter. As a result, AFG recorded a $30 million pretax charge ($19.5 million after tax) in the fourth quarter of 2002. The agreement allows up to 10% of the settlement to be paid in AFG Common Stock.

The settlement has received the approval of the bankruptcy court supervising the reorganization of A.P. Green. It remains subject to the confirmation by the bankruptcy court of a plan of reorganization that includes an injunction prohibiting the assertion against Great American of any present or future asbestos personal injury claims under policies issued to A.P. Green and related companies. No assurance can be made that a plan of reorganization will be confirmed; no payments are required until completion of the process. If there is no plan confirmation, the outcome of this litigation will again be subject to the complexities and uncertainties associated with a Chapter 11 proceeding and asbestos coverage litigation.

AFG tracks its A&E claims by policyholder. The following table shows, by type of claim, the number of policyholders that did not receive any payments in the calendar year separate from policyholders that did receive a payment. Policyholder counts represent policies written by AFG subsidiaries and do not include assumed reinsurance. The significant decline in policyholder counts in 2004 reflects the sale of Transport Insurance Company.

	2004	2003	2002
Number of policyholders with no payments:			
Asbestos	**158**	226	219
Environmental	**276**	324	328
Other Mass Tort	**88**	93	57
	522	643	604
Number of policyholders with payments:			
Asbestos	**80**	74	50
Environmental	**17**	30	12
Other Mass Tort	**5**	9	6
	102	113	68
Total	**624**	756	672

Amounts paid (net of amounts received from reinsurers) for asbestos, environmental and other mass tort claims, including loss adjustment expenses, were as follows (in millions):

	2004	2003	2002
Asbestos	**$12.2**	$23.6	$16.8
Environmental	**33.2**	15.6	9.6
Other Mass Tort	**2.4**	4.3	2.3
Total	**$47.8**	$43.5	$28.7

Contingencies related to American Premier's Former Operations

At December 31, 2004, American Premier had liabilities aggregating $103.5 million for various environmental and occupational injury and disease claims and other contingencies arising out of the railroad operations and certain manufacturing operations disposed of by American Premier and its predecessor. For information on the settlement of American Premier's largest outstanding environmental exposure and a discussion of the uncertainties in determining American Premier's ultimate liability for remediation costs at the remaining sites, see Note O – "Commitments and Contingencies" to the Financial Statements.

Results of Operations—Three Years Ended December 31, 2004

General

The following table shows AFG's net earnings and diluted earnings per share as stated in the Statement of Earnings as well as the after-tax effect of other items included in these GAAP measures that are listed below to assist investors in analyzing their impact on the trend in operating results (in millions, except per share amounts):

	2004	2003	2002
Net earnings	**$359.9**	$293.8	$84.6
After tax income (expense) items included in net earnings:			
Charges resulting from litigation settlements	**(33.8)**	(23.1)	(19.5)
Arbitration settlement	—	(28.5)	—
Special tax benefits	—	141.5	31.0
Net earnings (losses) from investee corporations	**(3.2)**	9.1	(9.0)
Realized investment gains (losses)	**192.2**	50.8	(44.7)
Discontinued operations	**(2.4)**	(33.6)	1.4
Cumulative effect of accounting changes	**(5.6)**	6.3	(40.4)
Diluted per share amounts:			
Net earnings	**$4.81**	$4.12	$1.22
Charges resulting from litigation settlements	**(.45)**	(.33)	(.28)
Arbitration settlement	**—**	(.41)	—
Special tax benefits	—	2.01	.44
Investee corporations	**(.04)**	.13	(.13)
Realized investment gains (losses)	**2.57**	.73	(.64)
Discontinued operations	**(.03)**	(.48)	.02
Cumulative effect of accounting changes	**(.08)**	.09	(.59)

In addition to the effects of items shown in the table above, net earnings increased in 2004 due primarily to improved property and casualty underwriting results and higher operating earnings in the annuity, supplemental insurance and life operations. Net earnings increased in 2003 as improved property and casualty underwriting results more than offset a decline in the fixed annuity operations.

Property and Casualty Insurance—Underwriting

Following the disposal of substantially all of its Personal insurance business in 2003, AFG revised its reporting of the Specialty insurance business into the following components: (i) Property and Transportation, which includes inland and ocean marine, agricultural-related business and commercial automobile, (ii) Specialty Casualty, which includes executive and professional liability, umbrella and excess liability and excess and surplus, (iii) Specialty Financial, which includes fidelity and surety bonds and collateral protection, and (iv) California Workers' Compensation.

The Personal group wrote private passenger auto insurance and, to a lesser extent, homeowners' insurance.

To understand the overall profitability of particular lines, the timing of claims payments and the related impact of investment income must be considered. Certain "short-tail" lines of business (primarily property coverages) have quick loss payouts which reduce the time funds are held, thereby limiting investment income earned thereon. On the other hand, "long-tail" lines of business (primarily liability coverages and workers' compensation) have payouts that are either structured over many years or take many years to settle, thereby significantly increasing investment income earned on related premiums received.

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. A combined ratio under 100% is indicative of an underwriting profit. The combined ratio does not reflect investment income, other income or federal income taxes.

While AFG desires and seeks to earn an underwriting profit on all of its business, it is not always possible to do so. As a result, AFG attempts to expand in the most profitable areas and control growth or even reduce its involvement in the least profitable ones.

Over the last several years, AFG has been realigning its property and casualty business mix and focusing on rate adequacy in order to improve its operating profitability. Management has continued to direct capital in order to take advantage of certain specialty market opportunities. Management believes these actions have been successful and that the current mix of specialty businesses positions the company for solid growth and continuing improved profitability in the foreseeable future.

AFG's combined ratio has been better than the industry average for eighteen of the last nineteen years and excluding AFG's special A&E charges, for all nineteen years. Management believes that AFG's insurance operations have performed better than the industry as a result of product line diversification and stringent underwriting discipline.

Premiums and combined ratios for AFG's property and casualty insurance operations were as follows (dollars in millions):

	2004	2003	2002
Gross Written Premiums (GAAP)			
Specialty:			
Property and transportation	**$1,337**	$1,142	$ 886
Specialty casualty	**1,453**	1,413	1,235
Specialty financial	**468**	396	332
California workers' compensation	**380**	290	229
Other	**1**	2	31
Total Specialty	**3,639**	3,243	2,713
Personal (a)	**—**	265	1,222
Other	**7**	—	—
	$3,646	$3,508	$3,935
Net Written Premiums (GAAP)			
Specialty:			
Property and transportation	**$ 683**	$ 515	$ 413
Specialty casualty	**740**	679	609
Specialty financial	**395**	302	255
California workers' compensation	**339**	271	219
Other	**67**	87	81
Total Specialty	**2,224**	1,854	1,577
Personal (a)	**—**	158	837
Other	**5**	—	—
	$2,229	$2,012	$2,414
Combined Ratios (GAAP)			
Specialty:			
Property and transportation	**80.7%**	87.8%	90.1%
Specialty casualty	**99.8**	98.2	106.6
Specialty financial	**108.9**	108.4	101.4
California workers' compensation	**89.5**	92.0	96.4
Total Specialty (b)	**94.1**	96.0	98.4
Personal (a)	**—**	103.0	99.8
Aggregate (including discontinued lines) (b)(c)	**94.8%**	98.9%	101.0%

(a) Includes the operations of Infinity through the sale date in mid-February 2003 and the direct auto business through its sale at the end of April 2003.
(b) Includes 1.8 points in 2004 for the effect of hurricane losses.
(c) Includes 2.3 points in 2003 for the effect of an arbitration decision relating to a claim arising from a business in runoff and 1.2 points for 2002 relating to the A. P. Green asbestos litigation charge.

As shown in Note Q under "Insurance Reserves," AFG's property and casualty operations recorded loss development of $140 million in 2004, $167 million in 2003 and $171 million in 2002 related to prior accident years. Major areas of adverse development were as follows (in millions):

	2004	2003	2002
Property and transportation	**$ 16**	$ 32	$ 19
Specialty casualty	**75**	82	78
Specialty financial	**13**	*	*
California workers' compensation	**22**	*	*
Personal lines	**—**	*	15
Arbitration settlement	**—**	44	—
Asbestos	**—**	—	49
Other	**14**	9	10
	$140	$167	$171

(*) Amounts are immaterial and included in Other.

The prior year development in Property and transportation related primarily to higher than anticipated frequency of claims in the 1993 through 2001 accident years for certain portions of the homebuilders' liability business which are in runoff. In 2004, the adverse development was partially offset by favorable development in inland marine and agricultural-related coverages.

Specialty casualty development includes amounts related to executive liability, other liability excess casualty runoff and commutation of reinsurance. Executive liability development impacted all three years and resulted primarily from claim severity on directors' and officers' liability policy coverages for 1996 through 2000, as both settlement and defense costs related to shareholder lawsuits have increased beyond estimates; the development in 2004 and 2003 in particular related to two claims (one in each year). Development in other liability impacted both 2003 and 2002 reflecting an unexpected shift of judicial climate in some previously conservative states; verdicts, judgments, and settlements have increased. Development in excess casualty runoff impacted all three years reflecting higher frequency and severity of claims related to the 1999 through 2001 accident years. In 2004, the development includes a $9 million charge relating to commuting reinsurance agreements.

Specialty financial development in 2004 related to severity of a few fidelity and crime claims and higher claim severity in the surety business.

The development in California workers' compensation in 2004 reflects the effect of additional information received on individual claims from prior years.

In the personal lines, personal injury and uninsured motorist claims experienced increased severity. During 2002, claims remained open longer and settlement amounts were higher than in previous years.

The arbitration settlement represents a charge in the second quarter of 2003 for an unfavorable decision resulting from Great American's share of a 1995 property fire and business interruption claim. Great American was a 9.5% participant with a number of other companies in the insurance pool that insured the loss during the 1995 coverage year.

Asbestos development was due primarily to a charge of $30 million for the settlement of asbestos-related coverage in litigation in 2002. See *"Uncertainties – Asbestos and Environmental-related Reserves"* for additional information about these claims.

Specialty

The Specialty group's gross written premiums increased 12% for 2004 compared to 2003 reflecting volume growth in crop, California workers' compensation, collateral protection and other profitable product lines and the impact of continuing rate increases. Specialty rate increases averaged approximately 6% during 2004. The 20% increase in net written premiums during 2004 also reflects a decrease in reinsurance ceded.

The Specialty group reported an underwriting profit of $123 million for 2004, including $37 million (1.8 points) for the effect of Southeastern U.S. hurricane losses. Overall, the combined ratio for 2004 improved 1.9 points compared to 2003.

Gross written premiums increased approximately 20% for 2003 compared to 2002, reflecting the impact of rate increases and volume growth in most of its businesses. Specialty rate increases averaged approximately 20% during 2003. Net written premiums increased 18% in 2003 compared to 2002. The combined ratio for 2003 improved 2.4 points over 2002 reflecting rate increases partially offset by $16 million in higher prior year development in 2003.

Property and transportation gross written premiums increased about 17% during 2004 reflecting primarily volume increases in the crop, equine and transportation insurance businesses. Net written premiums increased 33% for 2004 reflecting an overall reduction in reinsurance ceded. The combined ratio for 2004 included 4.7 points for the effect of the hurricane losses. Even with the hurricane losses, the combined ratio improved 7.1 points over 2003 reflecting exceptionally strong profitability in the crop business.

Gross and net written premiums increased 29% and 25%, respectively, for 2003 compared to 2002 reflecting significant volume growth in the federal crop insurance program. In addition, the other property and transportation business experienced rate increases and volume growth in 2003. The 2.3 point improvement in property and transportation's combined ratio for 2003 compared to 2002 reflects rate increases, partially offset by $13 million in additional prior year development in 2003 compared to 2002.

Specialty casualty net written premiums increased 9% for 2004 compared to 2003 while gross written premiums were relatively flat. The increase is primarily a result of a decrease in reinsurance ceded and rate increases. The 2004 combined ratio includes 1.2 points for the effect of a charge related to the commutation of a reinsurance agreement. In addition, both 2004 and 2003 contain significant amounts of adverse prior year development. Despite these items, solid underwriting profits from other operations allowed this group to end 2004 with a combined ratio of 99.8%.

Gross and net written premiums increased 14% and 11%, respectively, for 2003 compared to 2002 primarily due to rate increases. Rate increases also led to an 8.4 point combined ratio improvement compared to 2002.

Specialty financial gross written premiums increased 18% for 2004 due to substantial volume growth in collateral protection products for financial institutions. The 31% increase in net written premiums also reflects a decrease in reinsurance ceded, including the impact of premiums returned in connection with the commutation of a reinsurance agreement. The impact of the commutation increased the 2004 combined ratio by about 4.1 points, driving it slightly higher than 2003.

The increase of approximately 19% in gross and net written premiums in 2003 compared to 2002 reflects rate increases as well as volume growth in the fidelity and crime products and certain collateral protection products. This group's combined ratio deterioration of 7 points is primarily a result of the decline in results related to the residual value products. Lower used car prices, dealer incentives on new cars and the volume of used cars available from expiring leases contributed to the deterioration in the residual value results.

California workers' compensation gross and net written premiums grew 31% and 25%, respectively, in 2004 compared to 2003, reflecting significant volume growth. The group continued to experience improving claims results due to the workers' compensation reform enacted in California. The reforms have enabled the group to offer coverage at lower rates while maintaining solid underwriting profits.

Gross and net written premiums increased 27% and 24%, respectively, in 2003 compared to 2002 related mostly to rate increases. The combined ratio for 2003 improved 4.4 points compared to 2002 as rate increases and a benefit related to the California reforms (mentioned above) were partially offset by increased claim costs.

