Notes to Consolidated Financial Statements

NOTE 1—ORGANIZATION AND BASIS OF PRESENTATION

Infinity Property and Casualty Corporation ("Infinity") was formed in September 2002 as an indirect wholly-owned subsidiary of American Financial Group, Inc. ("AFG") to acquire and conduct, as a separate public company, AFG's personal insurance business written through independent agents. At December 31, 2002, AFG transferred to Infinity all of the issued and outstanding capital stock of the following personal auto insurance subsidiaries: Atlanta Casualty Company, Infinity Insurance Company, Leader Insurance Company and Windsor Insurance Company (collectively the "NSA Group").

Through a reinsurance transaction effective January 1, 2003, Infinity assumed the personal lines business written through agents (the "Assumed Agency Business") by AFG's principal property and casualty subsidiary, Great American Insurance Company ("GAI") GAI, in turn, transferred to Infinity assets (primarily investment securities) with a market value of $125.3 million and permits Infinity to continue to write standard and preferred insurance on policies issued by the same GAI companies which had previously issued such policies. This arrangement will continue until Infinity makes the proper rate and form filings to allow its insurance subsidiaries to write these policies or non-renews the business, which is expected by the end of 2006.

The business assumed from GAI in 2003 is not included in the consolidated statements of Infinity for 2002. The Assumed Agency Business reported the following selected financial data as of December 31, 2002 (in millions):

	2002
Earnings Statement Data:	
Earned Premiums	$107.2
Underwriting Loss	(10.0)
Balance Sheet Data:	
Assets (excluding investments) to be transferred	$ 53.5
Investments to be transferred	125.3
Unpaid losses and loss adjustment expenses	125.6
Liabilities to be transferred	178.8

At December 31, 2002, AFG beneficially owned all of Infinity's Common Stock. In February of 2003, AFG sold 12.5 million shares (61%) of Infinity in an initial public offering. In December of 2003, AFG disposed of its remaining investment (7.9 million shares) in Infinity in the December 2003 public offering.

The accompanying Consolidated Financial Statements include the accounts of Infinity and its subsidiaries as of and for the twelve-month period ended December 31, 2004 and December 31, 2003. Infinity's prior period financial statements represent the combined statements of the NSA Group. Earnings per share data for 2002 is not applicable because the Consolidated Statement of Earnings represents the combined statements of wholly-owned subsidiaries.

The accompanying income statements include corporate general and administrative expenses for the twelve-month periods ended December 31, 2004, 2003, and 2002. Infinity was a wholly-owned subsidiary of AFG for the periods prior to 2003 and corporate holding company expenses were not allocated to Infinity for these periods. All appropriate expenses are included in other expenses for the twelve-month period ended December 31, 2002. Infinity considered the guidance in Staff Accounting Bulletin 55, "Allocation of Expenses and Related Disclosure in Financial Statements of Subsidiaries, Divisions or Lesser Business Components of Another Entity" (Topic 1.B) in preparing these Consolidated Financial Statements.

The accompanying income statements include expenses incurred directly by Infinity as well as charges for fees allocated by other AFG subsidiaries to Infinity for various services. For 2002, charges billed by GAI for corporate staff services, including human resources, risk management, legal, and financial reporting were based on the percentage of capital that each of the AFG property and casualty insurance subsidiaries needs to run its business, which approximates estimated usage. Investment management fees for 2002 have been based on the proportion each subsidiary's portfolio (at market value) bears to the total portfolios being managed. Management believes that these charges billed by AFG were reasonable and the accompanying Consolidated Financial Statements are representative of the costs of Infinity doing business on a stand-alone basis. All significant inter-company balances and transactions have been eliminated. The results of operations of companies since their formation or acquisition are included in the Consolidated Financial Statements.

The acquisition of the NSA Group has been accounted for at AFG's historical carrying amounts as transfers of net assets between entities under common control in accordance with Statement of Financial Accounting Standards ("SFAS") No. 141.

These financial statements reflect certain adjustments necessary for a fair presentation of Infinity's results of operations and financial position. Such adjustments consist of normal, recurring accruals recorded to accurately match expenses with their related revenue streams and the elimination of all significant inter-company transactions and balances. In addition, certain reclassification adjustments have been made to historical results to achieve consistency in presentation.

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.

NOTE 2—ACCOUNTING POLICIES

Investments

All fixed maturity securities are considered "available for sale" and reported at fair value with unrealized gains or losses reported as a separate component of shareholders' equity. Fair values of investments 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 the fair value of comparable securities, discounted cash flow models or similar methods. 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 credit worthiness 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 and the cost basis of that investment is reduced.

Securities having a carrying value of about $42 million at December 31, 2004 were on deposit as required by regulatory authorities.

Goodwill

Goodwill carried on Infinity's balance sheet represents the excess of AFG's carrying value over tangible assets in the NSA Group and the Assumed Agency Business at the date of transfer to Infinity in contemplation of Infinity's initial public offering in early 2003. In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," Infinity performs impairment test procedures on an annual basis. These procedures require Infinity to calculate the fair value of goodwill, compare the result to its carrying value and record the amount of any shortfall as an impairment charge. Infinity performed this test as of October 1, 2004 using a variety of methods, including estimates of future discounted cash flows and comparisons of the market value of Infinity to its major competitors as well as the overall market. The October 1, 2004 test results indicated that there was no impairment at that date. Infinity intends to perform this test annually each October 1.

