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

OVERVIEW

References to Infinity, unless the context requires otherwise, include the combined operations of Atlanta Casualty Company, Infinity Insurance Company, Leader Insurance Company and Windsor Insurance Company (collectively the "NSA Group") and the in-force personal insurance business assumed through a reinsurance contract (the "Assumed Agency Business") from American Financial Group Inc.'s ("AFG") principal property and casualty subsidiary, Great American Insurance Company ("GAI"). Unless indicated otherwise, the financial information herein is presented on a GAAP basis.

Infinity's profitability continued to improve in 2004. Diluted earnings per share increased 63% from $2.83 for the twelve months ended December 31, 2003 to $4.62 for the same period in 2004. Net earnings also increased substantially from $58.2 million for 2003 to $96.4 million in 2004. Return on equity for 2004 increased to 18.6%, up from 14.7% in 2003.

Increased earnings and returns were substantially a result of continued improvement in underwriting profitability. Gross of a reinsurance agreement with American Re-Insurance Company ("American Re") under which a portion of the NSA Group's auto physical damage business was ceded, GAAP Combined Ratios, which are the ratios of the sum of losses, loss adjustment expenses and underwriting expenses to net earned premiums, improved by 4.5 points from 2003 to 2004. Approximately 3.0 points of this was a result of $15 million of favorable loss reserve development from prior accident years, as compared with $14 million of unfavorable development in 2003. Underwriting margins for both 2003 and 2004 were substantially better than average over the last five to ten years. Since 2002, Infinity and other industry participants have enjoyed increases in insurance rates charged to policyholders, as well as lower claims frequencies (i.e. number of claims per insurance policy issued) and moderate claims severities (i.e. average cost per claim).

Investment income in 2004 increased $8.5 million over that in 2003, primarily as a result of lower interest credited to reinsurers on funds held balances. The American Re agreement was commuted on December 31, 2004 and was not renewed for 2005. In addition, average investment balances increased 11%, mostly from cash generated through operations and the proceeds from the July 2003 term loan (Refer to Note 4 to the Consolidated Financial Statements for more information). Offsetting this increase in average investment balances were lower yields on the portfolio, as overall market rates remained at historically low levels. Infinity continued to invest over 95% of its available funds in fixed income and cash equivalent securities. The average duration for the fixed income portfolio fell to 4.1 years as compared with 4.7 years at December 31, 2003.

Book value per share increased 18.8%, from $22.38 at December 31, 2003 to $26.60 at December 31, 2004 from the contribution of earnings in excess of shareholder dividends.

Revenues increased for the twelve months ended December 31, 2004 to $951.8 million, up 23.8% as compared with the same period in 2003. This was a result of lower utilization of reinsurance in 2004, an increase in investment income for reasons cited earlier, and an increase in capital gains from securities sales.

Premiums written gross of all reinsurance for 2004 actually fell 4.1% as compared with that in 2003. As of December 31, 2004, Infinity had 713,000 policies in force, a 0.3% increase over that at December 31, 2003. In 2001, Infinity instituted a program to shed under-performing business in several states where it either lacked critical mass to operate efficiently or where the regulatory and competitive environments impeded Infinity from achieving adequate returns. For these Non-Focus States, premiums written for the twelve months ended December 31, 2004 and policies in force at December 31, 2004 fell 47.7% and 31.6%, respectively, as compared with the same periods one year prior. Moreover, since 2002 Infinity has undertaken a program to roll out its three-tiered product structure to agents in its 17 Focus States. In addition, during this same period, Infinity appointed new agents or re-appointed agents (with whom it had existing agreements for the previous generation of products) to market the most recent generation of products. As a result of these efforts, in the Focus States, Infinity's premiums written for the twelve months ended December 31, 2004 and policies-in-force at December 31, 2004 increased 3.0% and 3.4%, respectively, as compared with the same periods in 2003.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements requires management to make estimates and assumptions that can have a significant effect on amounts reported in the financial statements. As more information becomes known, these estimates and assumptions could change and thus impact amounts reported in the future. Management believes that the establishment of insurance reserves, the determination of "other-than-temporary" impairment on investments, and accruals for litigation are the areas where the degree of judgment required to determine amounts recorded in the financial statements make the accounting policies critical.

