AMERICAN FINANCIAL GROUP INC
Form 10-Q
May 08, 2006

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2006 — Commission File

No. 1-13653

AMERICAN FINANCIAL GROUP, INC.

Incorporated under the Laws of Ohio — IRS Employer I.D. No. 31-1544320

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

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer:
Large Accelerated Filer _X_ Accelerated Filer ___ Non-Accelerated Filer ___

Indicate by check mark whether the Registrant is a shell company. Yes ___ No _X_

As of May 1, 2006, there were 78,541,477 shares of the Registrant's Common Stock outstanding, excluding 9,953,392 shares owned by a subsidiary.

AMERICAN FINANCIAL GROUP, INC.

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PART I

ITEM I - FINANCIAL STATEMENTS

AMERICAN FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET (unaudited)

(Dollars In Thousands)

	March 31, 2006	December 31, 2005
Assets:		
Cash and cash equivalents	$ 565,232	$ 471,849
Investments:		
Fixed maturities:		
Available for sale - at fair value		
(amortized cost - $14,617,054 and $14,272,314)	14,407,454	14,326,614
Trading - at fair value	279,649	271,851
Other stocks - at fair value		
(cost - $521,286 and $501,459)	595,186	556,659
Policy loans	254,567	258,744
	345,914	338,254
Real estate and other investments		
Total cash and investments	16,448,002	16,223,971
Recoverables from reinsurers and prepaid		
reinsurance premiums	3,130,473	3,263,128
Agents' balances and premiums receivable	554,337	574,882
Deferred policy acquisition costs	1,166,357	1,139,515
Other receivables	370,205	388,078

Variable annuity assets (separate accounts)	673,441	643,506
Prepaid expenses, deferred charges and other assets	399,566	416,030
Goodwill	166,882	166,882
	$22,909,263	$22,815,992
Liabilities and Capital:		
Unpaid losses and loss adjustment expenses	$ 5,794,333	$ 5,790,709
Unearned premiums	1,699,158	1,643,954
Annuity benefits accumulated	8,706,174	8,417,298
Life, accident and health reserves	922,949	1,088,016
Payable to reinsurers	294,637	298,664
Long-term debt	914,455	999,703
Variable annuity liabilities (separate accounts)	673,441	643,506
Accounts payable, accrued expenses and other liabilities	1,202,273	1,215,490
Total liabilities	20,207,420	20,097,340
Minority interest	252,818	261,110
Shareholders' Equity:		
Common Stock, no par value		
- 200,000,000 shares authorized		
- 78,482,208 and 78,067,514 shares outstanding	78,482	78,068
Capital surplus	1,208,901	1,194,600
Retained earnings	1,224,842	1,134,074
Unrealized gain (loss) on marketable securities, net	(63,200)	50,800
Total shareholders' equity	2,449,025	2,457,542
	$22,909,263	$22,815,992

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AMERICAN FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF EARNINGS (unaudited)

(In Thousands, Except Per Share Data)

	Three months ended March 31,	
	2006	2005
Income:		
Property and casualty insurance premiums	$579,084	$549,099
Life, accident and health premiums	82,043	92,056
Investment income	231,903	214,207
Realized gains (losses) on securities	29,812	(5,539)
Other income	74,769	82,160
	997,611	931,983
Costs and Expenses:		
Property and casualty insurance:		
Losses and loss adjustment expenses	337,111	348,378
Commissions and other underwriting expenses	173,336	158,891
Annuity benefits	83,275	80,762
Life, accident and health benefits	67,164	68,971
Annuity and supplemental insurance acquisition expenses	33,024	35,272
Interest charges on borrowed money	18,500	19,580
Other operating and general expenses	116,131	115,807
	828,541	827,661
Operating earnings before income taxes	169,070	104,322
Provision for income taxes	59,332	35,131
Net operating earnings	109,738	69,191
Minority interest expense	(7,778)	(5,872)
Equity in net losses of investee, net of tax	(450	(444
)	)	
Net Earnings	$101,510	$ 62,875
Earnings per Common Share:		
Basic	$1.30	$.82