Reinsurance

Infinity's insurance subsidiaries cede reinsurance to other companies. To the extent that any reinsuring companies are unable to meet obligations under agreements covering reinsurance ceded, Infinity's insurance subsidiaries would remain liable. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policies. Infinity'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 represents ceded premiums retained by Infinity's insurance subsidiaries to fund ceded losses as they become due. Infinity's insurance subsidiaries also assume reinsurance, primarily from other AFG subsidiaries. Income on reinsurance assumed is recognized based on reports received from ceding companies.

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 and charged against income ratably over the terms of the related policies. The method followed in computing DPAC limits the amount of such costs to their estimated realizable value without any consideration for anticipated investment income.

Unpaid Losses and Loss Adjustment Expenses ("LAE")

The net liabilities stated for unpaid claims and for expenses of investigation and adjustment of unpaid claims are based upon (a) the accumulation of case estimates for losses reported prior to the close of the accounting period on direct business written; (b) estimates received from ceding reinsurers and insurance pools and associations; (c) estimates of unreported losses based on past experience; (d) estimates based on experience of expenses for investigating and adjusting claims and (e) the current state of the law and coverage litigation. These liabilities are subject to the impact of changes in claim amounts and frequency and other factors. Unpaid losses and LAE have not been reduced for reinsurance recoverable. Changes in estimates of the liabilities for losses and LAE are reflected in the Consolidated 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 LAE are adequate.

Premiums and Receivables

Insurance premiums written are earned over the terms of the policies on a pro rata basis. Unearned premiums represent that portion of premiums written which is applicable to the unexpired terms of policies in force. On reinsurance assumed from other insurance companies or written through various underwriting organizations, unearned premiums are based on reports received from such companies and organizations. Infinity provides insurance and related services to individuals and small commercial accounts throughout the United States and offers a variety of payment plans. Infinity establishes an allowance for doubtful accounts based on prior experience, the relationship between receivables and unearned premium, on a policy basis, and an aging process of past due balances. Premiums due from insureds are charged off if not collected within 90 days of the policies' effective or cancellation dates.

Income Taxes

Infinity files a consolidated federal income tax return which includes all 80%-owned U.S. subsidiaries. Infinity and its 80%-owned subsidiaries are parties to a tax allocation agreement effective for periods following February 12, 2003, which designates how tax payments are shared by members of the tax group. In general, each subsidiary agrees to pay Infinity taxes computed on a separate company taxable income basis. Infinity agrees to pay each subsidiary for the tax benefit, if any, of net losses used by other members of the consolidated group. Taxes paid by Infinity in the years 2004 and 2003 were $33.6 million and $25.3 million, respectively. Prior to February 13, 2003, Infinity and its subsidiaries were part of the American Financial Corporation ("AFC," an AFG subsidiary) tax group and were parties to tax allocation agreements with AFC. In general, AFC companies computed taxes on a separate return basis and made payments to (or received benefits from) AFC based on taxable income. Taxes allocated to Infinity while included in the AFC tax group for the year 2002 were $25.1 million. The tax allocation agreements with AFC have not impacted the recognition of income tax expense and income tax payable in Infinity's financial statements.

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 basis 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. Current and deferred tax assets and liabilities are aggregated on the balance sheet.

Benefit Plans

Infinity provides retirement benefits to qualified employees of participating companies and health care and life insurance benefits to eligible retirees. Infinity also provides post-employment 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.

Statements 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. All other activities are considered "operating." Investments having original maturities of three months or less when purchased are considered to be cash equivalents for purposes of the financial statements.

Stock-Based Compensation

Infinity accounts for stock options and other stock-based compensation plans using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." The fair value of shares issued under Infinity's Restricted Stock Plan is recorded as unearned compensation and expensed over the vesting periods of the awards. Under Infinity'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. Refer to Note 8 for more information on stock-based compensation.

New Accounting Standards

On December 16, 2004, the FASB issued SFAS 123 (revised), "Share-Based Payment" ("SFAS 123(r)"). This new standard requires the recognition of compensation cost for share-based payments to employees, including stock option grants. SFAS 123(r) is effective for interim periods beginning after June 15, 2005; the Company plans to adopt the new standard at that time. In accordance with this new standard, pro forma amounts disclosed for periods up to this date will continue to be shown with comparative historical financial statements. No retroactive cumulative-effect adjustment will be recorded. Implementation of SFAS 123(r) in July 2005 is not expected to materially affect Infinity's results of operations or financial position.

On May 19, 2004, the FASB released FASB Statement of Position 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement, and Modernization Act of 2003" (the "Act"). This guidance requires sponsors of certain postretirement health care plans to determine whether the prescription benefits under the plan are actuarially equivalent to Medicare Part D benefits. If so, the plan qualifies for a federal subsidy under the Act and it must determine whether the subsidy is expected to lower the plan's cost of benefits. The plan assessment status is presented in Note 9 to the Consolidated Financial Statements. In January 2005, the Center for Medicare and Medicaid Services issued final regulations for the actuarial equivalence test. Infinity is currently evaluating its postretirement health care plan under the final rules and does not expect their application to materially affect its results of operations or financial position.

Proposed Accounting Standard

At December 31, 2004, the FASB was deliberating proposed FASB Staff Position EITF 03-1-a, "Implementation Guidance for the Application of EITF Issue No. 03-1, 'The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments.'" This guidance provides, among other things, that securities impaired by minor interest rate increases and/or changes in sector spreads can in some circumstances be considered temporary. If finalized in its current form, Infinity does not expect its application to materially affect its results of operations or financial position.