Insurance Reserves

Insurance reserves, or "Unpaid Losses and LAE," are management's best estimate of the ultimate amounts that will be paid for all claims that have been reported up to the date of the current accounting period but that have not yet been paid, plus an estimate of claims that have occurred but have not yet been reported to the Company ("incurred but not reported," or "IBNR"), and the expenses to be paid to settle claims.

Liabilities for the costs of losses and LAE for both reported and unreported claims are estimated based on historical trends adjusted for changes in loss cost trends, underwriting standards, policy provisions, product mix and other factors. Estimating dollar amounts for unpaid losses and LAE is inherently judgmental and is influenced by factors, which are subject to significant variation. Changes in underlying estimates or assumptions and the resulting adjustments to reserves are reflected in the results of operations in the periods in which estimates change.

Management analyzes the adequacy of reserves using actuarial data and analytical reserve development techniques, including projections of ultimate paid losses, to determine the ultimate amounts of reserves. Historical medical, hospitalization, material repair and replacement costs, general economic trends and the legal environment are examples of major factors taken into account in developing these estimates.

In developing IBNR reserve amounts, quarterly estimates are made of ultimate frequency, or number of claims per earned car year, and severity, or claim cost per earned car year. Frequency can be affected by factors such as driving patterns, gas prices, changes in classes of insured drivers, and weather events. Factors affecting the severity trend include medical cost and product repair cost trends, and litigation expense patterns. Management believes that Infinity's relatively low average policy limit and concentration on the nonstandard auto driver classification help stabilize fluctuations in frequency and severity.

An increase in either frequency or severity of 1% for the 2004 accident year would decrease earnings per share by approximately $0.15.

Other-Than-Temporary Losses on Investments

Changes in the market values of investment securities are usually recorded as changes in unrealized gains or losses on investments, a component of shareholders' equity. Net earnings are not affected until the disposition of a given security or, if an unrealized loss is deemed to be other-than-temporary, an impairment charge is recorded as a realized capital loss and the cost basis of the security 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:

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

Management regularly evaluates for potential impairment each security position that (i) has a market value of less than 80% of its book value or (ii) exceeds $100,000, as well as each position held for which one or more impairment charges have been recorded in the past. The process of evaluation includes assessments of each item listed above. Since it is not possible to accurately predict if or when a specific security will become other-than-temporarily impaired, total impairment charges could be material to the results of operations in a future period. Management believes that it is not likely, however, that such impairment charges will have a significant effect on Infinity's liquidity.

Accruals for Litigation

Infinity continually evaluates potential liabilities and reserves for litigation using the criteria established by Statement of Financial Accounting Standard ("SFAS") No. 5, "Accounting for Contingencies." Under this guidance, reserves for loss may only be recorded if the likelihood of occurrence is probable and the amount is reasonably estimable. Management considers each legal action using this guidance and records reserves for losses as appropriate. Infinity believes the current assumptions and other considerations used to estimate potential liability for litigation are appropriate. Certain claims and legal actions have been brought against Infinity for which no loss has been accrued, under the rules described above. While it is not possible to know with certainty the ultimate outcome of these claims or lawsuits, management does not expect them to have a material effect on Infinity's financial condition or liquidity.

LIQUIDITY AND CAPITAL RESOURCES

Ratios

The National Association of Insurance Commissioners' ("NAIC") model law for risk-based capital ("RBC") provides formulas to 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 Infinity insurance subsidiaries substantially exceeded the RBC requirements.

Sources of Funds

Infinity is organized as a holding company with all of its operations being conducted by its insurance subsidiaries. Accordingly, Infinity will have continuing cash needs for administrative expenses, the payment of principal and interest on borrowings, shareholder dividends, share repurchases and taxes.

Administrative expenses at the holding company have averaged approximately $6.4 million to $6.9 million annually since 2003.