Personal

The Personal group results represent primarily Infinity's underwriting results through the public offering in mid-February 2003 and the direct-to-consumer auto business, which was sold in April 2003. AFG's remaining personal lines business generated about 3% of net written premiums in 2003 and 2002. Beginning in 2004, the

remaining former Personal business is included in Specialty transportation (2004 net written premium of $27 million and underwriting profit of $3 million) and Other lines (businesses in runoff; 2004 net written premium of $6 million and underwriting loss of $2 million).

Life, Accident and Health Premiums and Benefits

The increase in life, accident and health premiums and benefits in 2004 and 2003 reflects the addition of new distribution sources for GAFRI's supplemental insurance products, partially offset by lower sales of life insurance products. Beginning in the second quarter of 2004, GALIC stopped issuing life insurance policies due to inadequate volume and returns. GAFRI will continue to service and accept renewal premiums on its in force block of these policies. GAFRI will also continue to sell life products through its supplemental insurance operations and Great American Life Puerto Rico.

Investment Income

Changes in investment income reflect fluctuations in market rates and changes in average invested assets. The increase in investment income for 2004 reflects an increase of about $1.4 billion (11%) in average cash and investments, partially offset by lower average yields on fixed maturity investments. Investment income decreased in 2003 compared to 2002 reflecting lower average yields on fixed maturity investments (due in part to an increase in tax-exempt bonds).

Gains (Losses) on Securities

In July 2004, AFG received common and preferred shares equivalent to 8.1 million common shares of National City Corporation in exchange for its ownership interest in Provident Financial Group and realized a $214.3 million pretax gain on the transaction.

Realized gains (losses) on sales of securities include provisions for other than temporary impairment of securities still held of $16.7 million in 2004, $58.4 million in 2003 and $179.4 million in 2002. Impairment charges in 2004 and 2003 reflect primarily the downturn in the airline industry and writedowns of certain asset-backed securities. Impairment charges in 2002 reflect primarily the downturn in the communications and airline industries and writedowns of certain asset-backed securities.

Realized gains (losses) on securities include losses of $1.1 million in 2003 and $11.9 million in 2002 to adjust the carrying value of AFG's investment in warrants to market value under SFAS No. 133.

Gains (Losses) on Sales of Subsidiaries and Investees

During 2003, AFG recognized a gain of $56.5 million on the December 2003 sale of its remaining interest in Infinity which more than offset the $39.4 million loss it recognized when it sold a 61% interest in Infinity in February 2003. Additional net gains of $2.7 million were recognized in 2003 on the sale of three small insurance subsidiaries and the settlement of disputed amounts under a contract covering a prior year sale.

In 2002, AFG recognized a $10.8 million pretax loss on the disposal of its New Jersey private passenger auto business.

Gain on Sale of Other Investments

In September 2002, AFG realized a $9.3 million pretax gain on the sale of its minority ownership in a residential homebuilding company.

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).

	2004	2003	2002
Other income	**$106.4**	$96.5	$115.0
Other operating and general expenses	**82.1**	73.7	71.7
Interest charges on borrowed money	**2.0**	2.3	2.6
Minority interest expense, net	**2.6**	1.9	1.1

Other income includes net pretax gains on the sale of real estate assets of $12.7 million in 2004, $10.3 million in 2003 and $31.0 million in 2002.

Other Income

2004 compared to 2003 Other income increased $51.9 million (19%) for 2004 compared to 2003 due primarily to a $14.5 million increase in revenues earned by AFG's warranty business, a $10.6 million increase in fee income in certain other property and casualty insurance operations, and an $11.4 million increase in policy fees earned in the annuity and life operations.

2003 compared to 2002 Other income increased $11.0 million (4%) in 2003 compared to 2002 due primarily to increased revenues earned by AFG's warranty business and higher fee income in certain other property and casualty insurance operations, partially offset by the absence of income from Infinity (following its sale in mid-February) and decreased gains on the sale of real estate.

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 crediting rates, actual surrender, death and annuitization experience or modifications in actuarial assumptions can affect this accrual. In 2004, this accrual was increased by approximately $5 million due to trends in actual experience.

The majority of GAFRI's fixed annuity products 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, 2004, approximately 4% of annuity benefits accumulated related to policies with a minimum crediting rate of less than 3%. The remaining balance is split almost evenly between policies with minimum guarantee rates of 3% and 4%.

Historically, management believes it has been able to react to changes in market interest rates and maintain a desired interest rate spread. Management believes that significant changes in projected investment yields could result in charges (or credits) to earnings in the period the projections are modified.

The increase in annuity benefits in 2004 compared to 2003 reflects the acquisition of the block of National Health Insurance Company business.

Annuity and Life Acquisition Expenses

Annuity and life acquisition expenses include amortization of annuity and life, accident and health deferred policy acquisition costs ("DPAC") as well as a portion of commissions on sales of insurance products. Annuity and life acquisition expenses also include amortization of the present value of future profits of businesses acquired.

2004 compared to 2003 Annuity and life acquisition expenses for 2004 were reduced by $5.1 million related to trends in actual experience. Conversely, in 2003, these expenses included net charges of $15.2 million related to spread narrowing.

2003 compared to 2002 The increase in annuity and life acquisition expenses in 2003 compared to 2002 reflects the continued narrowing of spreads in the fixed annuity operations, including the charges discussed above, and an increase in in-force policies, primarily in the annuities and supplemental insurance operations.

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 write-offs of DPAC in the future.

Interest on Borrowed Money

Changes in interest expense result from fluctuations in market rates as well as changes in borrowings. AFG has generally financed its borrowings on a long-term basis which has resulted in higher current costs.

2004 compared to 2003 Interest expense for 2004 increased $14.6 million compared to 2003 due primarily to higher average indebtedness and paydowns of lower variable-rate bank debt with the proceeds from fixed-rate debt offerings in 2003. The majority of the proceeds from debt issued in 2004 was used to retire higher coupon trust preferred securities. Accordingly, the increase in interest expense for 2004 was substantially offset by the $14 million reduction in interest on subsidiary trust obligations (see below).

2003 compared to 2002 Interest expense decreased in 2003 primarily due to lower average indebtedness and lower interest charges on amounts due reinsurers.

Interest on Subsidiary Trust Obligations

Interest on subsidiary trust obligations issued prior to 2003 was included in minority interest expense in 2003 and 2002. Interest on subsidiary trust obligations decreased $14 million for 2004 compared to 2003 due primarily to the March 2004 redemption of AFG's 9-1/8% trust preferred securities and GAFRI's 9-1/4% trust preferred securities and GAFRI's first quarter 2004 repurchases of $27.2 million of 8-7/8% preferred securities.

Other Operating and General Expenses

2004 compared to 2003 Other operating and general expenses for 2004 include a $52 million charge based on APU's settlement of litigation related to environmental clean-up costs at a former railroad site and a $4 million goodwill write-off in the annuity and life operations. In 2003, this expense includes a pretax charge of $35.5 million related to an agreement to settle a lawsuit alleging antitrust violations by a number of California workers' compensation insurers, including an AFG subsidiary. Excluding these items, other operating and general expenses increased $53.9 million (13%) for 2004 compared to 2003 due primarily to a $30.3 million

increase in expenses of AFG's warranty business and a $9.5 million increase in expenses in certain other property and casualty insurance operations.

2003 compared to 2002 Excluding the above-mentioned workers' compensation litigation settlement charge, other operating and general expenses decreased 3% in 2003 compared to 2002 as the absence of expenses from Infinity (following its sale in mid-February) offset higher expenses in AFG's warranty business.

Income Taxes

The 2003 provision for income taxes includes a benefit of $136 million related to the AFG/AFC merger for the effect of the elimination of deferred tax liabilities associated with AFC's holding of AFG stock and reflects $5.5 million in tax benefits related to AFG's basis in Infinity stock. The 2002 provision for income taxes includes $31 million in tax benefits for the reduction of previously accrued amounts due to the resolution of certain tax matters. See Note L to the Financial Statements for more information on the effects of the AFG/AFC merger and an analysis of items affecting AFG's effective tax rate.

Investee Corporations

Manufacturing Businesses

Equity in earnings (losses) of investees includes losses of two manufacturing businesses that were formerly subsidiaries. Equity in net earnings (losses) of investees includes $3.2 million in 2004 compared to $3.1 million in 2003 and $3.6 million in 2002 in losses of one of these businesses. Investee losses in 2002 include $5.4 million in losses of the other manufacturing business, which sold substantially all of its assets in December 2002.

Infinity Property and Casualty Corporation

AFG's proportionate share ($12.2 million) of Infinity's earnings is included in equity in net earnings (losses) of investees for the period between the initial sale of 61% of Infinity in February 2003 and AFG's sale of its remaining shares in December 2003.

Cumulative Effect of Accounting Changes

In January 2004, AFG recorded a $1.8 million charge (after tax and minority interest) resulting from GAFRI's implementation of Statement of Position ("SOP") 03-1, "Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts." This charge resulted primarily from a change in accounting for persistency bonuses and two-tier annuities.

In July 2004, AFG recorded a $3.8 million after-tax charge resulting from implementation of EITF 03-16, "Accounting for Investments in Limited Liability Companies." This charge reflects the cumulative effect of changing from the cost method to the equity method of accounting for AFG's investment in a limited liability company. This charge reduced AFG's investment in this entity to zero. Management believes the fair value of this investment substantially exceeds its carrying value prior to the writedown.

Effective December 31, 2003, AFG implemented Interpretation No. 46, "Consolidation of Variable Interest Entities." This interpretation sets forth the requirements for determining the status of entities that do not share economic risk and reward through typical equity ownership, but rather through contractual relationships that distribute economic risks and rewards among various parties. Once an entity is determined to be a variable interest entity, it is required to be consolidated by the primary beneficiary, which is deemed to be the party that is exposed to a majority of the expected losses, or benefits from a majority of the expected residual returns, or both.

See Note A – "Accounting Policies" – "Managed Investment Entity" and "Payable to Subsidiary Trusts." The cumulative effect of implementing FIN 46 was an increase in income of $6.3 million.

Effective January 1, 2002, AFG 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 a charge of $40.4 million (net of minority interest and taxes) for the cumulative effect of a change in accounting principle.

Recent Accounting Standards

The following accounting standards have been or may be implemented by AFG. The implementation of these standards is discussed under various subheadings of Note A to the Financial Statements; effects of each are shown in the relevant Notes.

Accounting Standard	Subject of Standard (Year Implemented)	Reference
SOP 03-1	Nontraditional Long Duration Contracts and Separate Accounts (2004)	
EITF 03-16	Limited Liability Companies (2004)	"Investments"
SFAS 123(R)	Share-Based Payment (2005)	"Stock-Based Compensation"

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

Proposed Accounting Standard

The FASB has proposed an amendment to SFAS 128, "Earnings per Share." Currently, SFAS 128 allows companies issuing securities that can be settled in cash or stock (such as AFG's convertible notes) to exclude the issuable shares from the calculation of diluted earnings per share when there is a stated intent and ability to deliver cash in lieu of stock upon settlement or conversion. The proposed statement would require companies to assume settlement in stock (despite the ability and intent to settle in cash) and include those shares in the calculation of diluted earnings per share. Should the FASB proposal be adopted as proposed, AFG anticipates that it will amend its indenture to eliminate the option to settle the accreted value of the notes in shares, and thereby mitigate the proposal's impact on dilution.

Quantitative and Qualitative Disclosures About Market Risk

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

Fixed Maturity Portfolio

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

The following table provides information about AFG's "available for sale" fixed maturity investments at December 31, 2004 and 2003, that are sensitive to interest rate risk. The table shows principal cash flows (in millions) 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. Mortgage-backed securities ("MBSs") and sinking fund issues are included based on maturity year adjusted for expected payment patterns. Actual cash flows may differ from those expected.

	December 31, 2004	
	Principal Cash Flows	Rate
2005	$ 595	6.3%
2006	906	5.6
2007	1,150	5.3
2008	1,392	5.4
2009	1,355	5.6
Thereafter	7,526	5.7
Total	$12,924	5.6%
Fair Value	$13,411	

	December 31, 2003	
	Principal Cash Flows	Rate
2004	$ 647	7.2%
2005	1,120	4.9
2006	947	6.2
2007	778	6.4
2008	1,132	6.0
Thereafter	6,994	5.9
Total	$11,618	5.9%
Fair Value	$12,102	

Equity Price Risk

Equity price risk is the potential economic loss from adverse changes in equity security prices. Although AFG's investment in "Other stocks" is less than 4% of total investments, about three-eighths of "Other stocks" is invested in National City Corporation.

Annuity Contracts

Substantially all of GAFRI's fixed rate annuity contracts permit GAFRI to change crediting rates (subject to minimum interest rate guarantees as determined by applicable law) enabling management to react to changes in market interest rates. 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. Actuarial assumptions used to estimate DPAC and certain annuity liabilities, 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 millions) in each of the subsequent five years and for all years thereafter on GAFRI's fixed annuity liabilities at December 31 were as follows.

	First	Second	Third	Fourth	Fifth	Thereafter	Total	Fair Value
2004	$750	$950	$870	$770	$720	$4,010	$8,070	$7,747
2003	610	710	870	740	690	3,355	6,975	6,781

Approximately 40% of GAFRI's fixed annuity liabilities at December 31, 2004, 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, 2004, the average stated crediting rate on the in-force block of GAFRI's principal fixed annuity products was approximately 3.9%. The current stated crediting rates (excluding bonus interest) on new sales of GAFRI's products generally range from 2.5% to 3.2%. GAFRI estimates that its effective weighted-average crediting rate on its in-force business over the next five years will approximate 3.6%. This rate reflects actuarial assumptions as to (i) expected investment spreads, (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 represent less than 3% of GAFRI's insurance reserves at December 31, 2004. These 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 and realized gains on the call options purchased by GAFRI. 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 a net effect of less than 1% of annuity benefits in 2004 and 2003. 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 (in millions) on fixed-rate long-term debt of AFG and its subsidiaries and related weighted average interest rates for each of the subsequent five years and for all years thereafter.