Notes to Consolidated Financial Statements

(continued)

NOTE 3—INVESTMENTS

Fixed maturities and equity securities consisted of the following (in millions):

	December 31, 2004			
			Gross Unrealized	
	Amortized Cost	Market Value	Gains	Losses
Fixed maturities:				
United States Government and government agencies and authorities	**$ 96.0**	**$ 97.1**	**$ 1.7**	**$(0.5)**
States, municipalities and political subdivisions	**232.6**	**237.1**	**4.9**	**(0.4)**
Public utilities	**80.5**	**85.2**	**4.8**	**(0.1)**
Mortgage-backed securities	**263.7**	**267.3**	**4.2**	**(0.6)**
All other corporate	**583.9**	**613.3**	**30.2**	**(0.8)**
Redeemable preferred stocks	**4.1**	**4.0**	**0.1**	**(0.2)**
	$ 1,260.8	**$ 1,304.1**	**$ 45.7**	**$(2.5)**
Equity securities	**$ 21.5**	**$ 25.0**	**$ 3.6**	**$(0.1)**

	December 31, 2003			
			Gross Unrealized	
	Amortized Cost	Market Value	Gains	Losses
Fixed maturities:				
United States Government and government agencies and authorities	$ 99.8	$ 101.7	$ 2.4	$(0.5)
States, municipalities and political subdivisions	218.8	224.6	6.2	(0.4)
Foreign government	2.3	2.3	0.1	—
Public utilities	114.8	120.7	6.2	(0.3)
Mortgage-backed securities	209.6	213.1	4.5	(1.0)
All other corporate	535.8	570.2	35.1	(0.6)
Redeemable preferred stocks	11.4	13.0	1.6	—
	$1,192.4	$1,245.8	$56.1	$(2.7)
Equity securities	$ 19.2	$ 21.4	$ 2.2	$(0.1)

The changes in unrealized gains or losses on marketable securities, which is included in the Consolidated Statements of Changes in Shareholders' Equity, was $(5.7) million, $12.0 million and $21.1 million for the twelve months ended December 31, 2004, 2003 and 2002 as detailed below:

	Pretax			
	Fixed Maturities	Equity Securities	Tax Effects	Net
Year ended December 31, 2004				
Unrealized holding gains (losses) on securities arising during the period	**$ (7.3)**	**$ 4.5**	**$ 1.0**	**$ (1.8)**
Realized (gains) included in net income	**(2.9)**	**(3.2)(a)**	**2.2**	**(3.9)**
Change in unrealized gain (loss) on marketable securities, net(b)	**$(10.2)**	**$ 1.3**	**$ 3.2**	**$ (5.7)**
Year ended December 31, 2003				
Unrealized holding gains (losses) on securities arising during the period	$16.0	$ 3.4	$ (6.8)	$12.6
Realized (gains) losses included in net income	(1.2)	0.3	0.3	(0.6)
Change in unrealized gain on marketable securities, net	$14.8	$ 3.7	$ (6.5)	$12.0
Year ended December 31, 2002				
Unrealized holding gains (losses) on securities arising during the period	$34.0	$(8.2)	$ (9.1)	$16.7
Realized losses included in net income	1.5	5.2	(2.3)	4.4
Change in unrealized gain (loss) on marketable securities, net	$35.5	$(3.0)	$(11.4)	$21.1

(a) Excludes realized (gains) on sales of subsidiaries of ($0.8) million.
(b) Excludes pretax change in unrealized gain on derivative of $0.3 million.

Infinity has recorded pretax other-than-temporary impairment charges on securities as follows (in thousands):

	Twelve Months Ended December 31,		
	2004	2003	2002
Beginning balance	**$11,784**	$13,962	$12,925
Impairments recorded:			
Fixed maturities	**758**	3,877	6,315
Equity securities	**372**	566	3,095
Sales, maturities, and paydowns	**(979)**	(6,621)	(8,373)
Ending balance	**$11,935**	$11,784	$13,962

Gross gains and losses on fixed maturity investment transactions included in the Consolidated Statements of Cash Flows consisted of the following (in millions):

	Twelve Months Ended December 31,		
	2004	2003	2002
Gross gains	**$ 4.1**	$ 5.8	$13.0
Gross losses	**(0.5)**	(0.7)	(9.0)
Net Realized Gains (losses) on sales of fixed maturities[(a)]	**$ 3.6**	$ 5.1	$ 4.0

(a) Excludes gains on sales of equities, other-than-temporary impairment charges, and other non-cash gains and losses.

The following chart summarizes Infinity's security positions with unrealized losses which were less than twelve months old and greater than twelve months old as of December 31, 2004 (dollars in millions):

	Less than twelve months			
	Number of Securities	Amortized Cost	Market Value	Unrealized Loss
Fixed maturities	70	$246.3	$244.1	$2.1
Equity securities	1	1.1	1.1	0.0
Total	71	$247.4	$245.2	$2.1

	Greater than twelve months			
	Number of Securities	Amortized Cost	Market Value	Unrealized Loss
Fixed maturities	7	$ 17.6	$ 17.2	$0.4
Equity securities	2	6.8	6.7	0.1
Total	9	$ 24.4	$ 23.9	$0.5

	December 31, 2004	December 31, 2003
Number of positions held with unrealized:		
Gains	**451**	451
Losses	**80**	63
Number of positions held that individually exceed unrealized:		
Gains of $500,000	**10**	11
Losses of $500,000	**—**	—
Percentage of positions held with unrealized:		
Gains that were investment grade	**89%**	88%
Losses that were investment grade	**97%**	85%

Infinity's investment portfolio included $2.6 million and $2.8 million of gross unrealized losses at December 31, 2004 and December 31, 2003, respectively. There was no single industry segment concentration that accounted for more than $1 million of these losses.