At December 31, 2004 Infinity had $200 million principal of senior notes due 2014, bearing a fixed 5.5% interest rate (the "Senior Notes"). Interest payments due in 2005 are $11.0 million. (Refer to Note 4 of the Consolidated Financial Statements for more information on the Senior Notes).

Also in January 2005, Infinity announced its intent to repurchase up to $50 million of its common stock in the open market or through privately negotiated transactions over the next three years.

In 2004 Infinity paid a dividend of $.055 per common share per quarter. In February 2005, Infinity increased the quarterly dividend to $.06 per share. Based on the current number of shares outstanding, this equates to a common stock dividend of approximately $5.0 million per year.

Funds to meet these obligations will come primarily from dividends from the insurance subsidiaries, as well as cash and investments held at the holding company. In 2004, Infinity's insurance subsidiaries paid Infinity $28.5 million in ordinary dividends. In 2005, they may pay to Infinity up to $62.7 million in ordinary dividends without prior regulatory approval. As of December 31, 2004, Infinity had $88.6 million of cash and investments. Other sources of additional liquidity include an unused line of credit in the amount of $20 million, the potential use of various reinsurance vehicles, and capital funds that could be supplied by additional debt or equity offerings.

Infinity's insurance subsidiaries generate liquidity to satisfy their obligations, primarily by collecting and investing premiums in advance of paying claims. Infinity's insurance subsidiaries had positive cash flow from operations of approximately $61 million in 2004, $67 million in 2003, and $45 million in 2002. In addition, Infinity's insurance subsidiaries have available to pay its obligations an additional $1,260.1 million in fixed maturity securities and $25.0 million in equity securities, all carried at market value with unrealized gains and losses reported as a separate component of shareholders' equity on an after-tax basis.

Management believes that cash and investment balances and cash flows generated from operations are adequate to meet the future liquidity needs for Infinity and its insurance subsidiaries.

Contractual Obligations

Infinity and its insurance subsidiaries' contractual obligations as of December 31, 2004 are (in thousands):

Due in:	Long-Term Debt	Operating Leases	Loss and LAE Reserves	Total
2005	$ 11,000	$ 18,412	$362,742	$ 392,154
2006–2007	22,000	33,896	223,266	279,162
2008–2009	22,000	25,325	51,253	98,578
2010 and after	293,500	28,174	22,011	343,685
Total	$348,500	$105,807	$659,272	$1,113,579

The payout pattern for reserves for losses and LAE is based upon historical payment patterns and do not represent actual contractual obligations. The timing and amounts ultimately paid can and will vary from these estimates, as discussed in the Critical Accounting Policies section.

The contractual obligations under the long-term debt category above include payments of interest.

INVESTMENTS

General

Infinity's investment portfolio at December 31, 2004 contained $1,304.1 million in fixed maturity securities and $25.0 million in equity securities, 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, Infinity had pretax net unrealized gains of $43.2 million on fixed maturities and $3.5 million on equity securities.

Approximately 94% of the fixed maturities that Infinity held were rated "investment grade" (credit rating of AAA to BBB) by nationally recognized rating agencies at December 31, 2004. The average rating for the fixed income portfolio at December 31, 2004 was AA-. Investment grade securities generally bear lower yields and lower degrees of risk than those that are unrated or non-investment grade. Management believes that a high quality investment portfolio is more likely to generate a stable and predictable investment return.

Investments in mortgage-backed securities ("MBSs") represented approximately one-fifth of Infinity'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. When these prepayments occur faster than planned, market rates are usually lower for new investments than those that were prepaid. Prepayments on MBSs were approximately $34 million and $45 million for the twelve months ended December 31, 2004 and December 31, 2003, respectively. Approximately 96% of Infinity's MBSs are rated "AAA" and all but one are investment grade.

Individual portfolio securities are sold creating gains or losses as market opportunities exist. Since all of these securities are carried at market value on the balance sheet, there is virtually no effect on liquidity or financial conditions upon the sale and ultimate realization of unrealized gains and losses. The average duration of Infinity's fixed maturity portfolio was 4.1 years at December 31, 2004.