	December 31, 2004	
	Scheduled Principal Payments	Rate
2005	$ 8.4	8.5%
2006	18.6	6.7
2007	75.4	7.1
2008	290.0	5.0
2009	298.1	7.1
Thereafter	331.5	7.4
Total	$1,022.0	6.6%
Fair Value	$1,093.2	

	December 31, 2003	
	Scheduled Principal Payments	Rate
2004	*	
2005	$ 9.9	9.1%
2006	18.6	6.7
2007	75.3	7.1
2008	289.9	5.0
Thereafter	434.5	7.3
Total	$829.0	6.5%
Fair Value	$877.8	

(*) Less than $2 million.

The AFG Convertible Debentures issued in 2003 are included in the above table at the first put date (2008). GAFRI has entered into interest rate swaps which effectively convert its 6-7/8% fixed-rate Notes due in 2008 (included in the table above) to a floating rate of 3-month LIBOR plus 2.9%.

No amounts were borrowed under the AFG or GAFRI bank lines at December 31, 2004 or 2003.

There were $77.8 million and $265 million of subsidiary trust preferred securities (payable to subsidiary trusts) with a weighted average interest rate of 8.04% and 8.74% outstanding at December 31, 2004 and 2003, respectively. None of these are scheduled for maturity or mandatory redemption during the next five years; however, $187.7 million of such securities were repurchased during 2004.

Consolidated Balance Sheet

(dollars in thousands)

December 31,	2004	2003
Assets		
Cash and short-term investments	**$ 861,742**	$ 593,552
Investments:		
Fixed maturities:		
Available for sale—at market		
(amortized cost—$13,035,165 and $11,724,181)	**13,411,365**	12,101,981
Trading—at market	**292,233**	195,390
Other stocks—at market (cost—$456,053 and $258,466)	**537,153**	454,866
Policy loans	**250,211**	215,571
Real estate and other investments	**283,929**	266,435
Total cash and investments	**15,636,633**	13,827,795
Recoverables from reinsurers and prepaid reinsurance premiums	**3,440,592**	3,131,775
Agents' balances and premiums receivable	**518,464**	502,458
Deferred acquisition costs	**1,114,433**	965,976
Other receivables	**359,746**	320,517
Investments of managed investment entity	**392,624**	424,669
Variable annuity assets (separate accounts)	**620,007**	568,434
Prepaid expenses, deferred charges and other assets	**311,146**	402,081
Goodwill	**165,882**	168,330
	$22,559,527	$20,312,035
Liabilities and Capital		
Unpaid losses and loss adjustment expenses	**$ 5,337,270**	$ 4,909,109
Unearned premiums	**1,612,035**	1,594,839
Annuity benefits accumulated	**8,069,681**	6,974,629
Life, accident and health reserves	**1,084,411**	1,018,861
Payable to reinsurers	**513,565**	408,518
Long-term debt:		
Holding company	**685,083**	574,618
Subsidiaries	**343,590**	262,244
Payable to subsidiary trusts (issuers of preferred securities)	**77,800**	265,472
Debt of managed investment entity	**371,368**	406,547
Variable annuity liabilities (separate accounts)	**620,007**	568,434
Accounts payable, accrued expenses and other liabilities	**1,194,584**	1,065,044
Total liabilities	**19,909,394**	18,048,315
Minority interest	**219,586**	187,559
Shareholders' Equity:		
Common Stock, no par value		
—200,000,000 shares authorized		
—76,634,204 and 73,056,085 shares outstanding	**76,634**	73,056
Capital surplus	**1,145,873**	1,035,784
Retained earnings	**976,340**	664,721
Unrealized gain on marketable securities, net	**231,700**	302,600
Total shareholders' equity	**2,430,547**	2,076,161
	$22,559,527	$20,312,035

See notes to consolidated financial statements.

Consolidated Statement of Earnings

(in thousands, except per share data)

Year Ended December 31,	2004	2003	2002
Income:			
Property and casualty insurance premiums	**$2,110,302**	$1,909,206	$2,402,600
Life, accident and health premiums	**351,365**	331,887	305,647
Investment income	**800,226**	773,188	861,503
Realized gains (losses) on:			
Securities	**301,957**	58,891	(78,968)
Subsidiaries and investees	**—**	19,824	(10,769)
Other investments	**—**	—	9,253
Revenues of managed investment entity	**23,843**	—	—
Other income	**318,572**	266,647	255,609
	3,906,265	3,359,643	3,744,875
Costs and Expenses:			
Property and casualty insurance:			
Losses and loss adjustment expenses	**1,416,290**	1,353,177	1,812,495
Commissions and other underwriting expenses	**582,462**	534,161	614,062
Annuity benefits	**313,627**	294,940	300,966
Life, accident and health benefits	**264,714**	250,713	245,271
Annuity and life acquisition expenses	**118,467**	121,322	114,507
Interest charges on borrowed money	**71,893**	57,320	60,407
Interest on subsidiary trust obligations	**9,218**	1,473	—
Expenses of managed investment entity	**20,151**	—	—
Other operating and general expenses	**519,905**	445,531	421,344
	3,316,727	3,058,637	3,569,052
Operating earnings before income taxes	**589,538**	301,006	175,823
Provision (benefit) for income taxes	**186,089**	(47,454)	17,117
Net operating earnings	**403,449**	348,460	158,706
Minority interest expense, net of tax	**(32,410)**	(36,393)	(26,149)
Equity in net earnings (losses) of investees, net of tax	**(3,174)**	9,084	(8,990)
Earnings from continuing operations	**367,865**	321,151	123,567
Discontinued operations	**(2,412)**	(33,636)	1,433
Cumulative effect of accounting changes	**(5,593)**	6,300	(40,360)
Net Earnings	**$ 359,860**	$ 293,815	$ 84,640
Premium over stated value paid on redemption of subsidiaries' preferred shares	**—**	(4,121)	—
Net earnings available to Common Shares	**$ 359,860**	$ 289,694	$ 84,640
Basic earnings per Common Share:			
Continuing operations	**$5.00**	$4.53	$1.80
Discontinued operations	**(.03)**	(.48)	.02
Cumulative effect of accounting changes	**(.08)**	.09	(.59)
Net earnings available to Common Shares	**$4.89**	$4.14	$1.23
Diluted earnings per Common Share:			
Continuing operations	**$4.92**	$4.51	$1.79
Discontinued operations	**(.03)**	(.48)	.02
Cumulative effect of accounting changes	**(.08)**	.09	(.59)
Net earnings available to Common Shares	**$4.81**	$4.12	$1.22
Average number of Common Shares:			
Basic	**73,631**	69,937	68,800
Diluted	**74,825**	70,272	69,203
Cash dividends per Common Share	**$ .50**	$ .50	$ .50

See notes to consolidated financial statements.

Consolidated Statement of Changes in Shareholders' Equity

(dollars in thousands)

	Common Shares	Common Stock and Capital Surplus	Retained Earnings	Unrealized Gain on Securities	Total
Balance at December 31, 2001	68,491,610	$ 979,566	$359,513	$159,300	$1,498,379
Net earnings	—	$ —	$ 84,640	$ —	$ 84,640
Change in unrealized	—	—	—	164,600	164,600
Comprehensive income					249,240
Dividends on Common Stock	—	—	(34,367)	—	(34,367)
Shares issued:					
Exercise of stock options	28,837	656	—	—	656
Dividend reinvestment plan	298,076	6,616	—	—	6,616
Employee stock purchase plan	45,869	1,143	—	—	1,143
Retirement plan contributions	260,040	6,589	—	—	6,589
Deferred compensation distributions	1,809	45	—	—	45
Directors fees paid in stock	3,904	96	—	—	96
Shares tendered in option exercises	(774)	(11)	(9)	—	(20)
Tax effect of intercompany dividends	—	(3,200)	—	—	(3,200)
Other	(19)	671	—	—	671
Balance at December 31, 2002	69,129,352	$ 992,171	$409,777	$323,900	$1,725,848
Net earnings	—	$ —	$293,815	$ —	$ 293,815
Change in unrealized	—	—	—	(21,300)	(21,300)
Comprehensive income					272,515
Dividends on Common Stock	—	—	(34,750)	—	(34,750)
Shares issued:					
AFG/AFC merger	3,299,563	75,032	(4,048)	—	70,984
Exercise of stock options	35,000	771	—	—	771
Dividend reinvestment plan	165,428	3,412	—	—	3,412
Employee stock purchase plan	41,940	914	—	—	914
Retirement plan contributions	376,234	7,740	—	—	7,740
Deferred compensation distributions	3,300	71	—	—	71
Directors fees paid in stock	5,272	115	—	—	115
Elimination of tax effect of prior intercompany dividends	—	34,000	—	—	34,000
Repurchase of trust preferred securities	—	—	(73)	—	(73)
Other	(4)	(5,386)	—	—	(5,386)
Balance at December 31, 2003	73,056,085	$1,108,840	$664,721	$302,600	$2,076,161
Net earnings	**—**	**$ —**	**$359,860**	**$ —**	**$ 359,860**
Change in unrealized	**—**	**—**	**—**	**(70,900)**	**(70,900)**
Comprehensive income					**288,960**
Dividends on Common Stock	**—**	**—**	**(36,722)**	**—**	**(36,722)**
Shares issued:					
Public Offerings	**2,679,000**	**81,866**	**—**	**—**	**81,866**
Exercise of stock options	**1,352,698**	**34,875**	**—**	**—**	**34,875**
Dividend reinvestment plan	**59,499**	**1,596**	**—**	**—**	**1,596**
Employee stock purchase plan	**28,255**	**838**	**—**	**—**	**838**
Retirement plan contributions	**140,323**	**4,206**	**—**	**—**	**4,206**
Deferred compensation distributions	**34,218**	**977**	**—**	**—**	**977**
Directors fees paid in stock	**11,666**	**339**	**—**	**—**	**339**
Shares tendered in option exercises	**(727,540)**	**(11,109)**	**(11,519)**	**—**	**(22,628)**
Other	**—**	**79**	**—**	**—**	**79**
Balance at December 31, 2004	**76,634,204**	**$1,222,507**	**$976,340**	**$231,700**	**$2,430,547**

See notes to consolidated financial statements.

Consolidated Statement of Cash Flows

(in thousands)

Year Ended December 31,	2004	2003	2002
Operating Activities:			
Net earnings	**$ 359,860**	$ 293,815	$ 84,640
Adjustments:			
Cumulative effect of accounting changes	**5,593**	(6,300)	40,360
Equity in net (earnings) losses of investees	**3,174**	(9,084)	8,990
Minority interest	**32,410**	16,470	6,096
Depreciation and amortization	**174,220**	176,857	174,990
Annuity benefits	**313,627**	294,940	300,966
Realized (gains) losses on investing activities	**(316,421)**	(35,633)	49,093
Net purchases/sales of trading securities	**(94,790)**	12,259	—
Deferred annuity and life policy acquisition costs	**(120,132)**	(148,247)	(170,194)
Increase in reinsurance and other receivables	**(305,630)**	(515,698)	(669,776)
Decrease (increase) in other assets	**84,459**	(85,511)	30,978
Increase in insurance claims and reserves	**620,784**	717,010	703,244
Increase (decrease) in payable to reinsurers	**105,605**	(21,398)	212,256
Increase in other liabilities	**138,000**	56,277	39,415
Other, net	**6,913**	3,743	1,252
	1,007,672	749,500	812,310
Investing Activities:			
Purchases of and additional investments in:			
Fixed maturity investments	**(5,608,918)**	(8,013,349)	(6,199,022)
Equity securities	**(188,466)**	(147,836)	(16,583)
Subsidiaries	**(10,382)**	—	(48,447)
Real estate, property and equipment	**(56,373)**	(29,699)	(53,639)
Maturities and redemptions of fixed maturity investments	**1,270,334**	1,833,418	1,807,482
Sales of:			
Fixed maturity investments	**3,642,660**	4,745,708	3,566,812
Equity securities	**254,411**	59,987	23,669
Subsidiaries and investees	**—**	461,386	—
Real estate, property and equipment	**21,457**	16,649	22,417
Cash and short-term investments of businesses acquired or sold, net	**(72,058)**	(112,666)	4,684
Collection of receivable from investee	**—**	55,000	—
Decrease in other investments	**148**	578	27,220
	(747,187)	(1,130,824)	(865,407)
Financing Activities:			
Fixed annuity receipts	**686,249**	788,174	874,470
Annuity surrenders, benefits and withdrawals	**(729,759)**	(572,013)	(549,919)
Net transfers from variable annuity assets	**1,436**	966	20,807
Additional long-term borrowings	**195,392**	337,208	224,560
Reductions of long-term debt	**(11,621)**	(454,775)	(159,926)
Issuances of trust preferred securities	**—**	33,943	—
Repurchases of trust preferred securities	**(188,961)**	(11,322)	—
Issuances of Common Stock	**91,480**	1,516	1,608
Subsidiary's issuance of stock in rights offering	**—**	10,632	—
Cash dividends paid on Common Stock	**(35,126)**	(31,338)	(27,834)
Other, net	**(1,385)**	782	(3,739)
	7,705	103,773	380,027
Net Increase (Decrease) in Cash and Short-term Investments	**268,190**	(277,551)	326,930
Cash and short-term investments at beginning of period	**593,552**	871,103	544,173
Cash and short-term investments at end of period	**$ 861,742**	$ 593,552	$ 871,103

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

A. Accounting Policies

Basis of Presentation

The consolidated financial statements include the accounts of American Financial Group, Inc. ("AFG") and its subsidiaries. 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 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.

Subsidiary Realignment

In 2003, AFG merged with two of its subsidiaries, American Financial Corporation ("AFC") and AFC Holding Company resulting in AFC's Series J Preferred stock being acquired and retired in exchange for approximately 3.3 million shares of AFG Common Stock (aggregate value of $75 million). In addition, approximately $170 million in deferred tax liabilities associated with AFC's holding of AFG stock were eliminated.