Net Investment Income

The following table shows (in millions) investment income earned and investment expenses (including interest charges on payables to reinsurers) incurred by Infinity's insurance companies.

	Twelve Months Ended December 31,		
	2004	2003	2002
Investment income:			
Fixed maturities	**$68.7**	$64.7	$70.3
Equity securities	**0.9**	1.0	1.1
Other	**—**	0.2	0.2
	69.6	65.9	71.6
Investment expenses[(a)]	**(3.9)**	(8.7)	(10.3)
Net investment income	**$65.7**	$57.2	$61.3

(a) Investment expenses include interest credited in connection with physical damage quota share agreements of $1.5 million, $6.3 million and $7.7 million for the twelve-month periods ended December 31, 2004, 2003 and 2002, respectively.

Infinity's fixed maturity portfolio includes securities with fair values totaling $1.4 million that have not produced investment income for at least twelve months as of December 31, 2004.

Notes to Consolidated Financial Statements

(continued)

NOTE 4—LONG-TERM DEBT

Infinity repaid the $55 million note due to AFG in July 2003 with proceeds from a $200 million seven-year amortizing term loan. The loan proceeds of $196.3 million (net of issued costs of $3.7 million) were also used to supplement the capital of Infinity's insurance subsidiaries, to reduce Infinity's reliance on reinsurance and for general corporate purposes. The term loan (prepaid in full in February 2004) accrued interest at a variable rate and at Infinity's choice of LIBOR plus 2.5% or Prime plus 1.5%. To hedge against future adverse movements in short-term interest rates, Infinity entered into an interest rate swap for $100 million of the principal, in which the variable rate payments due for the first three years of the term were exchanged for a fixed rate of 4.89%. The covenants of the loan had required Infinity to maintain certain minimum interest and fixed charge coverage ratios, as well as minimum levels of capital and surplus; the requirements of all loan covenants were met as of December 31, 2003. The first two loan principal repayment amounts of $2.25 million each were made on September 30 and December 31, 2003. In compliance with the loan agreement, Infinity made an additional principal payment of $2.5 million, one-half of the over-allotment proceeds received by Infinity from the December 2003 public offering, in January 2004. The remainder was to be repaid in quarterly installments.

In February 2004, Infinity issued $200 million principal of Senior Notes due 2014. The notes bear interest at a fixed 5.5% coupon rate which is payable semiannually. The proceeds of the Senior Notes were used to retire the term loan referenced above. Unamortized debt issuance costs relating to the issuance of the variable rate term loan were written off upon the retirement of this loan, resulting in a pretax charge of $3.4 million in the first quarter of 2004. Infinity capitalized $2.1 million of debt issuance costs related to the Senior Notes. In addition, the interest rate swap, which Infinity held in conjunction with the term loan, was settled and resulted in a pretax charge of $0.3 million in the first quarter of 2004.

Interest paid by Infinity on long-term debt was $6.5 million for both of the twelve-month periods ended December 31, 2004 and 2003.

NOTE 5—EQUITY IN AFFILIATES

At December 31, 2000, Infinity owned 2 million shares (3%) of Chiquita common stock. AFG and its subsidiaries, then an affiliate of Infinity, owned an additional 22 million shares (33%) of Chiquita common stock at that date. Chiquita reported net losses attributable to common shares of $112 million in 2000.

In January 2001, Chiquita announced a restructuring initiative that included discontinuing all interest and principal payments on its public debt. Due to the expected restructuring, Infinity recorded a fourth quarter 2000 pretax charge of $14.2 million to write down its investment in Chiquita to quoted market value at December 31, 2000. In 2001, Infinity suspended accounting for the investment under the equity method and reclassified the investment to "Equity securities." In the third quarter of 2001, Infinity wrote down its investment in Chiquita by an additional $669,000. In March 2002, the court approved Chiquita's plan of reorganization under Chapter 11 of the U.S. Bankruptcy Code. Under the plan, over $700 million in principal and accrued interest related to Chiquita's public debt was converted into common equity. As a result, Infinity received approximately 14,400 "new" shares in the reorganized company plus warrants expiring in 2009 to purchase an additional 240,000 shares at $19.23 per share. All of the common shares were sold in 2002 and the warrants were sold in September of 2003.

NOTE 6—INCOME TAXES

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

	Year Ended December 31,		
	2004	2003	2002
Earnings before income taxes	**$129,461**	$87,404	$70,933
Income taxes at statutory rate	**$ 45,311**	$30,591	$24,827
Effect of:			
Dividends received deduction	**(217)**	(368)	(450)
Tax-exempt interest	**(1,814)**	(1,061)	0
Adjustment to valuation allowance	**(7,447)**	0	0
Other	**(2,770)**	6	686
Provision for income taxes as shown on the Consolidated Statement of Operations	**$ 33,063**	$29,168	$25,063
GAAP Effective Tax Rate	**25.5%**	33.4%	35.3%

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

Current	**$ 36,149**	$31,124	$34,070
Deferred	**(3,086)**	(1,956)	(9,007)
	$ 33,063	$29,168	$25,063

The Infinity consolidated tax group generated capital losses in 2003 in addition to the capital loss carryforward from AFG. The tax benefit of the capital loss carryforwards at December 31, 2004 is (in millions):

	Expiring	Amount
Capital loss carryforward	2007	$18.3
Capital loss carryforward	2008	8.1

As shown in the following chart, at December 31, 2004 the deferred taxes relating to the capital loss carryforwards have been fully offset by the valuation allowance. Therefore, in the future, the tax benefit from the utilization of any of these capital loss carryforwards will be reflected in current tax expense and will impact the effective tax rate calculation for that period.