	Twelve Months Ended December 31,			
	2004		2003	
(in millions)	Amortized Cost	Market Value	Amortized Cost	Market Value
Cash and Cash Equivalents	**$ 112.1**	**$ 112.1**	$ 125.0	$ 125.0
Fixed Maturities:				
U.S. Government and agencies	**96.0**	**97.1**	99.8	101.7
State and municipal	**232.6**	**237.1**	218.8	224.6
Foreign government	**—**	**—**	2.3	2.3
Public utilities	**80.5**	**85.2**	114.8	120.7
Mortgage-backed securities	**263.7**	**267.3**	209.6	213.1
Corporate and other	**583.9**	**613.3**	535.8	570.2
Redeemable preferred stocks	**4.1**	**4.0**	11.4	13.0
Total Fixed Maturities	**$ 1,260.8**	**$1,304.1**	$1,192.4	$1,245.8
Equity Securities	**21.5**	**25.0**	19.2	21.4
Total	**$ 1,394.4**	**$1,441.1**	$1,336.7	$1,392.2

The following table presents the yields of Infinity's investment portfolios as reflected in the financial statements.

	Twelve Months Ended December 31,		
	2004	2003	2002
Yield on Fixed Income Securities:			
Excluding realized gains and losses	**5.1%**	5.5%	6.4%
Including realized gains and losses	**5.3%**	5.6%	6.3%
Yield on Equity Securities:			
Excluding realized gains and losses	**4.7%**	4.8%	3.4%
Including realized gains and losses	**21.3%**	3.5%	(12.6%)
Yield on All Investments:			
Excluding realized gains and losses	**5.1%**	5.5%	6.3%
Including realized gains and losses	**5.5%**	5.5%	5.7%

Fixed Maturity Investments

The following table shows Infinity's bonds and redeemable preferred stocks, by NAIC designation and comparable Standard & Poor's Corporation rating as of December 31, 2004.

NAIC Rating	Comparable S&P Rating	Amortized Cost	Market Value Amount	Market Value %
1	AAA, AA, A	$ 990.8	$1,017.4	78.0%
2	BBB	202.4	214.0	16.4%
	Total investment grade	1,193.2	1,231.5	94.4%
3	BB	43.1	45.3	3.5%
4	B	19.5	21.3	1.6%
5	CCC, CC, C	2.5	3.0	0.2%
6	D	2.7	3.1	0.2%
	Total non-investment grade	67.7	72.6	5.6%
	Total	$1,260.8	$1,304.1	100.0%

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(continued)

The table below sets forth the scheduled maturities of fixed maturity securities at December 31, 2004 based on their market values (in millions). Securities that do not have a single maturity date 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	Securities With No Unrealized Gains or Losses	All Fixed Maturities
One year or less	$ 48.9	$ —	$1.8	$ 50.7
After one year through five years	358.6	105.9	—	464.5
After five years through ten years	345.6	54.2	6.2	406.0
After ten years	104.1	11.5	—	115.6
Mortgage-backed securities	177.5	89.8	—	267.3
Total	$1,034.7	$261.3	$8.0	$1,304.1

Exposure to Market Risk

Market risk represents the potential economic loss arising from adverse changes in the fair value of financial instruments. Infinity's exposures to market risk relate primarily to its investment portfolio which is exposed to interest rate risk, credit risk and, to a lesser extent, equity price risk.

The fair value of Infinity's fixed maturity portfolio is directly impacted by changes in market interest rates; generally, the market value of fixed-income investments moves inversely with movements in market interest rates. Infinity's fixed maturity portfolio is comprised of substantially all fixed rate investments with primarily short-term and intermediate-term maturities. This practice allows flexibility in reacting to fluctuations of interest rates. In addition, the risk of loss in market value is partially mitigated by higher market rates available for new funds available for investment. The portfolios of Infinity's insurance companies are managed with an attempt to achieve an adequate risk-adjusted return while maintaining sufficient liquidity to meet policyholder obligations.