Diluted	$1.27	$.81
Average number of Common Shares:		
Basic	78,251	76,738
Diluted	79,599	77,824
Cash dividends per Common Share	$.1375	$.125

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AMERICAN FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (unaudited)

(Dollars in Thousands)

	Common Shares	Common Stock and Capital Surplus	Retained Earnings	Unrealized Gain (Loss) on Securities	Total
Balance at January 1, 2006	78,067,514	$1,272,668	$1,134,074	$ 50,800	$2,457,542
Net earnings	-	-	101,510	-	101,510
Change in unrealized	-	-	-	(114,000)	(114,000)
Comprehensive income (loss)					(12,490)
Dividends on Common Stock	-	-	(10,742)	-	(10,742)
Shares issued:					
Exercise of stock options	331,770	10,555	-	-	10,555
Dividend reinvestment plan	35,051	1,275	-	-	1,275
Employee stock purchase plan	5,765	225	-	-	225
Deferred compensation distributions	42,108	1,646	-	-	1,646
Stock-based compensation expense	-	1,455	-	-	1,455
Capital transactions of subsidiaries	-	209	-	-	209
Other	-	(650)	-	-	(650)
Balance at March 31, 2006	78,482,208	$1,287,383	$1,224,842	($ 63,200)	$2,449,025

Balance at January 1, 2005	76,634,204	$1,222,507	$ 976,340	$231,700	$2,430,547
Net earnings	-	-	62,875	-	62,875
Change in unrealized	-	-	-	(131,400)	(131,400)
Comprehensive income (loss)					(68,525)
Dividends on Common Stock	-	-	(9,580)	-	(9,580)
Shares issued:					
Exercise of stock options	571,308	14,906	-	-	14,906
Dividend reinvestment plan	49,902	1,438	-	-	1,438
Employee stock purchase plan	6,432	198	-	-	198
Retirement plan contributions	35,896	1,104	-	-	1,104
Deferred compensation distributions	7,374	222	-	-	222
Shares tendered in option exercises	(339,411)	(5,414)	(4,999)	-	(10,413)
Capital transactions of subsidiaries	-	(724)	-	-	(724)
Other	-	(210)	-	-	(210)
Balance at March 31, 2005	76,965,705	$1,234,027	$1,024,636	$100,300	$2,358,963

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AMERICAN FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS (UNAUDITED)

(In Thousands)

	Three months ended March 31,	
	2006	2005
Operating Activities:		

Net earnings	$ 101,510	$ 62,875
Adjustments:		
Equity in net losses of investee	450	444
Minority interest	7,778	5,872
Depreciation and amortization	35,145	49,120
Annuity benefits	83,275	80,762
Realized (gains) losses on investing activities	(36,811)	2,941
Net purchases/sales of trading securities	(14,287)	5,020
Deferred annuity and life policy acquisition costs	(27,277)	(33,760)
Decrease in reinsurance and other receivables	213,347	333,603
Decrease in other assets	68,300	17,334
Increase (decrease) in insurance claims and reserves	62,828	(56,501)
Decrease in payable to reinsurers	(4,330)	(201,744)
Increase (decrease) in other liabilities	(47,667)	19,822
Other, net	4,963	4,833
Net cash provided by operating activities	447,224	290,621

Investing Activities

:

Purchases of and additional investments in:		
Fixed maturity investments	(1,063,005)	(1,710,026)
Equity securities	(63,693)	(63,643)
Subsidiary	(1,246)	-
Real estate, property and equipment	(6,615)	(4,233)
Maturities and redemptions of fixed maturity investments	291,436	241,082
Sales of:		
Fixed maturity investments	409,231	820,199
Equity securities	55,075	26,493
Subsidiary	37,500	-
Real estate, property and equipment	23,854	3,856
Cash and cash equivalents of businesses acquired or sold, net	99,960	-
Decrease (increase) in other investments	21,733	(796
	)	
Net cash used in investing activities	(195,770	(687,068
)	)	

Financing Activities

:

Fixed annuity receipts	220,261	266,521
Annuity surrenders, benefits and withdrawals	(294,286)	(224,260)
Net transfers from variable annuity assets	4,056	256