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

	Twelve Months Ended December 31,	
	2004	2003
Deferred tax assets:		
Discount on loss reserves	**$ 17.4**	$ 19.9
Unearned premium reserve	**26.3**	22.7
Net operating loss carryforward	**0.0**	1.2
Net capital loss carryforward	**26.4**	27.2
Alternative minimum tax credit	**0.0**	2.5
Other, net	**13.5**	9.8
	83.6	83.3
Valuation allowance for deferred tax assets	**(26.4)**	(33.8)
	57.2	49.5
Deferred tax liabilities:		
Deferred policy acquisition costs	**(24.0)**	(17.8)
Depreciation and amortization	**(1.4)**	(3.0)
Investment securities	**(12.5)**	(15.4)
	(37.9)	(36.2)
Net deferred tax assets	**$ 19.3**	$ 13.3

The gross deferred tax asset has been reduced by a valuation allowance based on an analysis of the likelihood of realization. Factors considered in assessing the need for a valuation allowance include: (i) opportunities to generate taxable income from sales of appreciated assets to allow for the utilization of net capital loss carryovers, and (ii) the likelihood of generating larger amounts of taxable income in the future to allow for the utilization of deductible temporary differences. The likelihood of realizing deferred tax assets 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.

Changes in Deferred Tax Assets and Valuation Allowance

Operating loss carryforwards decreased by $1.2 million from 2003 to 2004 as a result of utilizing the operating loss carryforward in the 2003 consolidated federal income tax return filed for the Infinity companies. The operating loss carryforward was generated while the Infinity companies were included in the AFC tax group. Capital loss carryforwards decreased by $0.8 million from 2003 to 2004 due to a $3.9 million increase in the losses recognized by the Infinity companies at the IPO date for which AFC was not able to fully utilize in their consolidated federal income tax return. There was an offsetting decrease of $4.7 million due to the utilization of capital loss carryforwards in 2004. The alternative minimum tax ("AMT") credit decreased by $2.5 million from 2003 to 2004 as a result of fully utilizing the AMT credit in the 2003 consolidated federal income tax return for the Infinity companies.

The valuation allowance decreased by $7.4 million from 2003 to 2004 primarily as a result of utilization of the operating loss carryforward in the 2003 consolidated federal income tax return and the utilization of a portion of the capital loss carryforwards in 2004. There was also a reduction to the tax reserve, generated while the Infinity companies were included in the AFC tax group, of $2.0 million from 2003 to 2004.

NOTE 7—COMPUTATIONS OF EARNINGS PER SHARE

The following table illustrates the reconciliation of the denominators in Infinity's computations of basic and diluted earnings per common share (in thousands, except per share figures):

	Twelve Months Ended December 31,		
	2004	2003	2002
Net earnings	**$96,398**	$58,236	$45,870
Basic average shares outstanding	**20,560**	20,348	N/A
Basic EPS	**$ 4.69**	$ 2.86	N/A
Basic average shares outstanding	**20,560**	20,348	N/A
Restricted stock not vested	**96**	117	N/A
Dilutive effect of assumed option exercises	**203**	130	N/A
Average diluted shares outstanding	**20,859**	20,594	N/A
Diluted EPS	**$ 4.62**	$ 2.83	N/A

NOTE 8—EQUITY COMPENSATION PLANS

Infinity established the Employee Stock Purchase Plan ("ESPP") in 2004. Under this plan, all eligible full-time employees may purchase shares of Infinity common stock at a 15% discount to the current market price. Employees may participate up to 25% of their base salary with a maximum annual participation amount of $25,000. If a participant sells any shares purchased under the plan within one year, that employee is precluded from participating in the plan for one year from the date of sale. The source of shares issued to participants is treasury shares and/or authorized but previously unissued shares. Infinity's ESPP is qualified under Section 423 of the Internal Revenue Code of 1986, as amended, ("the Code") and so Infinity does not recognize the 15% market discount as expense in its financial statements. Participants' shares are issued and outstanding for earnings per share calculations.

Infinity established the 2002 Stock Option Plan to enable it to attract and motivate its employees and to encourage the identification of their interests with those of Infinity's shareholders.The plan provides for the grant of incentive stock options that are qualified under the Code and for the grant of nonqualified stock options.

The maximum number of shares of Infinity's common stock for which options may be granted under the plan is 2,000,000 (subject to antidilution provisions). Infinity's Compensation Committee administers the plan. Each member of the Committee is an "outside director," as such term is defined under Section 162(m) of the Code, and a "non-employee director" as defined in Rule 16b-3(b) promulgated under the Securities Exchange Act of 1934.

Subject to specific limitations contained in the plan, Infinity's Board of Directors has the ability to amend, suspend or terminate the plan at any time without shareholder approval. Unless earlier terminated, the plan may continue in effect until December 16, 2012.

Options generally expire ten years after the date of grant, though the Committee can provide for a shorter term for a particular grant. Generally, subject to the discretion of the Compensation Committee, 20% of the shares underlying an option will become exercisable upon the first anniversary of the date of grant, and 20% become exercisable on each subsequent anniversary. Options issued to non-employee directors are immediately exercisable. Exercise prices for options granted under the plan may not be less than the fair market value on the date of grant. The Compensation Committee has broad discretion in determining the terms of the grant of awards under the plan, subject to the restrictions outlined above. Upon a change of control, as defined in the plan, all outstanding options will immediately vest in full and become exercisable.