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 shareholders' equity. Fixed maturities classified as "trading" are reported at fair value with changes in unrealized holding gains or losses during the period included in investment income. 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 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 difference between interest rates on 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.

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.

In 2003, the Financial Accounting Standards Board's ("FASB") Emerging Issues Task Force ("EITF") reached a final consensus on Issue 03-16, "Accounting for Investments in Limited Liability Companies" under which limited liability companies ("LLCs") are deemed to be the same as limited partnerships for which the equity method of accounting is generally required for ownership levels of "more than 3 to 5 percent." EITF 03-16 became effective for periods beginning after June 15, 2004. The cumulative effect of changing from the cost method to the equity method of accounting for AFG's investment in an LLC is shown separately in the Statement of Earnings.

Derivatives

Derivatives included in AFG's Balance Sheet consist primarily of (i) the interest component of certain life reinsurance contracts (included in other liabilities), (ii) interest rate swaps (included in debt), and (iii) the equity-based component of certain annuity products (included in annuity benefits accumulated) and related call options (included in other investments) 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.

The terms of the interest rate swaps match those of the debt; therefore, the swaps are considered to be (and are accounted for as) 100% effective fair value hedges. Both the swaps and the hedged debt are adjusted for changes in fair value by offsetting amounts. Accordingly, since the swaps are included with long-term debt in the Balance Sheet, the only effect on AFG's financial statements is that the interest expense on the hedged debt is recorded based on the variable rate.

Managed Investment Entity

The FASB issued revised Interpretation ("FIN") No. 46, "Consolidation of Variable Interest Entities" ("VIE") in December 2003. FIN 46 sets forth the requirements for consolidating entities that do not share economic risk and reward through typical equity ownership, but rather through contractual relationships that distribute economic risks and rewards among various parties. Once an entity is determined to be a VIE, it is generally required to be consolidated by the primary beneficiary (the party with a majority of either the expected losses or residual rewards or both). Under FIN 46, AFG is considered to be the primary beneficiary of a collateralized debt obligation ("CDO") in which it owns subordinated notes (considered equity) representing approximately two-thirds of the CDO's equity (but less than 50% of the voting power) and 5% of the total notes issued by the CDO. Accordingly, AFG implemented FIN 46 effective December 31, 2003; the cumulative difference between accounting for the CDO as an investment and as a consolidated subsidiary at that date is shown in the Statement of Earnings as the cumulative effect of an accounting change. Since AFG has no right to use the CDO assets and the CDO liabilities can be extinguished only by using CDO assets, the assets and liabilities of the CDO are shown separate from AFG's other assets and liabilities in the Balance Sheet. Income and expenses of the CDO are shown separately in the Statement of Earnings; related minority interest is shown in Note J under "Minority Interest Expense."

Goodwill

Goodwill represents the excess of cost of subsidiaries over AFG's equity in their underlying net assets. Goodwill is subject to an impairment test at least annually. As required under Statement of Financial Accounting Standards ("SFAS") No. 142, AFG completed the transitional test for goodwill impairment (as of January 1, 2002) in 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.

Insurance

As discussed under "Reinsurance" below, unpaid losses and loss adjustment expenses and unearned premiums have not been reduced for reinsurance recoverable.

Reinsurance

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. Payable to reinsurers includes ceded premiums retained by AFG's property and casualty insurance subsidiaries under contracts to fund ceded losses as they become due. AFG's insurance subsidiaries also assume reinsurance from other companies. Income on reinsurance assumed is recognized based on reports received from ceding companies.

Subsidiaries of AFG's 82%-owned subsidiary, Great American Financial Resources, Inc. ("GAFRI"), 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, GAFRI implemented SFAS No. 133 Implementation Issue B36 ("B36"). 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, GAFRI 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.

Deferred Policy Acquisition Costs ("DPAC")

Policy acquisition costs (principally commissions, premium taxes and other marketing and underwriting expenses) related to the production of new business are deferred. 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 deferred to the extent deemed recoverable and amortized, with interest, in relation to the present value of expected gross profits on the policies. To the extent that realized gains and losses result in adjustments to the amortization of DPAC related to annuities, such adjustments are reflected as components of realized gains. DPAC related to annuities is also adjusted, net of tax, for the change in amortization that would have been recorded if the unrealized gains (losses) from securities had actually been realized. This adjustment is included in "Unrealized gains (losses) on marketable securities, net" in the shareholders' 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. DPAC includes the present value of future profits on business in force of insurance companies acquired by GAFRI, which represents the portion of the costs to acquire companies that is allocated to the value of the right to receive future cash flows from insurance contracts existing at the date of acquisition. The present value of future profits is 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 and Life Acquisition Expenses

Annuity and life acquisition expenses on the Statement of Earnings consists primarily of amortization of DPAC related to the annuity and life, accident and health businesses. This line item also includes certain marketing and commission costs that are expensed as paid.

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. Establishing reserves for asbestos and environmental claims involves considerably more judgment than other types of claims due to, among other things, inconsistent court decisions, an increase in bankruptcy filings as a result of asbestos-related liabilities, novel theories of coverage, and judicial interpretations that often expand theories of recovery and broaden the scope of coverage.

Loss reserve 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 spite of the variability inherent in such estimates, 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 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.

Variable Annuity Assets and Liabilities

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

Premium Recognition

Property and casualty premiums are earned generally 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.

Payable to Subsidiary Trusts (Issuers of Preferred Securities)

Under FIN 46, AFG deconsolidated wholly-owned subsidiary trusts (formed prior to 2003) because they are "variable interest entities" in which AFG 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, and beginning in 2004, the related interest expense is shown in the Statement of Earnings as "interest on subsidiary trust obligations." Prior to 2004, this interest was included in the Statement of Earnings as "minority interest expense, net of tax." Implementation of FIN 46 with respect to the preferred securities had no effect on earnings.

Minority Interest

For balance sheet purposes, minority interest represents the interests of noncontrolling shareholders in consolidated entities. For income statement purposes, minority interest expense represents such shareholders' interest in the earnings of those entities. See "Payable to Subsidiary Trusts" above.

Income Taxes

Prior to the AFG/AFC merger in November 2003, AFC filed consolidated federal income tax returns which included all 80%-owned U.S. subsidiaries, except for certain life insurance subsidiaries and their subsidiaries. Because holders of AFC Preferred Stock held in excess of 20% of AFC's voting rights, AFG (parent) and AFC Holding Company were not eligible to file consolidated returns with AFC, and therefore, filed separately. Following the merger, AFG files consolidated federal income tax returns which include the companies previously included in the AFC consolidated return.

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 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 ("APB") No. 25, "Accounting for Stock Issued to Employees." Under AFG's stock option plan, options are granted to officers, directors and key employees at exercise prices equal to the fair value of the shares at the dates of grant. No compensation expense is recognized for stock option grants.

The following table illustrates the effect on net earnings (in thousands) and earnings per share had compensation cost been recognized and determined based on the "fair values" at grant dates consistent with the method prescribed by SFAS No. 123. See Note K – "Shareholders' Equity" for further information on stock options.

For SFAS No. 123 purposes, the "fair value" of $8.92 per option granted in 2004, $5.62 per option granted in 2003 and $8.52 in 2002 was calculated using the Black-Scholes option pricing model and the following assumptions: expected dividend yield of 2%; expected volatility of 29% for 2004 and 30% for 2003 and 2002; risk-free interest rate of 3.7% for 2004, 3.6% for 2003 and 4.9% for 2002; and expected option life of 7.5 years in 2004 and 7.4 years in 2003 and 2002. 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".

	2004	2003	2002
Net earnings, as reported	**$359,860**	$293,815	$84,640
Pro forma stock option expense, net of tax	**(6,866)**	(6,362)	(5,639)
Adjusted net earnings	**$352,994**	$287,453	$79,001
Earnings per share (as reported):			
Basic	**$4.89**	$4.14	$1.23
Diluted	**$4.81**	$4.12	$1.22
Earnings per share (adjusted):			
Basic	**$4.79**	$4.05	$1.15
Diluted	**$4.74**	$4.04	$1.14

In December 2004, the FASB issued SFAS No. 123(R), "Share-Based Payment." SFAS 123(R) revises SFAS 123 and eliminates the use of the intrinsic value method prescribed by APB 25. Under SFAS 123(R), companies must recognize compensation expense for all new share-based awards (including employee stock options), and the nonvested portions of prior awards, based on their fair value at the date of grant. AFG expects to implement the new standard on July 1, 2005 on a prospective basis. After that date, all share-based grants will be recognized as compensation expense over the vesting period. While AFG currently uses the Black-Scholes pricing model to measure the fair value of employee stock options for purposes of disclosing pro forma earnings, the use of other models is also permitted. AFG has not yet determined which model it will use to measure the fair value of future stock option grants.

Benefit Plans

AFG provides retirement benefits to qualified employees of participating companies through the AFG Retirement and Savings Plan, a defined contribution plan. AFG makes all contributions to the retirement fund portion of the plan and matches a percentage of employee contributions to the savings fund. Employees have been permitted to direct the investment of their contributions to independently managed investment funds, while Company contributions have been initially invested primarily in securities of AFG and affiliates. Since 2002, employees have been permitted to direct the investment of their vested retirement fund account balances from securities of AFG and its affiliates to independently managed investment funds. The plan sells small amounts of AFG securities each day in a program intended to keep funds available for requested transfers to other funds. As of December 31, 2004, the Plan owned 9% of AFG's outstanding Common Stock. Company contributions are expensed 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 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. The calculation of diluted earnings per share includes the following dilutive effect of common stock options: 2004 – 1,194,000 shares; 2003 – 335,000 shares; and 2002 – 403,000 shares.

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. Acquisitions and Sales of Subsidiaries

Transport Insurance Company

In November 2004, AFG completed the sale of Transport Insurance Company, realizing a pretax loss of $2.3 million. See Note M – "Discontinued Operations."

National Health Annuity Business

In May 2004, GAFRI acquired the fixed annuity business of National Health Insurance Company (over 30,000 policies). This transaction increased both annuity benefits accumulated and cash and investments by approximately $750 million.

Fidelity Excess and Surplus Insurance Company

In June 2003, AFG sold Fidelity Excess and Surplus Insurance Company, an inactive subsidiary, for $28.9 million, realizing a pretax gain of $4.3 million. AFG retained all liability for Fidelity's business related to the period AFG owned the company.

Direct automobile insurance business

In April 2003, AFG sold two of its subsidiaries that market automobile insurance directly to customers for $32.2 million, realizing a pretax gain of $3.4 million on the sale. The transaction included the transfer of the right of Great American Insurance Company ("GAI"), an AFG subsidiary, to renew certain of its personal automobile insurance business written on a direct basis in selected markets. Premiums generated by the businesses sold were approximately $79 million in 2002.

Infinity Property and Casualty Corporation

In public offerings in February and December of 2003, AFG sold all the shares of Infinity Property and Casualty Corporation ("Infinity", its Personal auto business) for a total of $400 million, realizing a net pretax gain of $17.1 million. The businesses sold generated aggregate net written premiums of approximately $690 million in 2002.

New Jersey Private Passenger Automobile Insurance Business

In September 2002, an AFG subsidiary entered into an agreement under which two unrelated entities assumed the subsidiary's obligations to renew its private passenger automobile insurance business written in New Jersey. AFG recognized a $10.8 million pretax loss on the transaction.

Manhattan National Life Insurance

In June 2002, GAFRI paid $48.5 million for Manhattan National Life Insurance Company ("MNL"), which no longer was writing new business, but had approximately 90,000 policies in force (primarily term life). GAFRI has reinsured 90% of this in force business.

C. Segments of Operations

AFG manages its business as three segments: (i) property and casualty insurance, (ii) annuity, supplemental insurance and life products, and (iii) other, which includes holding company assets and costs, and beginning December 31, 2003, the assets and operations of the CDO that AFG manages.

Since AFG disposed of substantially all of its Personal group business in 2003, it has revised its reporting of the Specialty insurance business into the following components: (i) Property and transportation, which includes inland and ocean marine, agricultural-related business and commercial automobile, (ii) Specialty casualty, which includes executive and professional liability, umbrella and excess liability and excess and surplus, (iii) Specialty financial, which includes fidelity and surety bonds and collateral protection and (iv) California workers' compensation. AFG's annuity, supplemental insurance and life business markets primarily retirement annuities and various forms of supplemental insurance and life products. AFG's reportable segments and their components were determined based primarily upon similar economic characteristics, products and services.

AFG's businesses operate throughout the United States. In 2004, 2003, and 2002, AFG derived just over 2% of its revenues from the sale of life and supplemental health products in Puerto Rico and just over 1% of its revenues from the sale of property and casualty insurance in Mexico, Canada and Europe.

The following tables (in thousands) show AFG's assets, revenues and operating profit (loss) by significant business segment and sub-segment. Operating profit (loss) represents total revenues less operating expenses.