Credit risk is managed by diversifying the portfolio to avoid concentrations in any single industry group and by maintaining a minimum average credit quality rating on the portfolio.

The following table provides information about Infinity's fixed maturity investments at December 31, 2004 and 2003, which are sensitive to interest rate risk. The table shows expected principal cash flows (in millions) by expected maturity date for each of the five subsequent years and collectively for all years thereafter. Callable bonds and notes are included based on call date or maturity date depending upon which date produces the most conservative yield. MBSs and sinking fund issues are included based on maturity year adjusted for expected payment patterns. Actual cash flows may differ from those expected.

	Principal Cash Flows for Twelve Months Ended December 31,		
	2004		2003
2005	**$ 86.5**	2004	$ 66.9
2006	**112.5**	2005	93.8
2007	**139.5**	2006	120.4
2008	**159.2**	2007	123.3
2009	**203.0**	2008	157.1
thereafter	**535.5**	thereafter	608.3
Total	**$1,236.2**	Total	$1,169.8
Fair Value	**$1,304.1**	Fair Value	$1,245.8

Equity Price Risk

Equity price risk is the potential economic loss from adverse changes in equity security prices. Although Infinity's investment in equity securities is only 1.5% of total investments, it is concentrated in a relatively limited number of positions; approximately half of the total is in five investments; two of these five are electric utilities. While this approach allows management to more closely monitor the companies and industries in which they operate, it does increase risk exposure to adverse price declines in a major position.

RESULTS OF OPERATIONS

Underwriting

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

Underwriting expenses include expenses that vary directly with premium volume (commissions and premium taxes) as well as expenses that are relatively fixed (administrative expenses). Accordingly, underwriting expenses tend to move in the same direction as premiums but at a slower rate. As a result, the underwriting expense ratio tends to decrease when premiums grow and increase when premiums decline.

Since early 2000, Infinity's insurance subsidiaries have been increasing their premium rates with a goal of achieving underwriting profits, even if it entails foregoing volume. As with all property and casualty companies, the beneficial impact of these price increases is reflected in Infinity's financial results over time. Infinity implements price increases on its in-force policies as they are renewed, which generally takes between six and twelve months for the entire book of business. Infinity recognizes increased premiums on particular policies as the premiums are earned, generally over the course of the six to twelve months after the policy is effective.

Net earned premiums and combined ratios for the NSA Group and the Assumed Agency Business were (in millions):

	Twelve Months Ended December 31,		
	2004	2003	2002
Net Earned Premiums (GAAP)			
NSA Group			
Gross written premiums	**$882.5**	$ 868.3	$ 914.6
Ceded reinsurance	**(46.0)**	(187.5)	(301.6)
Net written premiums	**836.5**	680.8	613.0
Change in unearned premiums	**(57.3)**	(75.2)	32.9
Net earned premiums	**$779.2**	$ 605.6	$ 645.9
Assumed Agency Business[a],[b]			
Net written premiums gross of the Inter-Ocean agreement	**$ 74.2**	$ 159.1	$ 152.8
Ceded premiums under Quota Share Agreements[c]	**7.1**	(22.3)	(78.5)
Net written premiums net of Quota Share Agreements	**81.3**	136.8	74.3
Change in unearned premiums	**11.8**	(43.7)	32.9
Net earned premiums	**$ 93.2**	$ 93.1	$ 107.2
Combined Ratios (GAAP)			
NSA Group			
Loss and LAE ratio	**69.1%**	79.5%	81.8%
Underwriting expense ratio	**18.7%**	10.3%	12.2%
Combined ratio	**87.8%**	89.8%	94.0%
Assumed Agency Business			
Loss and LAE ratio	**69.5%**	81.4%	84.9%
Underwriting expense ratio	**31.1%**	28.0%	24.4%
Combined ratio	**100.6%**	109.4%	109.3%
Weighted Average of NSA Group and Assumed Agency:			
Loss and LAE ratio	**69.1%**	79.8%	82.2%
Underwriting expense ratio	**20.0%**	12.7%	13.9%
Combined ratio	**89.1%**	92.5%	96.1%
Combined ratio gross of Quota Share Agreements[c]	**89.8%**	94.3%	97.3%

(a) Excludes $48.0 million in unearned premiums transferred to Infinity with the Assumed Agency Business on January 1, 2003.