Payment for shares purchased upon exercise of an option must be made in cash. The Committee, however, may permit payment by delivery of shares of common stock already owned by the optionee having a fair market value equal to the cash option price of the shares, by assigning the proceeds of a sale or loan with respect to some or all of the shares being acquired (subject to applicable law), by a combination of the foregoing or by any other method.

Persons who receive options incur no federal income tax liability at the time of grant. Persons exercising nonqualified options recognize taxable income, and Infinity has a tax deduction at the time of exercise to the extent of the difference between market price on the day of exercise and the exercise price. Persons exercising incentive stock options do not recognize taxable income until they sell the underlying common stock. Sales within two years of the date of grant or one year of the date of exercise result in taxable income to the holder and a deduction for Infinity, both measured by the difference between the market price at the time of sale and the exercise price. Sales after such period are treated as capital transactions to the holder, and Infinity receives no deduction. The foregoing is only a summary of the federal income tax rules applicable to options granted under the plan and is not intended to be complete. In addition, this summary does not discuss the effect of the income or other tax laws of any state or foreign country in which a participant may reside.

The following chart describes activity for Infinity's Stock Option Plan for the twelve-month period ended December 31, 2004 and 2003:

	2004	
Options Outstanding	Number of Options	Weighted Average Exercise Price
As of January 1, 2004	419,180	$16.11
Granted	214,000	$33.56
Exercised	(13,700)	$16.00
Forfeited	(16,000)	$24.79
As of December 31, 2004	**603,480**	**$ 22.07**

	Number of Options		Remaining
Exercise Price	Outstanding	Exercisable	Contractual Life
$16.00	392,480	82,496	8.1 years
$25.56	5,000	5,000	8.7 years
$33.58	203,500	10,000	9.1 years
$31.94	2,500	2,500	9.4 years
	603,480	99,996	

Options Outstanding	2003 Number of Options	2003 Weighted Average Exercise Price
As of January 1, 2003	—	—
Granted	425,180	$16.11
Exercised	(2,500)	$16.00
Forfeited	(3,500)	$16.00
As of December 31, 2003	419,180	$16.11

Exercise Price	Number of Options Outstanding	Number of Options Exercisable	Remaining Contractual Life
$16.00	414,180	5,000	9.2 years
$25.56	5,000	5,000	9.7 years
	419,180	10,000	

Infinity's Restricted Stock Plan was also established in 2002. There were 500,000 shares of Infinity common stock reserved for issuance under the Restricted Stock Plan.

As permitted under SFAS No. 123, "Accounting for Stock-Based Compensation," Infinity accounts for stock options and other stock-based compensation plans using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." The fair value of shares issued under Infinity's Restricted Stock Plan is recorded as unearned compensation and expensed over the vesting periods of the awards. Under Infinity'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 related to stock options been determined and recognized based on "fair values" at grant dates consistent with the method prescribed by SFAS No. 123. For SFAS No. 123 purposes, the "fair values" were calculated using the Black-Scholes option-pricing model. There is no single reliable method to determine the actual value of options at grant date. Accordingly, the actual value of the option grants may be higher or lower than the SFAS No. 123 "fair value."

	Twelve Months Ended December 31, 2004	Twelve Months Ended December 31, 2003
Net earnings, as reported	**$96,398**	$58,236
Pro forma stock option expense	**(1,143)**	(477)
Adjusted net earnings	**$95,255**	$57,759
Earnings per share (as reported):		
Basic	**$ 4.69**	$ 2.86
Diluted	**$ 4.62**	$ 2.83
Earnings per share (adjusted):		
Basic	**$ 4.63**	$ 2.84
Diluted	**$ 4.57**	$ 2.81

The following table illustrates the assumptions used to obtain the pro forma stock option expense figures. All data presented is inception-to-date as of the dates indicated.

	As of December 31, 2004	As of December 31, 2003
Assumptions:		
Options outstanding	**603,480**	419,180
Weighted average:		
Fair value per option granted	**$13.87**	$5.98
Dividend yield	**1.2%**	1.4%
Expected volatility	**33.0%**	33.0%
Risk-free interest rate	**4.1%**	4.0%
Expected option life	**7.5 years**	7.5 years

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NOTE 9—BENEFIT PLANS

Infinity provides retirement benefits for all eligible employees by matching contributions made on a discretionary basis to participants' accounts in the Infinity 401(k) Retirement Plan. Eligible employees may contribute up to a maximum of the lesser of $13,000 per year or 25% of the participant's salary. Infinity retains the right to make discretionary supplemental contributions to the accounts of plan participants. The matching percentage made by Infinity is 100% of participants' contributions up to a ceiling of 3% of participants' earnings. The plan expense was $6.3 million and $5.7 million for the twelve-month periods ended December 31, 2004 and 2003, respectively. Infinity employees participated in the AFG 401(k) plan in 2002.

Additionally, Infinity's Supplemental Retirement Plan is a nonqualified deferred compensation plan that allows certain highly compensated employees to receive the full discretionary employer contribution that is precluded by the provisions of the 401(k) Retirement Plan or by law due to limits on compensation.

Infinity maintains for certain highly-compensated employees, a qualified deferred compensation plan, which permits the participants to defer a portion of their salaries and bonuses. The deferred amounts accrue interest at Infinity's approximate long-term borrowing rate. The deferred amounts are a general obligation liability of Infinity and amounted to $1.5 million and $0.9 million at December 31, 2004 and 2003, respectively. Interest credited by Infinity was approximately $74,000 and $49,000 for these same time periods.