	2004	2003	2002
Assets			
Property and casualty insurance (a)	**$10,182,551**	$ 9,230,244	$ 9,960,769
Annuities and life	**11,702,547**	10,292,616	9,349,280
Other	**674,429**	789,175	194,777
	$22,559,527	$20,312,035	$19,504,826

	2004	2003	2002
Revenues (b)			
Property and casualty insurance:			
Premiums earned:			
Specialty			
Property and transportation	**$ 611,266**	$ 480,597	$ 419,528
Specialty casualty	**717,102**	656,725	572,051
Specialty financial	**358,289**	262,280	229,415
California workers' compensation	**338,534**	262,691	213,879
Other	**71,366**	83,295	62,215
Personal (c)	**—**	163,610	905,246
Other lines	**13,745**	8	266
	2,110,302	1,909,206	2,402,600
Investment income	**261,290**	252,860	328,593
Realized gains (losses)	**239,223**	75,193	(52,862)
Other income	**193,160**	166,071	130,523
	2,803,975	2,403,330	2,808,854
Annuities, life and health (d)	**1,058,792**	931,018	897,365
Other	**43,498**	25,295	38,656
	$ 3,906,265	$ 3,359,643	$ 3,744,875
Operating Profit (Loss)			
Property and casualty insurance:			
Underwriting:			
Specialty			
Property and transportation	**$ 118,497**	$ 58,612	$ 41,336
Specialty casualty	**1,482**	11,560	(37,584)
Specialty financial	**(32,071)**	(21,866)	(3,127)
California workers' compensation	**35,502**	20,919	7,647
Other	**(569)**	(162)	16,272
Personal (c)	**—**	(4,795)	1,339
Other lines (e)	**(11,291)**	(42,400)	(49,840)
	111,550	21,868	(23,957)
Investment and other income (f)	**452,738**	255,891	206,861
	564,288	277,759	182,904
Annuities, life and health	**158,178**	87,335	61,553
Other (g)	**(132,928)**	(64,088)	(68,634)
	$ 589,538	$ 301,006	$ 175,823

(a) Not allocable to sub-segments.

(b) Revenues include sales of products and services as well as other income earned by the respective segments.

(c) There is no earned premium or underwriting profit for the Personal group in 2004 due to the sale of Infinity and the direct auto business during 2003, and the transfer, beginning in 2004, of the remaining former Personal business to Specialty property and transportation (2004 premium of $25 million and underwriting profit of $3 million) and Other lines (2004 premium of $14 million and underwriting loss of $2 million).

(d) Includes realized gains (losses) of $60 million, ($5) million and ($59) million for 2004, 2003 and 2002. Excluding realized gains (losses), investment income comprises approximately 55% of these revenues and premiums represent about 35%.

(e) Represents development of lines in "run-off" and includes a pretax charge of $43.8 million in 2003 for an arbitration decision relating to a 1995 property claim from a discontinued business. Includes a special charge of $30 million in 2002 related to the A.P. Green settlement.

(f) Includes a 2003 pretax charge of $35.5 million related to the settlement of litigation.

(g) Operating profit (loss) for 2004 includes a third quarter pretax charge of $52 million resulting from the settlement of litigation. Operating profit (loss) includes holding company expenses.

D. Investments

Fixed maturities and other stocks classified as available for sale at December 31 consisted of the following (in millions):

	2004				2003			
	Amortized Cost	Market Value	Gross Unrealized Gains	Gross Unrealized Losses	Amortized Cost	Market Value	Gross Unrealized Gains	Gross Unrealized Losses
Fixed maturities:								
United States Government and government agencies and authorities	$ 1,684.3	$ 1,694.0	$ 18.3	($ 8.6)	$ 1,392.6	$ 1,411.8	$ 24.4	($ 5.2)
States, municipalities and political subdivisions	1,009.2	1,030.4	22.7	(1.5)	946.9	973.5	28.8	(2.2)
Foreign government	141.4	145.2	3.8	—	143.1	146.5	3.9	(0.5)
Public utilities	944.7	994.0	51.5	(2.2)	1,011.4	1,068.8	61.7	(4.3)
Mortgage-backed securities	3,564.1	3,582.2	40.4	(22.3)	3,387.5	3,388.1	45.7	(45.1)
All other corporate	5,643.5	5,913.8	280.8	(10.5)	4,780.5	5,043.0	277.3	(14.8)
Redeemable preferred stocks	48.0	51.8	4.8	(1.0)	62.2	70.3	8.3	(0.2)
	$13,035.2	$13,411.4	$422.3	($ 46.1)	$11,724.2	$12,102.0	$450.1	($72.3)
Other stocks	$ 456.1	$ 537.2	$ 84.2	($ 3.1)	$ 258.5	$ 454.9	$197.5	($ 1.1)

The following table shows gross unrealized losses on fixed maturities and other stocks by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2004 and 2003.

	Twelve Months or Less			More Than Twelve Months		
2004	Unrealized Loss	Market Value	Market as % of Cost	Unrealized Loss	Market Value	Market as % of Cost
Fixed maturities:						
United States Government and government agencies and authorities	($ 6.8)	$1,012.3	99%	($ 1.8)	$ 55.8	97%
States, municipalities and political subdivisions	(0.7)	136.6	99%	(0.8)	26.9	97%
Foreign government	—	3.0	100%	—	—	—%
Public utilities	(1.8)	123.7	99%	(0.4)	16.9	98%
Mortgage-backed securities	(8.4)	887.2	99%	(13.9)	441.2	97%
All other corporate	(8.9)	638.0	99%	(1.6)	47.9	97%
Redeemable preferred stocks	(1.0)	13.0	93%	—	—	—%
	($27.6)	$2,813.8	99%	($18.5)	$588.7	97%
Other stocks	($ 2.5)	$ 25.4	91%	($ 0.6)	$ 24.9	98%
2003						
Fixed maturities:						
United States Government and government agencies and authorities	($ 5.2)	$ 316.4	98%	$ —	$ 0.1	94%
States, municipalities and political subdivisions	(0.7)	94.6	99%	(1.5)	31.7	95%
Foreign government	(0.5)	42.6	99%	—	—	—%
Public utilities	(2.9)	80.7	97%	(1.4)	26.6	95%
Mortgage-backed securities	(44.1)	2,039.8	98%	(1.0)	10.9	92%
All other corporate	(6.6)	390.7	98%	(8.2)	117.6	94%
Redeemable preferred stocks	(0.2)	10.5	98%	—	—	—%
	($60.2)	$2,975.3	98%	($12.1)	$186.9	94%
Other stocks	($ 0.9)	$ 36.9	98%	($ 0.2)	$ 3.5	95%

At December 31, 2004, the gross unrealized losses relate to nearly 400 securities with no single unrealized loss in excess of $1.6 million. Investment grade securities (as determined by nationally recognized rating agencies) represented about 93% and 97% of the total unrealized loss and market value, respectively. Of the mortgage-backed securities, more than 97% of the losses relate to AAA rated securities. Management believes that AFG will recover its cost basis in the securities having unrealized losses at December 31, 2004 and AFG has the ability and intent to hold such securities until they recover in value or mature.

The table below sets forth the scheduled maturities of fixed maturities based on market value as of December 31, 2004. 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 5-1/2 years at December 31, 2004.

Maturity	
One year or less	3%
After one year through five years	26
After five years through ten years	33
After ten years	11
	73
Mortgage-backed securities	27
	100%

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.

The only investment (other than U.S. Treasury Notes) which exceeded 10% of Shareholders' Equity at December 31, 2004 or 2003 was AFG's investment in Provident Financial Group, Inc., which had a market value of $227 million at December 31, 2003.

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

	Fixed Maturities	Equity Securities	Tax Effects	Total
2004				
Realized – Continuing operations	**$49,728**	**$252,229**	**($150,589)**	**$196,368**
Realized – Discontinued operations	**2,744**	**—**	**(960)**	**1,784**
Change in Unrealized	**(1,600)**	**(115,300)**	**41,100**	**(75,800)**
2003				
Realized – Continuing operations	51,647	7,244	(20,514)	38,377
Realized – Discontinued operations	1,600	11	(564)	1,047
Change in Unrealized	(79,400)	70,600	3,000	(5,800)
2002				
Realized – Continuing operations	(61,614)	(17,354)	27,594	(51,374)
Realized – Discontinued operations	389	(500)	39	(72)
Change in Unrealized	301,900	(100)	(103,800)	198,000

Gross gains and losses on available for sale fixed maturity investment transactions included in the Statement of Cash Flows consisted of the following (in millions):

	2004	2003	2002
Gross Gains	**$91.9**	$152.2	$155.3
Gross Losses	**($39.4)**	($ 99.0)	($216.5)

Unrealized Gain (Loss) on Marketable Securities, Net

In addition to adjusting equity securities and fixed maturity securities classified as "available for sale" to fair value, SFAS 115 requires that certain other balance sheet amounts be adjusted to the extent that unrealized gains and losses from securities would result in adjustments had those gains or losses actually been realized. The following table shows the components of the unrealized gain (loss) on marketable securities, net of tax, and its effect on various balance sheet captions (in millions).

	2004	2003
Increase (decrease) in assets		
Fixed maturities – available for sale	**$376.2**	$377.8
Other stocks	**81.1**	196.4
Deferred acquisition costs	**(59.5)**	(67.6)
Deferred taxes (included in other assets)	**(139.2)**	(175.0)
(Increase) decrease in liabilities and minority interest		
Minority interest	**(34.2)**	(29.0)
Annuity benefits and other liabilities	**7.3**	—
	$231.7	$302.6

E. Deferred Acquisition Costs

Included in deferred acquisition costs in AFG's Balance Sheet are $72.7 million and $57.9 million at December 31, 2004 and 2003, respectively, representing the present value of future profits ("PVFP") related to acquisitions by AFG's annuity and life business. The PVFP amounts are net of $73.2 million and $65.8 million of accumulated amortization. Amortization of the PVFP was $7.4 million in 2004, $8.5 million in 2003 and $11.8 million in 2002. 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.

F. Managed Investment Entity

AFG has made investments in, and acts as investment manager for, three CDOs. The investments are primarily lowest tier securities (considered equity), credited with residual income of the CDO after it pays stated rates of interest on senior levels of securities. AFG is also paid management fees based on a percentage of the investments managed. Under FIN 46, AFG has been determined to be the "primary beneficiary" of one CDO and began consolidating it as of December 31, 2003. The two other CDOs (formed in 2000 and 2004) are not required to be consolidated and are included in fixed maturities. The following summarizes AFG's experience with the CDOs since inception (in millions):

	Cons. CDO	Other CDOs	Total
Initial investment in CDOs	$ 21	$ 33	$ 54
Income earned on investments in CDOs	21	8	29
Distributions from CDOs	(12)	(32)	(44)
Impairment charges recorded before consolidation under FIN 46	(14)	—	(14)
Carrying values at December 31, 2004	$ 16	$ 9	$ 25
Assets in CDOs at December 31, 2004	$393	$830	$1,223
Management fees earned	$ 7	$ 8	$ 15

Upon formation in 1999, the consolidated CDO issued securities in various senior and subordinate classes and the proceeds were invested in primarily floating rate, secured bank loans, and to a lesser extent, high yield bonds, all of which serve as collateral for the securities issued by the CDO. None of the collateral was purchased from AFG. Income from the CDO's investments is used to service its debt and pay other operating expenses including management fees to AFG. AFG's investment in this CDO is subordinate to the senior classes (approximately 92% of the total securities) issued by the CDO. To the extent there are defaults and unrecoverable losses on the underlying collateral resulting in reduced cash flows, AFG's class would bear losses first.

The assets (substantially all cash and investments carried at market as "trading securities") of this managed investment entity are separately disclosed in the Balance Sheet because they are not available for use to satisfy AFG obligations. Likewise, the CDO liabilities (substantially all debt) are separately disclosed because they represent claims against only the CDO's assets and not against AFG's other assets. Accordingly, AFG's exposure to loss on this investment is limited to its investment (approximately $15.6 million at December 31, 2004).

Beginning in 2004, the operating results of the CDO are included in AFG's Statement of Earnings. However, due to the non-recourse nature of the instruments issued by the CDO, any excess losses included in AFG's results that are not absorbed by AFG's investment over the life of the CDO would ultimately reverse when the CDO is liquidated. Accordingly, while implementation of FIN 46 impacts the timing of income recognition, it does not impact the overall amount of income recognized over the life of this investment.

AFG began liquidating its consolidated CDO during the first quarter of 2005. The liquidation is expected to be completed in April 2005.

G. Goodwill

AFG completed its initial test in the fourth quarter of 2002 which resulted in a $40.4 million ($.59 per share, basic and diluted) impairment charge, net of tax, reported by restating first quarter 2002 results for the cumulative effect of a change in accounting principle.

Changes in the carrying value of goodwill during 2003 and 2004, by reporting segment, are presented in the following table (in thousands):

	Property and Casualty		Annuities	
	Specialty	Personal	and Life	Total
Balance December 31, 2002	$150,211	$ 77,791	$20,681	$248,683
Goodwill related to businesses sold	—	(77,791)	(645)	(78,436)
Other	—	—	(1,917)	(1,917)
Balance December 31, 2003	150,211	—	18,119	168,330
Goodwill from acquisitions	1,696	—	—	1,696
Impairment charge	—	—	(4,000)	(4,000)
Other	—	—	(144)	(144)
Balance December 31, 2004	$151,907	$ —	$13,975	$165,882

GAFRI recorded a goodwill impairment charge of $4.0 million (included in "Other operating and general expenses") during the third quarter of 2004 related to an insurance agency subsidiary. A review for impairment was prompted by a decrease in estimated future earnings from this agency. Fair value of the agency was estimated using the present value of expected future cash flows.

H. Long-Term Debt

Long-term debt consisted of the following at December 31 (in thousands):

	2004	2003
Holding Companies:		
AFG 7-1/8% Senior Debentures due April 2009, less discount of $1,112 and $1,349 (imputed rate - 7.2%)	**$296,843**	$301,501
AFG Senior Convertible Debentures due June 2033 (imputed rate - 4.0%)	**189,857**	189,857
AFG 7-1/8% Senior Debentures due February 2034	**115,000**	—
AFG 7-1/8% Senior Debentures due December 2007	**75,100**	75,100
Other	**8,283**	8,160
	$685,083	$574,618
Subsidiaries:		
GAFRI 7-1/2% Senior Debentures due November 2033	**$112,500**	$112,500
GAFRI 6-7/8% Senior Notes due June 2008	**100,000**	100,000
GAFRI 7-1/4% Senior Debentures due January 2034	**86,250**	—
Notes payable secured by real estate	**26,471**	27,063
American Premier Underwriters, Inc. ("APU") 10-7/8% Subordinated Notes due May 2011, including premium of $460 and $712 (imputed rate - 9.6%)	**8,181**	11,433
Other	**10,188**	11,248
	$343,590	$262,244

At December 31, 2004, sinking fund and other scheduled principal payments on debt for the subsequent five years were as follows (in millions):

	Holding Companies	Subsidiaries	Total
2005	$ —	$ 9.6	$ 9.6
2006	—	19.5	19.5
2007	80.5	.1	80.6
2008	—	100.1	100.1
2009	298.0	.1	298.1

In the first quarter of 2004, AFG issued $115 million principal amount of 7-1/8% senior debentures due 2034 and GAFRI issued $86.3 million principal amount of 7-1/4% senior debentures due 2034. Proceeds from both offerings were used to redeem at face value a portion of the outstanding trust preferred securities.