(b) The 2003 Inter-Ocean agreement was commuted in 2004, resulting in a return of unearned premium on the Assumed Agency Business.

(c) In 2003 and 2002, the NSA Group and Assumed Agency Business had an agreement with Inter-Ocean ("Inter-Ocean"), structured similarly to the agreement with American Re, whereby a portion of their auto physical damage business was ceded. Infinity commuted both the Inter-Ocean and American Re agreements (collectively the "Quota Share Agreements") effective December 31, 2004 and did not renew either agreement for 2005.

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2004 compared to 2003

The NSA Group's net earned premiums increased $173.6 million, or 28.7%, as Infinity reduced the amount of earned premiums ceded under the American Re agreement. Excluding the effect of this agreement, earned premiums were essentially unchanged at $832.5 million. The loss and LAE ratio improved 10.4 points from 2003 to 2004. Excluding the effect of the Quota Share Agreements, the loss and LAE ratio decreased by 5.1 points from 72.1% to 67.0% for the twelve months ended December 31, 2003 to the same period in 2004, respectively. Approximately 3.6 points of this improvement resulted from $11 million of favorable loss reserve development in 2004, primarily on Infinity's California book of business, as compared with $19 million of unfavorable development for the same period in 2003, primarily on its New York business. The underwriting expense ratio increased from 10.3% for the twelve months ended December 31, 2003, as compared with 18.7% for the same period in 2004. Excluding the effects of the American Re agreement, the expense ratio for the twelve months ended December 31, 2004 of 21.4% still showed a slight 0.9 point increase over the 20.5% ratio for the same period in 2003, primarily as a result of increased commissions paid to agents and brokers.

Net earned premiums for the Assumed Agency Business were essentially unchanged for 2004 as compared with that in 2003. Excluding the effect of the Quota Share Agreements, however, earned premiums fell from $132.2 million in 2003 to $93.2 million in 2004, or a reduction of 29.5%. Gross written premiums fell from $111.1 million (excluding the $48 million transfer of unearned premiums related to the transfer of the book of business from AFG at January 1, 2003) to $74.2 million in 2004, or a decrease of 33.2%. The decrease of premiums is a result of a deliberate effort by Infinity to reduce the writings in Non-Focus States. For 2004, gross written premiums in these states for the Assumed Agency book fell 52.0% as compared with the premiums written in all of 2003. Of the business in the Focus States, the business in Connecticut represented 60% of the total for the year 2003. Written premiums on this business declined 16.7% to $42.0 million in 2004 as compared with that in 2003, as a result of delays Infinity experienced in getting new programs approved by that state's department of insurance. The loss and LAE ratio for the Assumed Agency Business fell 11.9 points to 69.5% in 2004 as compared with 81.4% in 2003. Excluding the effect of the Quota Share Agreements, the loss and LAE ratio was 69.5% in 2004, about 4.9 points lower than 2003's 74.4%. The decrease was a result of the decline in business in unprofitable Non-Focus states as well as continued improvement in claims frequencies as experienced by the overall Infinity business as well as the personal auto insurance industry during 2004. (The Assumed Agency Business had $4 million of favorable reserve development in both 2004 and 2003). The expense ratio for the Assumed Agency book of business increased to 31.1% from 28.0% in 2004 and 2003, respectively. Excluding the effect of the Quota Share Agreements, the expense ratios for 2003 and 2004 were 29.6% and 33.4%, an increase of 3.8 points, stemming primarily from the reduction of premiums over which to spread fixed costs associated with the book.