Infinity also provides postretirement medical and life insurance benefits to retirees. The benefit obligation was allocated to Infinity from the former AFG plan in late 2002 in anticipation of the initial public offering. Data related to this plan is shown in the following tables (in thousands). This data does not reflect the impact of the subsidy provided by the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (the "Act"). The Company has not been able to conclude that the benefits provided under this plan are actuarially equivalent to Medicare Part D benefits under the Act. Infinity does not expect this legislation to have a material effect on its net benefit obligation or plan costs.

	2004	2003
Net benefit obligation at beginning of year	**$3,819**	$3,620
Service cost	**233**	251
Interest cost	**238**	255
Participant contributions	**80**	57
Plan amendments	**—**	(444)
Actuarial loss	**168**	304
Gross benefits paid	**(271)**	(224)
Net benefit obligation at end of year	**$4,267**	$3,819

Weighted average assumptions used to determine benefit obligations	**2004**	2003
Discount rate	**6.00%**	6.00%
Health care cost trend on covered charges	**10.4% decreasing to 5% in 2008**	10% decreasing to 5% in 2009

A one-percentage point change in the assumed healthcare cost trend rate would have the following effect on the postretirement benefit obligation:

	2004	2003
1% increase	**$ 284**	$ 54
1% decrease	**(276)**	(48)

Plan assets	**2004**	2003
Fair value of plan assets at beginning of year	**$ —**	$ —
Actual return on plan assets	**—**	—
Employer contributions	**191**	167
Participant contributions	**80**	57
Gross benefits paid	**(271)**	(224)
Fair value of plan assets at end of year	**$ —**	$ —

Expected future benefit payments	**2004**	2003
2004	**$ N/A**	$ 191
2005	**266**	233
2006	**298**	277
2007	**316**	312
2008	**327**	348
2009	**329**	N/A
2010–2014	**1,580**	2,160

Funded status:	**2004**	2003
Fair value of plan assets	**$ —**	$ —
Benefit obligations	**4,267**	3,819
Funded status at end of year	**(4,267)**	(3,819)
Contributions made after the measurement date	**48**	47
Unrecognized actuarial net (gain) loss	**472**	304
Unrecognized prior service cost	**(377)**	(444)
Net amount recognized at end of year	**$(4,124)**	$(3,912)

NOTE 10—QUARTERLY OPERATING RESULTS (UNAUDITED)

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 and are not necessarily indicative of results for longer periods of time.

The following are quarterly results of consolidated operations of Infinity for the two years ended December 31, 2004 (in millions):

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total Year
2004					
Revenues	**$ 230.2**	**$ 238.4**	**$ 240.5**	**$ 242.7**	**$ 951.8**
Net earnings	**16.9**	**24.8**	**23.0**	**31.7**	**96.4**
Earnings per share:					
Basic	**$ 0.82**	**$ 1.21**	**$ 1.12**	**$ 1.54**	**$ 4.69**
Diluted	**0.81**	**1.19**	**1.10**	**1.52**	**4.62**
2003					
Revenues	$181.0	$180.3	$190.0	$217.7	$769.0
Net earnings	11.5	12.3	15.0	19.4	58.2
Earnings per share:					
Basic	$ 0.57	$ 0.60	$ 0.73	$ 0.96	$ 2.86
Diluted	0.57	0.60	0.72	0.94	2.83

Realized gains (losses) on securities amounted to (in millions):

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total Year
2004	$ 1.6	$ 1.4	$ 2.8	$ 1.1	$ 6.9
2003	0.3	0.2	0.8	(0.3)	1.0

NOTE 11—INSURANCE RESERVES

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 two years on a GAAP basis (in millions):

	Twelve Months Ended December 31,		
	2004	2003	2002
Gross unpaid losses and LAE	**$ 714**	$ 607	$ 648
Less: reinsurance recoverables	**(30)**	(33)	(37)
Balance at beginning of period	**684**	574	611
Addition of Assumed Agency Business	**—**	126	—
		700	
Provision for losses and LAE occurring in the current year	**618**	543	527
Net increase (decrease) in provision for claims of prior years[a]	**(15)**	14	1
Total losses and LAE incurred	**603**	557	528
Payments for losses and LAE of:			
Current year	**(322)**	(233)	(252)
Prior years	**(323)**	(340)	(313)
Total payments	**(645)**	(573)	(565)
Balance at end of period	**642**	684	574
Add back reinsurance recoverables	**17**	30	33
Gross unpaid losses and LAE included in the Balance Sheet	**$ 659**	$ 714	$ 607

(a) Includes the assumption of the Agency Business

During calendar year 2002, the NSA Group settled, for $5.1 million, a state class action lawsuit involving the issue of whether there is an inherent diminished value in a damaged automobile that should be accounted for when calculating claim payments. The settlement increased the reserve deficiency for the 2001 calendar year-end reserves by $5.1 million. During calendar year 2003, $14 million of adverse loss and LAE reserve development occurred primarily due to business from New York, partially offset by other reserve releases. During calendar year 2004, Infinity enjoyed $15 million of favorable reserve development, primarily from continued favorable development in accident year 2003 on claim frequency on the California book of business, offset partially by continued unfavorable development in accident years 2000–2002, primarily from LAE on the declining New York book of business.