In June 2003, AFG issued Senior Convertible Notes due in 2033 at an issue price of 37.153% of the principal amount due at maturity. AFG received $189.9 million before issue costs of $4.5 million. Interest is payable semiannually at a rate of 4% of issue price per year through June 2008, after which, interest at 4% annually will be accrued and added to the carrying value of the Notes. The Notes are redeemable at AFG's option at any time on or after June 2, 2008, at prices ranging from $371.53 per Note to $1,000 per Note at maturity. Holders may require AFG to purchase all or a portion of their Notes on five year anniversaries beginning in 2008, at the accreted value. Generally, holders may convert each Note into 11.5016 shares of AFG Common Stock (at $32.30 per share currently) (i) if the average market price of AFG Common Stock to be received upon conversion exceeds 120% of the accreted value ($38.76 per share currently), (ii) if the credit rating of the Notes is significantly lowered, or (iii) if AFG calls the notes for redemption. AFG intends to deliver cash in lieu of Common Stock upon conversion of the Notes, accordingly, shares that would have been issued upon conversion of the Notes are not treated as dilutive.

In November 2003, GAFRI received approximately $109 million from the sale of $112.5 million principal amount of 7-1/2% senior debentures due 2033.

GAFRI has entered into interest rate swaps that effectively convert its 6-7/8% fixed-rate Senior Notes to a floating rate of 3-month LIBOR plus 2.9%. The swaps realign GAFRI's mix of floating and fixed rate debt.

In November 2004, AFG replaced its existing credit agreement with a $300 million, four-year credit facility. Amounts borrowed bear interest at rates ranging from 1% to 2% over LIBOR based on AFG's credit rating. In August 2004, GAFRI replaced its existing line of credit with a credit agreement under which it can borrow up to $150 million through August 2008 at interest rates ranging from 1% to 2% over LIBOR based on GAFRI's credit rating.

Cash interest payments of $62 million, $48 million and $47 million were made on long-term debt in 2004, 2003 and 2002, respectively. Interest expense in the Statement of Earnings includes interest credited on funds held by AFG's insurance subsidiaries under reinsurance contracts and other similar agreements as follows: 2004 – $5.2 million; 2003 – $7.8 million; and 2002 – $11.7 million.

I. Payable to Subsidiary Trusts (Issuers of Preferred Securities)

The preferred securities supported by the payable to subsidiary trusts consisted of the following (in thousands):

		Amount Outstanding	
Date of Issuance	Issue (Maturity Date)	**2004**	2003
October 1996	AFG 9-1/8% TOPrS (2026)	$ —	$95,459
November 1996	GAFRI 9-1/4% TOPrS (2026)	—	65,013
March 1997 (a)	GAFRI 8-7/8% Pfd (2027)	**42,800**	70,000
May 2003 (b)	GAFRI 7.35% Pfd (2033)	**20,000**	20,000
May 2003 (c)	Variable Rate Pfd (2033)	**15,000**	15,000

(a) Redeemable beginning 3/1/2007
(b) Redeemable beginning 5/15/2008
(c) Redeemable beginning 5/23/2008

AFG and GAFRI effectively provide unconditional guarantees of their respective trusts' obligations. The AFG 9-1/8% trust preferred securities and the GAFRI 9-1/4% trust preferred securities were redeemed at face value in the first quarter of 2004. In addition, during the first quarter of 2004, GAFRI repurchased $27.2 million of its 8-7/8% preferred securities for $28.5 million in cash.

In May 2003, a GAFRI subsidiary and a 68%-owned subsidiary of GAI issued an aggregate of $35 million in trust preferred securities maturing in 2033.

J. Minority Interest

Minority interest in AFG's Balance Sheet represents the interest of noncontrolling investors in the following (in thousands):

	2004	2003
Subsidiaries' common stock	**$214,292**	$180,937
Managed investment entity	**5,294**	6,622
	$219,586	$187,559

Minority Interest Expense

Minority interest expense is comprised of (in thousands):

	2004	2003	2002
Interest of noncontrolling investors in earnings of:			
Subsidiaries	**$28,882**	$16,470	$6,096
Managed Investment Entity	**3,528**	—	—
Accrued distributions by consolidated subsidiaries on preferred securities:			
Trust issued securities, net of tax	—	14,151	14,281
AFC preferred stock	—	5,772	5,772
	$32,410	$36,393	$26,149

K. Shareholders' Equity

AFG sold 2,679,000 shares of its Common Stock through public offerings in the fourth quarter of 2004 at an average price of $30.56 per share, net of commissions and fees. In addition, APU sold 1,361,711 previously issued and outstanding AFG common shares that it was holding for the benefit of certain creditors and other claimants pursuant to the 1978 plan of reorganization of its predecessor, The Penn Central Transportation Company. The $41.5 million in proceeds were placed in escrow to be used to settle such claims. In November 2003, in conjunction with the AFG/AFC merger, AFG issued 3.3 million shares of Common Stock in exchange for all of the outstanding shares of AFC Series J preferred stock.

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.

Stock Options

At December 31, 2004, there were 8.3 million shares of AFG Common Stock reserved for issuance under AFG's Stock Option Plan. Options are granted with an exercise price equal to the market price of AFG Common Stock at the date of grant. 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. Options generally expire ten years after the date of grant. Data for AFG's Stock Option Plan is presented below:

	2004		2003		2002	
	Shares	Average Exercise Price	Shares	Average Exercise Price	Shares	Average Exercise Price
Outstanding at beginning of year	**7,715,656**	**$26.56**	6,982,562	$27.58	6,089,131	$27.91
Granted	**896,950**	**$30.01**	956,250	$18.54	1,056,750	$25.78
Exercised	**(1,352,698)**	**$23.31**	(35,000)	$21.12	(28,837)	$20.80
Forfeited	**(40,815)**	**$26.25**	(188,156)	$25.02	(134,482)	$29.41
Outstanding at end of year	**7,219,093**	**$27.59**	7,715,656	$26.56	6,982,562	$27.58
Options exercisable at year-end	**4,938,143**	**$29.03**	5,404,330	$28.51	4,560,210	$29.01
Options available for grant at year-end	**1,086,746**		1,942,881		2,710,975	

No compensation cost has been recognized for stock option grants. For information about the SFAS #123 "fair value" of options granted, see Note A – "Accounting Policies – Stock-based Compensation." AFG realizes a tax benefit upon the exercise of non-qualified stock options and disqualifying dispositions of incentive stock options based on the difference between the market value of the common stock and the option exercise price on the date the options are exercised. Such benefits are credited to capital surplus and amounted to $3.3 million in 2004, $32,000 in 2003 and $56,000 in 2002.

The following table summarizes information about stock options outstanding at December 31, 2004:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Shares	Average Exercise Price	Average Remaining Life	Shares	Average Exercise Price
$18.45 – $20.00	2,262,616	$19.29	6.5 years	1,318,726	$19.60
$20.01 – $25.00	461,891	$23.95	0.7 "	458,691	$23.96
$25.01 – $30.00	970,110	$25.86	7.0 "	485,000	$25.92
$30.01 – $35.00	1,790,500	$30.19	5.1 "	941,750	$30.35
$35.01 – $40.00	1,457,476	$36.81	3.3 "	1,457,476	$36.81
$40.01 – $45.19	276,500	$42.40	3.2 "	276,500	$42.40

Unrealized Gain (Loss) on Marketable Securities, Net

The change in unrealized gain (loss) on marketable securities included the following (in millions):

	Pretax	Tax Effects	Minority Interest	Net
2004				
Unrealized holding gains on securities arising during the period	**$202.9**	**($ 70.7)**	**($12.2)**	**$120.0**
Realized gains included in net income and unrealized loss of subsidiary sold	**(304.4)**	**106.5**	**7.0**	**(190.9)**
Change in unrealized gain on marketable securities, net	**($101.5)**	**$ 35.8**	**($ 5.2)**	**($ 70.9)**
2003				
Unrealized holding gains on securities arising during the period	$ 86.5	($ 30.6)	$ 1.0	$ 56.9
Adoption of FIN 46	(2.1)	0.8	0.1	(1.2)
Transfer to Trading Securities	(16.1)	5.6	1.9	(8.6)
Realized gains included in net income and unrealized gains of subsidiary sold	(104.5)	36.7	(0.6)	(68.4)
Change in unrealized gain on marketable securities, net	($ 36.2)	$ 12.5	$ 2.4	($ 21.3)
2002				
Unrealized holding gains on securities arising during the period	$195.7	($ 66.6)	($11.8)	$117.3
Realized losses included in net income	79.1	(27.7)	(4.1)	47.3
Change in unrealized gain on marketable securities, net	$274.8	($ 94.3)	($15.9)	$164.6

L. Income Taxes

The following is a reconciliation of income taxes at the statutory rate of 35% and income taxes as shown in the Statement of Earnings (in thousands):

	2004	2003	2002
Earnings (loss) before income taxes:			
Operating	**$589,538**	$301,006	$175,823
Minority interest expense	**(32,410)**	(44,013)	(33,839)
Equity in net earnings (losses) of investees	**(4,883)**	13,975	(13,830)
Discontinued operations	**(3,755)**	(51,795)	2,196
Accounting changes	**(8,821)**	6,300	(57,716)
Total	**$539,669**	$225,473	$ 72,634
Income taxes at statutory rate	**$188,884**	$ 78,916	$ 25,422
Effect of:			
Adjustment to prior year taxes	**(2,608)**	(143,500)	(33,192)
Minority interest	**9,968**	7,764	3,058
Tax exempt interest	**(6,332)**	(4,970)	(1,367)
Effect of foreign operations	**(4,194)**	(4,416)	(4,212)
Dividends received deduction	**(3,599)**	(2,539)	(2,313)
Amortization and writeoff of intangibles	**491**	907	3,711
Losses utilized	**—**	—	(3,300)
Other	**(2,802)**	(504)	187
Total Provision (Credit)	**179,808**	(68,342)	(12,006)
Amounts applicable to:			
Minority interest expense	**—**	7,620	7,690
Equity in net (earnings) losses of investees	**1,709**	(4,891)	4,840
Discontinued operations	**1,344**	18,159	(763)
Accounting changes	**3,228**	—	17,356
Provision (credit) for income taxes as shown on the Statement of Earnings	**$186,089**	($ 47,454)	$ 17,117

The AFG/AFC merger in November 2003 resulted in the elimination of $170 million in deferred tax liabilities associated with AFC's holding of AFG stock. From 1980 through March 1995, AFC accounted for its investment in AFG's predecessor using the equity method of accounting. During this period, as AFC's book basis in the investment increased, AFC recorded a deferred tax liability (aggregating $136 million) on the excess of book over tax basis in this investment. In April 1995, AFC received AFG shares in exchange for its investment in AFG's predecessor. AFC retained the deferred tax liability related to this investment because AFC and AFG were in separate tax groups. Between 1995 and 2003, dividends on the AFG shares were treated as "return of capital" for tax purposes, thereby reducing AFC's tax basis and resulting in increases (aggregating $34 million) in the liability for deferred income taxes. In AFG's consolidated financial statements, the increase in deferred taxes resulted in a corresponding decrease to capital surplus because AFG's dividends to AFC were, in substance, capital contributions. The 2003 merger eliminated AFC's investment in AFG in a tax-free transaction thereby allowing the reversal of the related deferred tax liabilities.

Total earnings before income taxes include income subject to tax in foreign jurisdictions of $26.6 million in 2004, $27.4 million in 2003 and $25.5 million in 2002.

The total income tax provision (credit) consists of (in thousands):

	2004	2003	2002
Current taxes:			
Federal	**$ 64,012**	$ 43,028	$17,535
Foreign	**1,849**	3,115	2,293
State	**2,234**	707	236
Deferred taxes:			
Federal	**112,542**	(116,338)	(33,762)
Foreign	**(829)**	1,146	1,692
	$179,808	($ 68,342)	($12,006)

For income tax purposes, AFG and certain members of its consolidated tax group had the following carryforwards available at December 31, 2004 (in millions):

	Expiring	Amount
Operating Loss	2005 – 2009	$ 5.2
Operating Loss	2010 – 2019	51.0
Operating Loss	2020 – 2022	92.6
Capital Loss	2006	1.9
Capital Loss	2008	107.5
Other – Tax Credits		4.4

Deferred income tax assets and liabilities reflect temporary differences between the carrying amounts of assets and liabilities recognized for financial reporting purposes and the amounts recognized for tax purposes. The significant components of deferred tax assets and liabilities included in the Balance Sheet at December 31, were as follows (in millions):

	2004	2003
Deferred tax assets:		
Net operating loss carryforwards	$ 52.1	$ 56.0
Capital loss carryforwards	38.3	86.0
Insurance claims and reserves	308.2	263.2
Other, net	162.3	112.8
	560.9	518.0
Valuation allowance for deferred tax assets	(50.0)	(50.0)
	510.9	468.0
Deferred tax liabilities:		
Deferred acquisition costs	(324.5)	(222.2)
Investment securities	(110.8)	(93.4)
	(435.3)	(315.6)
Net deferred tax asset (liability)	$ 75.6	$152.4

The gross deferred tax asset has been reduced by a valuation allowance related to a portion of AFG's net operating loss carryforwards ("NOL") which is subject to the separate return limitation year ("SRLY") tax rules. A SRLY NOL can be used only by the entity that created it and only in years that both the entity and the consolidated group have taxable income. The likelihood of realizing this asset will be reviewed periodically; any adjustments required to the valuation allowance will be made in the period in which the developments on which they are based become known.