2003 compared to 2002

The NSA Group's net earned premiums fell $40.3 million, or 6.2%, in the twelve-month period ended December 31, 2003 compared to the twelve-month period ended December 31, 2002 primarily as a result of actions taken to discontinue writing inadequately priced business in certain focus states. Earned premiums, excluding the effect of the Inter-Ocean reinsurance agreement, declined 12% to $833 million, due primarily to a reduction in business volume partially offset by rate increases. The loss and LAE ratio improved by 2.3 points for the twelve-month period ended December 31, 2003 from the same period in 2002. Excluding the effects of the Inter-Ocean reinsurance agreement, the loss and LAE ratio improved 1.7 points. The expense ratio improved by 1.9 points in 2003 compared to 2002 primarily as a result of savings from consolidation efforts taken. Excluding the effect of the Inter-Ocean agreement, the expense ratio improved 1.6 points from 22.1% in the twelve-month period ended December 31, 2002 to 20.5% in the same period in 2003.

The Assumed Agency Business's net earned premiums decreased $14.1 million, or 13.2%, for the twelve-month period ended December 31, 2003 compared to the twelve-month period ended December 31, 2002 primarily as a result of a reduction in business volume. Earned premiums excluding the effect of the Inter-Ocean reinsurance agreement declined $29.9 million, or a reduction of 18.4%, due primarily to a reduction in business volume partially offset by rate increases. The loss and LAE ratios for the Assumed Agency Business improved from 84.9% during the twelve-month period ended December 31, 2002 to 81.4% as a result of increases in rates, lower frequency of claims per auto insured and moderate increases in the average cost per claim as well as a reduction in business in the Non-Focus States. Excluding the effects of the Inter-Ocean reinsurance agreement, the loss and LAE ratio improved from 77.8% to 74.4%. The expense ratio increased 3.6 points from 24.4% for the twelve-month period ended December 31, 2002 to 28.0% for the same period in 2003. Excluding the effects of the Inter-Ocean reinsurance agreement, the expense ratio increased by 1.3 points from 28.3% for the twelve months of

2002 to 29.6% for 2003. This increase was attributable to a charge of $4.0 million from an increase in the rate of amortization of deferred acquisition costs following a periodic review of the deferability of specific acquisition costs. Excluding this charge, the expense ratio fell 1.7 points for the twelve-month period ended December 31, 2003 from the same period in 2002.

Investment Income

Investment income is composed primarily of gross investment revenue, investment management fees and expenses and interest expense incurred on the Quota Share Agreements, as shown in the following table (in millions):

	Twelve Months Ended December 31,		
	2004	2003	2002
Gross investment income	**$69.6**	$65.9	$71.5
Investment expenses	**2.4**	2.5	2.6
Interest expense on Quota Share Agreements	**1.5**	6.2	7.6
Net investment income	**$65.7**	$57.2	$61.3

2004 compared to 2003

Changes in investment income reflect fluctuations in market rates and changes in average invested assets. Net investment income increased $8.5 million for the twelve-month period ended December 31, 2004 from the corresponding 2003 period. This increase was due to (i) the decrease in interest expense associated with the Quota Share Agreements of $4.7 million for the twelve-month period ended December 31, 2004 versus the corresponding 2003 period, due to the lower utilization of the Quota Share Agreements in 2004 as compared to 2003 and (ii) higher gross investment income from a 11.4% increase in average invested assets, partially offset by a decrease in Infinity's weighted average gross investment yield from 5.5% to 5.1% for the twelve-month periods ended December 31, 2003 and 2004, respectively.

2003 compared to 2002

Net investment income decreased $4.1 million for the twelve-month period ended December 31, 2003 versus the comparable 2002 period due to lower yields available for newly invested funds, and to a lesser extent due to a reallocation to tax advantaged securities, partially offset by an increase in average invested assets of 10.4%. Average invested assets increased as a result of the transfer at January 1, 2003 of $125.3 million of securities and cash in conjunction with Infinity's assumption of insurance liabilities of the Assumed Agency Business, as well as proceeds received in July 2003 from the term loan.