NOTE 12—REINSURANCE

During 2002, Infinity's insurance subsidiaries participated in a reinsurance agreement with Inter-Ocean under which Infinity agreed to cede 90% of its automobile physical damage business written through December 2002. This agreement was renewed for 2003 on terms substantially equivalent to those in effect in 2002, except that Infinity could elect on a quarterly basis to reduce the amount ceded from 90% to 20% of the policies effective in the last two quarters of 2003. In 2004, Infinity entered into a reinsurance agreement with American Re on substantially similar terms as through the Inter-Ocean agreement except that (i) the

Notes to Consolidated Financial Statements

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Assumed Agency Business was not included and (ii) minimum cession under the agreement was 10% as compared to 20% in the Inter-Ocean agreement. Under these agreements, Infinity retained all of the ceded premiums to fund ceded losses as they became due from the reinsurers. Interest was credited to the reinsurers for funds held on their behalf. Premiums ceded under these agreements were $14 million, $170 million and $296 million for the twelve-month periods ended December 31, 2004, 2003 and 2002, respectively. In addition, premiums ceded for the Assumed Agency Business were $22 million and $79 million for the twelve-month periods ended December 31, 2003 and 2002, respectively. Interest credited, which is reported as a reduction of net investment income, was $1.5 million, $6.2 million and $7.6 million for the twelve-month periods ended December 31, 2004, 2003 and 2002, respectively. Infinity commuted the 2001 agreement in 2003 and the 2003 and 2004 agreements on December 31, 2004 and did not renew any agreement for 2005.

In addition, Infinity's insurance subsidiaries assume a limited amount of other business, primarily from affiliates of AFG. The following table shows (in millions): (i) written and earned premiums included in income for reinsurance assumed, (ii) amounts deducted from written and earned premiums in connection with reinsurance ceded and (iii) reinsurance recoveries deducted from losses and loss adjustment expenses.

	Twelve Months Ended December 31,		
	2004	2003	2002
Direct premiums written	**$861**	$ 846	$ 873
Reinsurance assumed	**103**	159	42
Reinsurance ceded	**(46)**	(187)	(302)
Net written premiums	**$918**	$ 818	$ 613
Direct premiums earned	**$831**	$ 833	$ 906
Reinsurance assumed	**115**	123	46
Reinsurance ceded	**(74)**	(257)	(306)
Net earned premiums	**$872**	$ 699	$ 646
Reinsurance recovered	**$ 38**	$ 132	$ 174

NOTE 13—STATUTORY INFORMATION

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

Net Earnings (Loss)			Policyholders' Surplus	
2004	2003	2002	**2004**	2003
$87.2	$(23.5)	$65.6	**$507.2**	$446.1

For the twelve-month period ended December 31, 2004 and December 31, 2002, statutory results differed from net earnings on a GAAP basis primarily due to the amortization of deferred acquisition costs.

For the twelve-month period ended December 31, 2003, statutory results differed from net earnings on a GAAP basis due to (i) a realized loss from the write-off of an investment in Penn Central U.K. Limited and its insurance subsidiary of $55 million for statutory purposes and (ii) amortization of deferred acquisition costs. For GAAP purposes, the $55 million loss from the insurance subsidiary has been recorded in the NSA Group's financial statements prior to 2003 using the equity method of accounting.

NOTE 14—ADDITIONAL INFORMATION

Allowances for Uncollectible Accounts

Agents' balances and premiums receivable included in the balance sheet are shown net of allowances for uncollectible accounts. The provision for such losses is included in other operating and general expenses. A progression of the aggregate allowance follows (in millions):

	2004	2003	2002
Beginning balance	**$ 7.9**	$ 8.9	$ 10.1
Provision for losses	**14.6**	10.5	14.1
Uncollectible amounts written off	**(11.0)**	(11.5)	(15.3)
Ending balance	**$ 11.5**	$ 7.9	$ 8.9

Restrictions on Transfer of Funds and Assets of Subsidiaries

Payments of dividends, loans and advances by Infinity's insurance 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 payable in 2005 from Infinity's insurance subsidiaries without seeking regulatory clearance is approximately $63 million. Additional amounts of dividends, loans and advances require regulatory approval.

Rent Expense

Total rental expense for various leases of office space and equipment was $22.3 million, $20.7 million, and $15.2 million for the twelve month periods ended December 31, 2004, 2003, and 2002, respectively.

Future minimum rentals, primarily related to office space, required under operating leases having initial or remaining lease terms in excess of one year at December 31, 2004 were as follows: 2005–$17.6 million; 2006–$17.4 million; 2007–$16.5 million; 2008–$15.1 million; 2009–$10.2 million and $28.2 million thereafter.

Future sublease revenue was $1.3 million for 2005, 2006 and 2007, $1.2 million for 2008, $1.1 million for 2009 and $0.7 million thereafter.

Contingencies

Infinity is subject to litigation resulting principally from normal insurance activities. Management believes that the outcome of such matters will not have a material effect upon Infinity's consolidated financial position.

Related Party Transactions

In December 2003, AFG sold its remaining holdings of Infinity common stock through a secondary public offering. As of that date, Infinity no longer was an affiliate with AFG.

Various business had transacted between Infinity and AFG and its subsidiaries while AFG was affiliated with the Company, including insurance, computer processing and programming, payroll processing, office rental and sales of assets. Aggregate charges for these items were insignificant in relation to revenues.

Infinity's investment portfolio is managed by a subsidiary of AFG. Net investment income includes investment management charges of $2.0 million in 2003 and $1.8 million in 2002.

Infinity has purchased and sold securities at fair value in transactions with AFG subsidiaries; it has also transferred securities to its former parent in the form of capital distributions and received securities from its former parent as capital contributions. Such purchases, sales and transfers and related realized gains (losses) were as follows (in millions):

	Acquisitions	Dispositions	Realized Losses
2003	$114.7[a]	$ 4.7	$(0.6)
2002	—	102.7	(7.9)

(a) Consists entirely of securities transferred from AFG to Infinity to support the net reserves of the Assumed Agency Business.