The American Jobs Creation Act of 2004 provides a special one-time dividends received deduction on the repatriation of certain foreign earnings. While AFG is still evaluating whether it will remit any qualified foreign earnings under this provision in 2005, it does not believe the impact of any such election will be material to its results of operations.

Cash payments for income taxes, net of refunds, were $55.1 million, $51.8 million and $31.2 million for 2004, 2003 and 2002, respectively.

M. Discontinued Operation

In the fourth quarter of 2004, AFG completed the sale of Transport Insurance Company, an inactive property and casualty subsidiary with only run-off liabilities. In December 2003, AFG recorded a $55 million impairment charge to reduce its investment in Transport for its estimated loss on sale, which was determined based on negotiations with potential buyers.

Transport's results are reflected as discontinued for all periods presented in the Statement of Earnings; 2003 Balance Sheet amounts have not been reclassified. The carrying amount of the major classes of Transport's assets and liabilities and a summary of the discontinued operations follow (in millions):

	2004	2003	2002
Assets:			
Investment in fixed-maturity securities		$ 70.8	
Amounts due from reinsurers and prepaid reinsurance premiums		59.3	
Liabilities:			
Unpaid losses and loss adjustment expenses		$111.8	
Operations:			
Revenue	$5.4	$ 6.1	$4.7
Pretax earnings (loss)	(1.5)	3.2	2.2
Provision (benefit) for income taxes	(0.6)	1.1	0.8
Earnings (loss) from discontinued operations	(0.9)	2.1	1.4
Loss on sale, net of tax	(1.5)	(35.7)	—
Discontinued operations	($2.4)	($ 33.6)	$1.4

N. Equity in Net Earnings (Losses) of Investees

Equity in net earnings (losses) of investees includes AFG's share of the losses from a manufacturing business ($3.2 million in 2004, $3.1 million in 2003 and $3.6 million in 2002). In 2002, equity in investees also includes a loss of $5.4 million representing AFG's share of the losses of another manufacturing business that was sold in December 2002. From the date of the initial sale of 61% of Infinity in February 2003 through the date of the sale of its remaining interest in Infinity in December 2003, AFG accounted for its ownership interest in Infinity as an investee using the equity method. Equity in Infinity's net earnings during this period was $12.2 million.

O. Commitments and Contingencies

Loss accruals (included in other liabilities) have been recorded for various environmental and occupational injury and disease claims and other contingencies arising out of the railroad operations disposed of by American Premier's predecessor, Penn Central Transportation Company ("PCTC"), prior to its bankruptcy reorganization in 1978 and certain manufacturing operations disposed of by American Premier.

In November 2004, American Premier reached an agreement with two other responsible parties on the allocation of environmental clean-up costs at a former railroad site in Paoli, Pennsylvania. Based on the settlement, American Premier recorded a charge (included in "Other operating and general expenses") of $52 million to increase its liabilities for environmental exposures. Although American Premier has been advised by counsel that it should be able to recover a significant amount of these costs from a financially viable third party, no recovery asset has been recorded for its Paoli Yard costs.

At December 31, 2004, American Premier had liabilities for environmental and personal injury claims aggregating $103.5 million. The environmental claims consist of a number of proceedings and claims seeking to impose responsibility for hazardous waste remediation costs related to certain sites formerly owned or operated by the railroad and manufacturing operations. Remediation costs are difficult to estimate for a number of reasons, including the number and financial resources of other potentially responsible parties, the range of costs for remediation alternatives, changing technology and the time period over which these matters develop. The personal injury claims include pending and expected claims, primarily by former employees of PCTC, for injury or disease allegedly caused by exposure to excessive noise, asbestos or other substances in the workplace.

GAFRI has accrued approximately $7 million at December 31, 2004, for environmental costs and certain other matters associated with the sales of former operations.

AFG's insurance subsidiaries continue to receive claims related to environmental exposures, asbestos and other mass tort claims. Establishing reserves for these claims is subject to uncertainties that are significantly greater than those presented by other types of claims. The liability for asbestos and environmental reserves at December 31, 2004 and 2003, respectively, was $401 million and $515 million; related recoverables from reinsurers (net of allowances for doubtful accounts) at those dates were $59 million and $92 million, respectively. The 2003 amounts include the reserves ($70 million) and reinsurance recoverables ($18 million) of Transport Insurance Company, which AFG sold in 2004.

While management believes AFG has recorded adequate reserves for the items discussed in this note, the outcome is uncertain and could result in liabilities exceeding amounts AFG has currently recorded. Additional amounts could have a material adverse effect on AFG's future results of operations and financial condition.

P. Quarterly Operating Results (Unaudited)

The operations of certain of AFG's business segments are seasonal in nature. While insurance premiums are recognized on a relatively level basis, claim losses related to adverse weather (snow, hail, hurricanes, tornadoes, etc.) may be seasonal. Quarterly results necessarily rely heavily on estimates. These estimates and certain other factors, such as the nature of investees' operations and discretionary sales of assets, cause the quarterly results not to be necessarily indicative of results for longer periods of time.

The following are quarterly results of consolidated operations for the two years ended December 31, 2004 (in millions, except per share amounts).

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total Year
2004					
Revenues	**$874.3**	**$901.4**	**$1,153.5**	**$977.1**	**$3,906.3**
Earnings (loss) from:					
Continuing operations	**74.4**	**56.3**	**143.0**	**94.2**	**367.9**
Discontinued operations	**.6**	**(.4)**	**(1.0)**	**(1.6)**	**(2.4)**
Cumulative effect of accounting change	**(1.8)**	**—**	**(3.8)**	**—**	**(5.6)**
Net earnings (loss)	**73.2**	**55.9**	**138.2**	**92.6**	**359.9**
Basic earnings (loss) per common share:					
Continuing operations	**$1.02**	**$.77**	**$1.94**	**$1.26**	**$5.00**
Discontinued operations	**.01**	**(.01)**	**(.01)**	**(.02)**	**(.03)**
Cumulative effect of accounting change	**(.03)**	**—**	**(.05)**	**—**	**(.08)**
Net earnings (loss) available to Common Shares	**$1.00**	**$.76**	**$1.88**	**$1.24**	**$4.89**
Diluted earnings (loss) per common share:					
Continuing operations	**$1.00**	**$.76**	**$1.91**	**$1.25**	**$4.92**
Discontinued operations	**.01**	**(.01)**	**(.01)**	**(.02)**	**(.03)**
Cumulative effect of accounting change	**(.03)**	**—**	**(.05)**	**—**	**(.08)**
Net earnings (loss) available to Common Shares	**$ .98**	**$.75**	**$1.85**	**$1.23**	**$4.81**
Average number of Common Shares:					
Basic	**73.2**	**73.4**	**73.6**	**74.3**	**73.6**
Diluted	**74.3**	**74.7**	**74.8**	**75.5**	**74.8**
2003					
Revenues	$839.9	$776.6	$848.3	$894.8	$3,359.6
Earnings (loss) from:					
Continuing operations	24.8	29.9	41.2	225.2	321.1
Discontinued operations	.3	.6	.4	(34.9)	(33.6)
Cumulative effect of accounting change	—	—	—	6.3	6.3
Net earnings (loss)	25.1	30.5	41.6	196.6	293.8
Basic earnings (loss) per common share:					
Continuing operations	$.36	$.43	$.59	$3.10	$4.53
Discontinued operations	—	.01	.01	(.49)	(.48)
Cumulative effect of accounting change	—	—	—	.09	.09
Net earnings (loss) available to Common Shares	$.36	$.44	$.60	$2.70	$4.14
Diluted earnings (loss) per common share:					
Continuing operations	$.36	$.43	$.58	$3.08	$4.51
Discontinued operations	—	.01	.01	(.49)	(.48)
Cumulative effect of accounting change	—	—	—	.09	.09
Net earnings (loss) available to Common Shares	$.36	$.44	$.59	$2.68	$4.12
Average number of Common Shares:					
Basic	69.3	69.6	69.7	71.2	69.9
Diluted	69.4	69.9	70.0	71.7	70.3

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

Results for the third quarter of 2004 include a $214.3 million pretax gain on the sale of Provident Financial Group, partially offset by a $52 million charge based on APU's settlement of litigation related to environmental clean-up costs at a former railroad site and $35 million in losses related to hurricanes in the Southeastern United States.

Results for 2003 include (i) a $5.5 million first quarter tax benefit related to AFG's investment in Infinity, (ii) a $43.8 million second quarter charge for an arbitration decision relating to a 1995 property claim, (iii) a $12.5 million second quarter charge related to the narrowing of spreads on GAFRI's fixed annuities, (iv) a $35.5 million third quarter charge related to a litigation settlement, (v) a fourth quarter tax benefit of $136 million related to the elimination of deferred taxes in connection with the AFG/AFC merger, and (vi) a fourth quarter $55 million charge related to the planned sale of Transport Insurance Company (included in discontinued operations).

AFG has realized gains (losses) on sales of subsidiaries in recent years (see Note B). Realized gains (losses) on securities, affiliates and other investments amounted to (in millions):

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total Year
2004	**$36.2**	**$ 0.7**	**$223.6**	**$41.5**	**$302.0**
2003	(37.7)	25.3	21.8	69.3	78.7

Q. Insurance

Securities owned by insurance subsidiaries having a carrying value of approximately $880 million at December 31, 2004, were on deposit as required by regulatory authorities.

Insurance Reserves

The liability for losses and loss adjustment expenses for long-term scheduled payments under certain workers' compensation insurance has been discounted at about 7%, an approximation of long-term investment yields. As a result, the total liability for losses and loss adjustment expenses at December 31, 2004, has been reduced by $31 million.

The following table provides an analysis of changes in the liability for losses and loss adjustment expenses, net of reinsurance (and grossed up), over the past three years on a GAAP basis (in millions). Adverse development recorded in 2004, 2003 and 2002 in prior year reserves related primarily to charges for asbestos and certain Specialty lines in run-off.

	2004	2003	2002
Balance at beginning of period	**$2,850**	$3,400	$3,253
Provision for losses and LAE occurring in the current year	**1,282**	1,203	1,664
Net increase (decrease) in provision for claims of prior years	**140**	167	171
Total losses and LAE incurred (*)	**1,422**	1,370	1,835
Payments for losses and LAE of:			
Current year	**(377)**	(389)	(594)
Prior years	**(726)**	(849)	(1,094)
Total payments	**(1,103)**	(1,238)	(1,688)
Reserves of businesses sold	**(66)**	(682)	—
Balance at end of period	**$3,103**	$2,850	$3,400
Add back reinsurance recoverables, net of allowance	**2,234**	2,059	1,804
Gross unpaid losses and LAE included in the Balance Sheet	**$5,337**	$4,909	$5,204

(*) Before amortization of deferred gains on retroactive reinsurance of $15 million in 2003 and $20 million in 2002. Includes losses of Transport Insurance Company which have been reclassed to discontinued operations: 2004 – $7 million; 2003 and 2002 – $2 million.

Net Investment Income

The following table shows (in millions) investment income earned and investment expenses incurred by AFG's insurance companies.

	2004	2003	2002
Insurance group investment income:			
Fixed maturities	**$774.9**	$753.6	$849.7
Equity securities	**23.1**	13.1	9.6
Other	**.7**	.4	.6
	798.7	767.1	859.9
Insurance group investment expenses (*)	**(27.2)**	(39.7)	(40.3)
	$771.5	$727.4	$819.6

(*) Included primarily in "Other operating and general expenses" in the Statement of Earnings.

Statutory Information

AFG's insurance subsidiaries are required to file financial statements with state insurance regulatory authorities prepared on an accounting basis prescribed or permitted by such authorities (statutory basis). Net earnings and policyholders' surplus on a statutory basis for the insurance subsidiaries were as follows (in millions):

	Net Earnings (Loss)			Policyholders' Surplus	
	2004	2003	2002	**2004**	2003
Property and casualty companies	**$390**	$94	$116	**$2,071**	$1,814
Life insurance companies	**122**	78	(24)	**623**	549

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. The following table shows (in millions) (i) amounts deducted from property and casualty written and earned premiums in connection with reinsurance ceded, (ii) written and earned premiums included in income for reinsurance assumed and (iii) reinsurance recoveries deducted from losses and loss adjustment expenses.

	2004	2003	2002
Direct premiums written	**$3,675**	$3,530	$4,027
Reinsurance assumed	**62**	100	80
Reinsurance ceded	**(1,508)**	(1,618)	(1,693)
Net written premiums	**$2,229**	$2,012	$2,414
Direct premiums earned	**$3,643**	$3,455	$3,798
Reinsurance assumed	**77**	79	91
Reinsurance ceded	**(1,610)**	(1,625)	(1,486)
Net earned premiums	**$2,110**	$1,909	$2,403
Reinsurance recoveries	**$1,203**	$1,155	$1,136

GAFRI has reinsured approximately $26 billion and $28 billion in face amount of life insurance as of December 31, 2004 and 2003, respectively. Life premiums ceded were $86 million, $85 million and $61 million for 2004, 2003 and 2002, respectively.

R. Additional Information

Total rental expense for various leases of office space and equipment was $35 million, $38 million and $52 million for 2004, 2003 and 2002, respectively.

