CINCINNATI FINANCIAL CORP
Form 10-Q
August 07, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark one)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the quarterly period ended June 30, 2007.

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the transition period from ___to ___.

Commission file number 0-4604
CINCINNATI FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

Ohio	31-0746871
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
6200 S. Gilmore Road, Fairfield, Ohio	45014-5141
(Address of principal executive offices)	(Zip code)

Registrant s telephone number, including area code: (513) 870-2000

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):

o Yes þ No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

þ Yes o No

As of July 31, 2007, there were 171,830,691 shares of common stock outstanding.

CINCINNATI FINANCIAL CORPORATION
FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2007
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Part I Financial Information

Item 1. Financial Statements (unaudited)

Cincinnati Financial Corporation And Subsidiaries

Condensed Consolidated Balance Sheets

(Dollars in millions except per share data)	June 30, 2007	December 31, 2006
ASSETS		
Investments		
Fixed maturities, at fair value (amortized cost: 2007 $5,910; 2006 $5,739)	$ 5,891	$ 5,805
Equity securities, at fair value (cost: 2007 $2,944; 2006 $2,621)	7,650	7,799
Short-term investments, at fair value (amortized cost: 2007 $101; 2006 $95)	101	95
Other invested assets	70	60
Total investments	13,712	13,759
Cash and cash equivalents	122	202
Securities lending collateral	976	0
Investment income receivable	124	121
Finance receivable	100	108
Premiums receivable	1,217	1,128
Reinsurance receivable	751	683
Prepaid reinsurance premiums	12	13
Deferred policy acquisition costs	479	453
Land, building and equipment, net, for company use (accumulated depreciation: 2007 $275; 2006 $261)	212	193
Other assets	51	58
Separate accounts	508	504
Total assets	$ 18,264	$ 17,222
LIABILITIES		
Insurance reserves		
Loss and loss expense reserves	$ 3,953	$ 3,896
Life policy reserves	1,446	1,409
Unearned premiums	1,662	1,579
Securities lending payable	976	0
Other liabilities	619	533
Deferred income tax	1,434	1,653
Note payable	49	49
6.125% senior notes due 2034	371	371
6.9% senior debentures due 2028	28	28
6.92% senior debentures due 2028	392	392
Separate accounts	508	504
Total liabilities	11,438	10,414

Commitments and contingent liabilities (Note 6)

SHAREHOLDERS EQUITY		
Common stock, par value $2 per share; (authorized: 2007 500 million shares, 2006 500 million shares; issued: 2007 196 million shares, 2006 196 million shares)	**392**	391
Paid-in capital	**1,035**	1,015
Retained earnings	**3,213**	2,786
Accumulated other comprehensive income	**3,013**	3,379
Treasury stock at cost (2007 24 million shares, 2006 23 million shares)	**(827)**	(763)
Total shareholders equity	**6,826**	6,808
Total liabilities and shareholders equity	**$ 18,264**	$ 17,222

Accompanying notes are an integral part of these statements.

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Cincinnati Financial Corporation And Subsidiaries
Condensed Consolidated Statements Of Income

	Three months ended June 30,		Six months ended June 30,	
(In millions except per share data)	**2007**	2006	**2007**	2006
REVENUES				
Earned premiums				
Property casualty	**$ 787**	$ 793	**$ 1,571**	$ 1,571
Life	**35**	29	**66**	56
Investment income, net of expenses	**150**	143	**298**	281
Realized investment gains and losses	**293**	11	**355**	671
Other income	**5**	5	**11**	9
Total revenues	**1,270**	981	**2,301**	2,588
BENEFITS AND EXPENSES				
Insurance losses and policyholder benefits	**490**	546	**974**	1,047
Commissions	**160**	156	**330**	322
Other operating expenses	**87**	84	**176**	167
Taxes, licenses and fees	**19**	14	**39**	39
Increase in deferred policy acquisition costs	**(7)**	(7)	**(23)**	(22)
Interest expense	**13**	13	**26**	26
Total benefits and expenses	**762**	806	**1,522**	1,579
INCOME BEFORE INCOME TAXES	**508**	175	**779**	1,009
PROVISION (BENEFIT) FOR INCOME TAXES				
Current	**156**	48	**233**	340
Deferred	**1**	(5)	**1**	(15)
Total provision for income taxes	**157**	43	**234**	325
NET INCOME	**$ 351**	$ 132	**$ 545**	$ 684
PER COMMON SHARE				
Net income basic	**$ 2.04**	$ 0.77	**$ 3.16**	$ 3.94
Net income diluted	**$ 2.02**	$ 0.76	**$ 3.13**	$ 3.90

Accompanying notes are an integral part of these statements.