Realized Gains (Losses) on Investments

Infinity recorded impairments for unrealized losses deemed other-than-temporary and realized gains on sales and disposals as follows (before tax, in thousands):

	Twelve Months Ended December 31,		
	2004		
	Impairments on Securities	Net Realized Gains (Losses) on Sales	Total Realized Gains (Losses)
Fixed maturities	**$ (758)**	**$ 3,649**	**$ 2,891**
Equities	**(372)**	**3,534**	**3,162**
Gain on sale of subsidiaries	**0**	**830**	**830**
	$ (1,130)	**$ 8,013**	**$ 6,883**
	2003		
	Impairments on Securities	Net Realized Gains (Losses) on Sales	Total Realized Gains (Losses)
Fixed maturities	$(3,877)	$ 5,124	$ 1,247
Equities	(566)	278	(288)
	$(4,443)	$ 5,402	$ 959
	2002		
	Impairments on Securities	Net Realized Gains (Losses) on Sales	Total Realized Gains (Losses)
Fixed maturities	$(6,315)	$ 4,856	$(1,459)
Equities	(3,095)	(2,153)	(5,248)
	$(9,410)	$ 2,703	$(6,707)

Other Income

Other income decreased $5.3 million for the twelve-month period ended December 31, 2004 from the corresponding 2003 period, primarily due to a nonrecurring gain of $6.7 million on the commutation of service and indemnity agreements with AFG in 2003. Other income increased $8.1 million for the twelve-month period ended December 31, 2003 from the corresponding 2002 period, primarily due to the aforementioned $6.7 million gain and increased finance and service charge income.

Interest Expense

Interest expense was accrued at a fixed rate of 8.5% on the $55 million note due to AFG until its repayment in mid-July, 2003 using a portion of the proceeds of the $200 million term loan. The term loan accrued interest at a variable rate, which averaged 3.7% from July 16, 2003, the date of issue, through February 18, 2004, at which time it was refinanced with the Senior Notes. The Senior

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

Notes carry a coupon rate of 5.50%, effective yield of 5.55%, require no amortization payment and mature in 2014. The risk of variability in future interest expense was partially hedged by the interest rate swap.

	Twelve Months Ended December 31,	
	2004	2003
$55 million note due to AFG	**$ —**	$2,545
$200 million term loan	**947**	3,422
Interest rate swap	**166**	565
Senior Notes	**9,613**	—
Total	**$10,726**	$6,532

Other Operating and General Expenses

Corporate general and administrative expenses include costs associated with the new public company beginning in February 2003. Other expenses increased $1.8 million for the twelve-month period ended December 31, 2003 to 2004 due to increased bad debt expense on uncollectible premiums, and increased litigation expenses during 2004, partially offset by a loss recorded in 2003 on an office sublease. Other expenses fell $4.4 million for the twelve-month period ended December 31, 2003 from the same period in 2002 due primarily to a $5.3 million litigation settlement in 2002.

Income Taxes

Infinity's effective tax rate was 25.5% in 2004, 33.4% in 2003, and 35.3% in 2002. The effective tax rate for 2003 fell from that in 2002 as a result of increases in tax-exempt interest on Infinity's municipal fixed income portfolio. The effective tax rate for 2004 fell from that in 2003 as a result of increases in tax-exempt interest from a larger municipal fixed income portfolio, the release of $2.0 million of tax reserves, and a $7.4 million reduction in the valuation allowance for deferred tax assets. See Note 6 to Infinity's Consolidated Financial Statements for a detailed analysis of the effective tax rate.

Controls and Procedures

Infinity's chief executive officer and chief financial officer, with assistance from management, have evaluated the effectiveness of Infinity's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of the end of the period covered by this report. Based on that evaluation, they concluded that the controls and procedures are effective. There have been no significant changes in Infinity's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f) and 15d-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2004 based on the framework in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in *Internal Control—Integrated Framework*, our management concluded that our internal control over financial reporting was effective as of December 31, 2004.

Because of its inherent limitations, a system of internal control over financial reporting can provide only reasonable assurance and may not prevent or detect misstatements. Further, because of changes in conditions, effectiveness of internal controls over financial reporting may vary over time. Our system contains self-monitoring mechanisms, and actions are taken to correct deficiencies as they are identified.

Management's assessment of the effectiveness of Infinity's 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 the following report in which they expressed an unqualified opinion.