Additional long-term borrowings	26,197	100
Reductions of long-term debt	(116,771)	(14,626)
Issuances of Common Stock	10,506	3,351
Subsidiary's issuance of stock in public offering	-	40,444
Cash dividends paid on Common Stock	(9,467)	(8,142)
Other, net	1,433	(1,548)
Net cash provided by (used in) financing activities	(158,071)	62,096
Net Increase (Decrease) in Cash and Cash Equivalents	93,383	(334,351)
Cash and cash equivalents at beginning of period	471,849	861,742
Cash and cash equivalents at end of period	$ 565,232	$ 527,391

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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A. **Accounting Policies**

Basis of Presentation

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

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

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

Investments

Fixed maturity securities and equity 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. Loans receivable are carried primarily at the aggregate unpaid balance. Premiums and discounts on fixed maturity securities are amortized using the interest method; 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.

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 (losses)) and the cost basis of that investment is reduced.

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.

Goodwill

Goodwill represents the excess of cost of subsidiaries over AFG's equity in their underlying net assets. Goodwill is not amortized, but is subject to an impairment test at least annually.

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 paid and 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 due to reinsurers as well as 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 81%-owned subsidiary, Great American Financial Resources, Inc. ("GAFRI"), cede life insurance policies to a third party on a funds withheld basis whereby GAFRI retains the assets (securities) associated with the reinsurance contracts. Interest is credited to the reinsurer based on the actual investment performance of the retained assets. These reinsurance contracts are considered to contain embedded derivatives (that must be adjusted to fair value) 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. GAFRI classifies the securities related to these transactions as "trading." The adjustment to fair value on the embedded derivatives offsets the investment income recorded on the adjustment to fair value 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 actual and 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 gain (loss) 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 Supplemental Insurance Acquisition Expenses

Annuity and supplemental insurance acquisition expenses on the Statement of Earnings consists of amortization of DPAC related to the annuity, supplemental insurance and run-off life businesses. This line item also includes certain marketing and commission costs of those businesses 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 (including possible development on known claims) 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, environmental and other mass tort 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. Despite 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 the fair value of 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

Certain subsidiaries have wholly-owned subsidiary trusts that issued preferred securities and, in turn, purchased a like amount of subordinated debt from their parent company. Interest and principal payments from the parent fund the respective trust obligations. AFG does not consolidate these subsidiary trusts because they are "variable interest entities" in which AFG is not considered to be the primary beneficiary. Accordingly, the subordinated debt due to the trusts is included in "long-term debt" in the Balance Sheet and the related interest expense is included in "interest charges on borrowed money" in the Statement of 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.

Income Taxes

AFG files consolidated federal income tax returns that include all U.S. subsidiaries that are at least 80%-owned, except for certain life insurance subsidiaries that have been owned for less than five years.

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

Effective January 1, 2006, AFG implemented Statement of Financial Accounting Standards ("SFAS") No. 123(R), "Share-Based Payment" using the modified prospective method under which prior year amounts are not restated. Under SFAS No. 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 calculated "fair value" at the date of grant. Beginning in 2006, all share-based grants are recognized as compensation expense over the vesting period. AFG uses the Black-Scholes pricing model to measure the fair value of employee stock options.

Prior to the implementation of SFAS No. 123(R), AFG accounted for stock options and other stock-based compensation plans using the intrinsic value method prescribed by Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees." Under this method, no compensation expense

for stock option grants was recognized because options are granted at exercise prices equal to the fair value of the shares at the dates of grant. See Note F - "Shareholders' Equity" for further information on stock options.

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. 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 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 (i) a deduction of $102,000 in the numerator in the first quarter of 2006 related to dilution of a majority-owned subsidiary and (ii) additions of 1,348,000 shares in 2006 and 1,086,000 shares in 2005 to the denominator representing the dilutive effect of common stock options.

Statement of Cash Flows

For cash flow purposes, "investing activities" are defined as making and collecting loans and acquiring and disposing of debt or equity instruments and property and equipment. "Financing activities" include 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

Old Standard Life Fixed Annuity Business

In January 2006, GAFRI acquired the fixed annuity business written by Old Standard Life Insurance Company through a reinsurance transaction. As part of the assets transferred in the reinsurance transaction, GAFRI acquired the stock of Old West Annuity and Life Insurance Company. In total, the transaction resulted in an increase of approximately $280 million in both annuity benefits accumulated and cash and investments.