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Cincinnati Financial Corporation And Subsidiaries
Condensed Consolidated Statements Of Shareholders Equity

(In millions)	Six months ended June 30, **2007**	2006
COMMON STOCK		
Beginning of year	**$ 391**	$ 389
Stock options exercised	**1**	2
End of period	**392**	391
PAID-IN CAPITAL		
Beginning of year	**1,015**	969
Stock options exercised	**10**	17
Share-based compensation	**8**	11
Other	**2**	0
End of period	**1,035**	997
RETAINED EARNINGS		
Beginning of year	**2,786**	2,088
Cumulative effect of change in accounting for hybrid financial securities	**5**	0
Cumulative effect of change in accounting for uncertain tax positions	**(1)**	0
Adjusted beginning of year	**2,790**	2,088
Net income	**545**	684
Dividends declared	**(122)**	(116)
End of period	**3,213**	2,656
ACCUMULATED OTHER COMPREHENSIVE INCOME		
Beginning of year	**3,379**	3,284
Cumulative effect of change in accounting for hybrid financial securities	**(5)**	0
Adjusted beginning of year	**3,374**	3,284
Other comprehensive income (loss), net	**(361)**	(531)
End of period	**3,013**	2,753
TREASURY STOCK		
Beginning of year	**(763)**	(644)
Purchase	**(64)**	(88)
End of period	**(827)**	(732)

Total shareholders equity	**$ 6,826**	$ 6,065
COMMON STOCK NUMBER OF SHARES OUTSTANDING		
Beginning of year	**173**	174
Stock options exercised	**0**	1
Purchase of treasury shares	**(1)**	(2)
End of period	**172**	173
COMPREHENSIVE INCOME		
Net income	**$ 545**	$ 684
Unrealized investment gains and losses during the period	**(561)**	(841)
Other	**4**	7
Taxes on other comprehensive income	**196**	303
Total comprehensive income	**$ 184**	$ 153

Accompanying notes are an integral part of these statements.

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Cincinnati Financial Corporation And Subsidiaries
Condensed Consolidated Statements Of Cash Flows

(In millions)	Six months ended June 30, **2007**	2006
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	**$ 545**	$ 684
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and other non-cash items	**16**	16
Realized gains on investments	**(355)**	(671)
Share-based compensation	**8**	11
Interest credited to contract holders	**16**	14
Changes in:		
Investment income receivable	**(3)**	1
Premiums and reinsurance receivable	**(156)**	(85)
Deferred policy acquisition costs	**(23)**	(22)
Other assets	**(8)**	(11)
Loss and loss expense reserves	**57**	135
Life policy reserves	**47**	28
Unearned premiums	**83**	75
Other liabilities	**19**	(15)
Deferred income tax	**1**	(15)
Current income tax	**88**	94
Net cash provided by operating activities	**335**	239
CASH FLOWS FROM INVESTING ACTIVITIES		
Sale of fixed maturities	**103**	68
Call or maturity of fixed maturities	**193**	148
Sale of equity securities	**565**	835
Collection of finance receivables	**20**	18
Purchase of fixed maturities	**(492)**	(510)
Purchase of equity securities	**(550)**	(585)
Change in short-term investments, net	**(5)**	79
Investment in buildings and equipment, net	**(34)**	(28)
Investment in finance receivables	**(12)**	(21)
Change in other invested assets, net	**(3)**	(10)
Change in securities lending collateral	**(976)**	(898)
Net cash used in investing activities	**(1,191)**	(904)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payment of cash dividends to shareholders	**(119)**	(112)
Purchase of treasury shares	**(64)**	(88)
Increase in notes payable	**0**	49
Proceeds from stock options exercised	**11**	17
Contract holder funds deposited	**11**	19
Contract holder funds withdrawn	**(37)**	(35)
Change in securities lending payable	**976**	898

Other		**(2)**		1
Net cash provided by financing activities		**776**		749
Net increase (decrease) in cash and cash equivalents		**(80)**		84
Cash and cash equivalents at beginning of year		**202**		119
Cash and cash equivalents at end of period	**$**	**122**	$	203
Supplemental disclosures of cash flow information:				
Interest paid (net of capitalized interest: 2007 $2; 2006 $1)	**$**	**26**	$	26
Income taxes paid		**143**		248
Non-cash activities:				
Conversion of securities	**$**	**17**	$	
Equipment acquired under capital lease obligations				7

Accompanying notes are an integral part of these statements.

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Notes To Condensed Consolidated Financial Statements (unaudited)

NOTE 1 Accounting Policies

The condensed consolidated financial statements include the accounts of Cincinnati Financial Corporation and its consolidated subsidiaries, each of which is wholly owned, and are presented in conformity with accounting principles generally accepted in the United States of America (GAAP). All significant intercompany balances and transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Our actual results could differ from those estimates. The December 31, 2006, consolidated balance sheet amounts are derived from the audited financial statements but do not include all disclosures required by accounting principles generally accepted in the United States of America.

Our June 30, 2007, condensed consolidated financial statements are unaudited. Certain financial information that is included in annual financial statements prepared in accordance with GAAP is not required for interim reporting and has been condensed or omitted. We believe that we have made all adjustments, consisting only of normal recurring accruals, that are necessary for fair presentation. The results of operations for interim periods do not necessarily indicate results to be expected for the full year.