Future minimum rentals, related principally to office space, required under operating leases having initial or remaining noncancelable lease terms in excess of one year at December 31, 2004, were as follows: 2005 – $35 million; 2006 – $32 million; 2007 – $25 million; 2008 – $16 million; 2009 – $12 million; and $29 million thereafter. In addition, AFG has 99-year land leases (approximately 92 years remaining) at one of its real estate properties. Minimum lease payments under these leases are expected to total approximately $300,000 in 2005 and are adjusted annually for inflation.

Other operating and general expenses included charges for possible losses on agents' balances, other receivables and other assets in the following amounts: 2004 – $15.1 million; 2003 – $1.3 million; and 2002 – $2.7 million. Losses and loss adjustment expenses included charges for possible losses on reinsurance recoverables of $12.7 million in 2004, $4.7 million in 2003, and $6.6 million in 2002. The aggregate allowance for all such losses amounted to approximately $82 million and $84 million at December 31, 2004 and 2003, respectively.

Fair Value of Financial Instruments

The following table presents (in millions) the carrying value and estimated fair value of AFG's financial instruments at December 31.

	2004		2003	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets:				
Fixed maturities	$13,704	$13,704	$12,297	$12,297
Other stocks	537	537	455	455
Liabilities:				
Annuity benefits accumulated	$ 8,070	$ 7,747	$ 6,975	$ 6,781
Long-term debt:				
Holding companies	685	751	575	629
Subsidiaries	344	350	262	257
Payable to subsidiary trusts	78	82	265	271
Shareholders' Equity	$ 2,431	$ 2,399	$ 2,076	$ 1,933

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 discounted cash flow models, 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 shareholders' equity is based on the quoted market price of AFG's Common Stock.

Financial Instruments with Off-Balance-Sheet Risk

On occasion, AFG and its subsidiaries have entered into financial instrument transactions which may present off-balance-sheet risks of both a credit and market risk nature. These transactions include commitments to fund loans, loan guarantees and commitments to purchase and sell securities or loans. At December 31, 2004, AFG and its subsidiaries had commitments to fund credit facilities and contribute limited partnership capital totaling up to $23 million.

Restrictions on Transfer of Funds and Assets of Subsidiaries

Payments of dividends, loans and advances by AFG's subsidiaries are subject to various state laws, federal regulations and debt covenants which limit the amount of dividends, loans and advances that can be paid. Under applicable restrictions, the maximum amount of dividends available to AFG in 2005 from its insurance subsidiaries without seeking regulatory clearance is approximately $247 million. Additional amounts of dividends, loans and advances require regulatory approval.

Benefit Plans

AFG expensed approximately $17 million in 2004 and $20 million in both 2003 and 2002 for its retirement and employee savings plans.

Transactions With Affiliates

In December 2004, AFG's Chairman and one of his brothers purchased 600,000 and 200,000 shares, respectively, of AFG's Common Stock as part of a public offering.

AFG purchased a $3.7 million minority interest in a residential homebuilding company from an unrelated party in 1995. At that same time, a brother of AFG's chairman purchased a minority interest in the company for $825,000. In 2000, that brother and another brother of AFG's chairman acquired the remaining shares from

the third parties. In addition, GAFRI had extended a line of credit to this company under which the homebuilder could borrow up to $8 million at 13%. In September 2002, the homebuilding company was sold to an unrelated party for a gain of $9.3 million (included in realized gains on other investments) and GAFRI's line of credit was repaid and terminated.

AFG owns a 29% interest in an aircraft; the remaining interests in the aircraft are owned by AFG's chairman and his two brothers. Costs of operating the aircraft are being borne proportionately.

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, AFG's Chairman beneficially owns 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. In December 2003, the ethanol company repaid a GAFRI subsidiary $4.0 million under a subordinated note that bore interest at 14%. In 2004, AFG's Chairman assumed AFG's obligation for a line of credit under which the ethanol company could borrow up to $10 million; AFG no longer has any interest or investment in the ethanol company.

In connection with the sale of the remaining shares of Infinity in December 2003, AFG paid Infinity $13.5 million to commute a prior indemnification and cost reimbursement obligation. AFG purchased at fair value $4.7 million in marketable securities from Infinity during 2003. During 2003, Infinity paid AFG $9.0 million for rent, information technology, investment, accounting, legal, actuarial and other services. In 2003, Infinity repaid a $55 million note due to AFG plus $2.5 million in interest.

During 2003, AFG subsidiaries invested $20 million in preferred stock and warrants of an unrelated party who utilized the proceeds to repay loans from several banks, including $3.4 million in loans and fees to the Provident Bank. At the time of the transaction, AFG's Chairman and members of his immediate family owned approximately one-fourth of Provident's parent company; AFG owned 14% of the parent company.

S. Subsequent Event (Unaudited)

National Interstate Public Offering

An AFG majority-owned subsidiary, National Interstate Corporation, issued 3.4 million of its common shares in a January 2005 initial public offering. National Interstate used $15 million of the $40.6 million in proceeds to repay a loan to Great American and the balance for general corporate purposes. Following the IPO, AFG owned approximately 54% of National Interstate's common stock.

Report of Management on Internal Control Over Financial Reporting

AFG's management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Securities Exchange Act Rules 13a-15(f). Under the supervision and with the participation of management, including AFG's principal executive officers and principal financial officer, AFG conducted an evaluation of the effectiveness of internal control over financial reporting as of December 31, 2004, based on the criteria set forth in "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission.

In conducting AFG's evaluation of the effectiveness of its internal control over financial reporting, AFG has excluded the 2004 acquisition of the fixed annuity business of National Health Insurance Company. This acquisition constituted less than 4% of total assets as of December 31, 2004 and less than 1% of total revenues and net earnings for the year then ended. Refer to Note B to the consolidated financial statements for further discussion of this acquisition.

There are inherent limitations to the effectiveness of any system of internal controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective internal controls and procedures can only provide reasonable assurance of achieving their control objectives.

Based on AFG's evaluation, management concluded that internal control over financial reporting was effective as of December 31, 2004. Management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2004 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report which is set forth on the following page.

Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting

Board of Directors and Shareholders
American Financial Group, Inc.

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that American Financial Group, Inc. maintained effective internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). American Financial Group, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment about the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As indicated in the accompanying Management's Report on Internal Control Over Financial Reporting, management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of the fixed annuity business of National Health Insurance Company, which is included in the 2004 consolidated financial statements of American Financial Group, Inc. and constituted less than 4% of total assets as of December 31, 2004, and less than 1% of total revenues and net earnings for the year then ended. Management did not assess the effectiveness of internal control over financial reporting at this entity because the Company acquired this entity during 2004. Our audit of internal control over financial reporting of American Financial Group, Inc. also did not include an evaluation of the internal control over financial reporting of the entity referred to above.

In our opinion, management's assessment that American Financial Group, Inc. maintained effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, American Financial Group, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of American Financial Group, Inc. as of December 31, 2004 and 2003, and the related consolidated statements of earnings, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2004, and our report dated March 9, 2005, expressed an unqualified opinion thereon.

Ernst & Young LLP

Cincinnati, Ohio
March 9, 2005

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
American Financial Group, Inc.

We have audited the accompanying consolidated balance sheet of American Financial Group, Inc. and subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of earnings, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (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 American Financial Group, Inc. and subsidiaries at December 31, 2004 and 2003, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles.

As discussed in Notes A and E to the consolidated financial statements, in 2002 the Company implemented Statement of Financial Accounting Standards No. 142, which required a change in the method of accounting for goodwill, in 2003 the Company implemented FASB interpretation No. 46, which required a change in consolidation policy related to variable interest entities, and in 2004 the Company implemented Statement of Position 03-01, which required a change in the method of accounting for certain nontraditional long duration insurance contracts and separate accounts and EITF 03-16, which required a change in the method of accounting for limited liability companies.

We also have audited in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of American Financial Group, Inc.'s internal control over financial reporting as of December 31, 2004, based upon criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 9, 2005 expressed an unqualified opinion thereon.

Ernst & Young LLP

Cincinnati, Ohio
March 9, 2005

Corporate and Investor Information

Board of Directors

Carl H. Lindner [1*]
Chairman of the Board

Carl H. Lindner III [1]
Co-Chief Executive Officer and Co-President, American Financial Group, Inc.
President, Great American Insurance Company

S. Craig Lindner [1]
Co-Chief Executive Officer and Co-President, American Financial Group, Inc.
President and Chief Executive Officer, Great American Financial Resources, Inc.

Theodore H. Emmerich [2*]
Retired Managing Partner, Ernst & Young LLP, certified public accountants, Cincinnati, Ohio

James E. Evans
Senior Vice President and General Counsel, American Financial Group, Inc.

Terry S. Jacobs [2, 4]
Chairman of the Board, CEO and Treasurer, Regent Communications, Inc., a broadcasting company

William R. Martin [2, 3*]
retired Chairman of the Board, MB Computing, Inc., a computer software and services company

William A. Schutzer [3, 4]
Managing Director, Evercore Partners, private equity and venture capital investing

William W. Verity [3, 4*]
President, Veritas Asset Management, LLC, an investment management company

Board of Directors Committees:
1. Executive Committee
2. Audit Committee
3. Compensation Committee
4. Governance Committee
* Chairman of Committee

Corporate Management

S. Craig Lindner
Co-Chief Executive Officer and Co-President

Carl H. Lindner III
Co-Chief Executive Officer and Co-President

James E. Evans
Senior Vice President and General Counsel

Keith A. Jensen
Senior Vice President

Thomas E. Mischell
Senior Vice President – Taxation

Kathleen J. Brown
Vice President – Taxation

Robert E. Dobbs
Vice President – Internal Audit

Karl J. Grafe
Vice President and Assistant Secretary

Sandra W. Heimann
Vice President

James C. Kennedy
Vice President, Deputy General Counsel and Secretary

Julie J. Murphy
Vice President – Chief Information Officer

Robert H. Ruffing
Vice President and Controller

Anne N. Watson
Vice President – Investor Relations

Corporate Offices

American Financial Group, Inc.
One East Fourth Street
Cincinnati, Ohio 45202
(513) 579-2121

Annual Shareholders' Meeting

The Annual Shareholders' Meeting is expected to be held at The Cincinnatian Hotel in Cincinnati on May 19, 2005. Notices will be mailed to all registered holders of the Company's voting stock.

Common Stock Market Information

American Financial Group's Common Stock is traded on both the New York Stock Exchange ("NYSE") and the NASDAQ National Market ("NASDAQ") under the symbol AFG. On March 1, 2005, approximately 13,300 holders of record own our shares.

The following table sets forth the high and low sales prices of AFG's Common Stock as reported on the NYSE Composite Tape.

2003	High	Low	Dividends Paid
First Quarter	24.21	18.00	0.125
Second Quarter	23.90	19.27	0.125
Third Quarter	23.77	21.27	0.125
Fourth Quarter	26.70	21.68	0.125
2004			
First Quarter	**30.93**	**26.28**	**0.125**
Second Quarter	**31.00**	**28.94**	**0.125**
Third Quarter	**30.95**	**28.75**	**0.125**
Fourth Quarter	**32.58**	**27.60**	**0.125**
2005			
First Quarter	**31.88**	**29.90**	**0.125**

Dividend Reinvestment Plan

This plan allows registered shareholders of twenty-five or more shares of AFG Common Stock to automatically reinvest their dividends towards the purchase (at a 4% discount) of additional AFG common shares. Dividend Reinvestment Plan information and enrollment forms may be obtained from the Company's Transfer Agent.

Duplicate Mailings

Please call or write the Company if you wish to eliminate any duplicate mailing of this report or other Company materials.

Transfer Agent for:

American Financial Group, Inc., American Premier Underwriters, Inc., and Great American Financial Resources, Inc.

c/o Securities Transfer Company
One East Fourth Street, Suite 1201
Cincinnati, Ohio 45202
Telephone: (513) 579-2414
or (800) 368-3417
Fax: (513) 287-8270

Effective around July 2005, Wachovia will become our new transfer agent.

Additional Information

Investors or analysts requesting additional information, including copies of the American Financial Group, Inc. Form 10-K (without cost) as filed with the Securities and Exchange Commission, may contact:

Investor Relations
American Financial Group, Inc.
580 Walnut Street, 9th Floor
Cincinnati, Ohio 45202
(513) 579-6652

SEC filings, news releases, and other information may also be accessed free of charge on American Financial Group's Internet site at: ***http://www.afginc.com***

Certifications

AFG has included as Exhibit 31 to its 2004 Annual Report on Form 10-K, certifications from its Co-Chief Executive Officers and Chief Financial Officer as to the integrity and quality of AFG's public disclosures. AFG's Co-Chief Executive Officers have also submitted to the NYSE certification indicating that they are not aware of any violations by AFG of the NYSE corporate governance listing standards.

Forward-Looking Statements

This document 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 include statements relating to: expectations concerning market and other conditions and their effect on future premiums, revenues, earnings and investment activities; recoverability of asset values; expected losses and the adequacy of reserves for asbestos, environmental pollution and mass tort claims; rate increases, and improved loss experience. Actual results could differ materially from those contained in or implied by such forward-looking statements for a variety of factors including:

- changes in economic conditions, including interest rates, performance of securities markets, and the availability of capital;
- regulatory actions;
- changes in legal environment;
- tax law changes;
- levels of natural catastrophes, terrorist events, incidents of war and other major losses;
- the ultimate amount of liabilities associated with certain asbestos and environmental-related claims;
- the unpredictability of possible future litigation if certain settlements do not become effective;
- adequacy of insurance reserves;
- trends in mortality and morbidity;
- availability of reinsurance;
- ability of reinsurers to pay their obligations;
- competitive pressures, including the ability to obtain rate increases; and
- changes in debt and claims paying ratings.

The forward-looking statements herein are made only as of the date of this report. The Company assumes no obligation to publicly update any forward-looking statements.

DESIGN THE INSIDERS PRINTING WENDLING PRINTING COMPANY

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

AMERICAN FINANCIAL GROUP, INC.
2004 ANNUAL REPORT