Great American Life Assurance Company of Puerto Rico

In the fourth quarter of 2005, GAFRI reached an agreement to sell its subsidiary, Great American Life Assurance Company of Puerto Rico ("GAPR"), for $37.5 million in cash and recorded an estimated $3.4 million pretax loss. GAFRI completed the sale in January 2006 and recognized an additional $463,000 loss (included in realized gains (losses) on securities) offsetting a like amount of earnings recorded prior to the sale. GAFRI acquired GAPR in 1997 for approximately $50 million. During 2005, GAPR paid $100 million in dividends to GAFRI.

Farmers Crop Insurance Alliance, Inc.

On September 30, 2005, AFG acquired the multi-peril crop insurance and the crop hail insurance business written through Farmers Crop Insurance Alliance, Inc. for $17.5 million in cash. AFG will pay additional amounts of up to 10% of annual premiums over the next three years based on certain customer retention criteria. Approximately $16.5 million of

the initial Farmers Crop purchase price was recorded as intangible renewal rights and is being amortized over an estimated retention period of four years on a straight-line basis. Any future payments (not expected to exceed $15 million) based on customer retention will also be recorded as intangible renewal rights. While there is uncertainty as to the amount of premiums that ultimately will be retained due to the departure of several Farmers' employees in the months preceding the acquisition, AFG expects this acquired business will generate gross written premiums of $130 million to $180 million in 2006.

C.

Segments of Operations AFG manages its business as three segments: (i) property and casualty insurance, (ii) annuity and supplemental insurance and (iii) other, which includes holding company costs.

AFG reports its property and casualty insurance business in the following Specialty sub-segments: (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 and supplemental insurance business markets primarily retirement annuities and various forms of supplemental insurance. AFG's reportable segments and their components were determined based primarily upon similar economic characteristics, products and services.

The following tables (in thousands) show AFG's revenues and operating earnings before income taxes by significant business segment and sub-segment.

	Three months ended March 31,	
	2006	2005
Revenues (a)		
Property and casualty insurance:		
Premiums earned:		
Specialty		
Property and transportation	$200,003	$168,071
Specialty casualty	188,215	184,167
Specialty financial	96,223	91,770
California workers' compensation	77,315	87,324
Other	16,731	16,407
Other lines	597	1,360
	579,084	549,099
Investment income	79,529	68,369
Realized gains	26,053	847
Other	47,034	51,568
	731,700	669,883
Annuity and supplemental insurance:		
Investment income	150,394	145,160
Life, accident and health premiums	82,043	92,056
Realized gains	3,721	45
Other	26,057	25,554

	262,215	262,815
Other	3,696	(715)
	$997,611	$931,983

	Three months ended March 31,	
	2006	2005
Operating Earnings Before Income Taxes		
Property and casualty insurance:		
Underwriting:		
Specialty		
Property and transportation	$ 42,051	$ 28,941
Specialty casualty	14,619	6,568
Specialty financial	812	(4,068)
California workers' compensation	12,514	13,022
Other	(159)	(1,169)
Other lines	(1,200)	(1,464)
	68,637	41,830
Investment income, realized gains and other	97,853	65,886
	166,490	107,716
Annuity and supplemental insurance	28,750	25,701

Other (b)	(26,170)	(29,095)
	$169,070	$104,322

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

(b) Includes holding company expenses.

D.

Deferred Policy Acquisition Costs Included in deferred policy acquisition costs in AFG's Balance Sheet are $48.9 million and $54.1 million at March 31, 2006, and December 31, 2005, respectively, representing the present value of future profits ("PVFP") related to acquisitions by AFG's annuity and supplemental insurance business. The PVFP amounts are net of $63.5 million and $82.5 million of accumulated amortization. The decrease in PVFP reflects the January 2006 sale of GAPR. Amortization of the PVFP was $1.6 million and $3.7 million during the first three months of 2006 and 2005, respectively.