Recent Accounting Pronouncements

Statements of Financial Accounting Standards (SFAS) No. 155, Accounting for Certain Hybrid Financial Instruments, an amendment of SFAS Nos. 133 and 140

Hybrid securities generally combine both debt and equity characteristics. The most common example is a convertible bond that has features of an ordinary bond but is heavily influenced by the price movements of the stock into which it is convertible.

Hybrid financial instruments are hybrid securities that contain embedded derivatives as defined under Statements of Financial Accounting Standards (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities. We adopted SFAS No. 133 in 2001. Under SFAS No. 133, we bifurcated the embedded derivative and recorded it at fair value, with changes in value recognized in realized investment gains and losses. We continued to account for the remainder of the security at amortized cost, with changes in value recognized in other comprehensive income.

On January 1, 2007, we adopted SFAS No. 155, Accounting for Certain Hybrid Financial Instruments, which allows us to account for the entire hybrid financial instrument at fair value, with changes in the fair value recognized in realized investment gains and losses rather than unrealized investment gains and losses. We elected the fair value option for hybrid financial instruments to simplify our reporting, to address cost-benefit considerations and to have a consistent and reliable fair value. Our transition adjustment increased retained earnings by $5 million, reducing accumulated other comprehensive income by the same amount. The transition adjustment was comprised of $12 million of gross realized investment gains and $4 million of gross realized investment losses before tax.

SFAS No. 157, Fair Value Measurements

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The provisions of SFAS No. 157 are effective for financial statements issued for fiscal years beginning after November 15, 2007, and for interim periods within those fiscal years. We currently are evaluating the impact of this statement on our financial position.

SFAS No. 159, Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, which is effective for fiscal years beginning after November 15, 2007. This statement permits an entity to choose to measure many financial instruments and certain other items at fair value at specified election dates. Subsequent unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. We are currently evaluating the potential impact of this statement on our financial position.

Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of SFAS No. 109

We adopted the provisions of FIN 48 on January 1, 2007. As a result, we recorded a charge of approximately $300,000 to the January 1, 2007, retained earnings. As of the adoption date, we had a gross unrecognized tax benefit (FIN 48 liability) of $24.8 million. There was no change to the FIN 48 liability for the three and

six months ended June 30, 2007. The FIN 48 liability is carried in other liabilities in the condensed consolidated balance sheet as of June 30, 2007. Of the total $24.8 million FIN 48 liability, an immaterial amount would affect the effective tax rate, if recognized. Although no penalties currently are accrued, if incurred, they would be recognized as a component of income tax expense. Any interest recognized is classified in the condensed consolidated statements of income as an offset to investment income. The accrued interest liability was $2.5 million and $3.2 million as of January 1, 2007, and June 30, 2007, respectively.

The Internal Revenue Service has concluded the examination phase of its audit for our 2002, 2003 and 2004 tax years. Unresolved issues for these years have been referred to the Appeals Office of the Internal Revenue Service. It is reasonably possible that a change in the unrecognized tax benefits may occur once settlement of issues has occurred. At this time, we can neither estimate a date for settlement nor quantify an estimated range for the change of unrecognized tax benefits.

In addition to filings with the Internal Revenue Service, we file income tax returns in various state jurisdictions. Ohio, Illinois and Florida are states where we pay a material amount of income tax. Our income tax filings currently are not under examination by any state although tax years 2003 and later remain open for examination.

SOP 05-1, Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts

SOP 05-1 defines an internal replacement as a modification in product benefits, features, rights or coverages that occurs by the exchange of a contract for a new contract; or by amendment, endorsement or rider to a contract; or by the election of a feature or coverage within a contract. Internal replacement contracts are those that are substantially changed from the replaced contract and are accounted for as an extinguishment of the replaced contract. Nonintegrated contract features are accounted for as separately issued contracts. Modifications resulting from the election of a feature or coverage within a contract or from an integrated contract feature generally do not result in an internal replacement contract subject to SOP 05-1 provided certain conditions are met. The provisions of SOP 05-1 were effective January 1, 2007, and did not have a material impact on our results of operations or financial position.

Subsequent Events

Credit line On July 2, 2007, Cincinnati Financial Corporation entered into an unsecured revolving credit facility that is administered by The Huntington National Bank and matures on July 2, 2012. We intend to use the $150 million revolving line of credit for general corporate purposes. The line also includes a swing line sub facility for same day borrowing in the amount of $35 million. The credit agreement provides alternative interest charges based on the type of borrowing and our debt rating. The interest rate charged for an advance is adjusted LIBOR plus the applicable margin. Based on our current debt ratings, interest for Eurodollar rate advances is adjusted LIBOR plus 29 basis points, and for floating rate advances is adjusted LIBOR. Utilization and commitment fees based on our current debt rating are 5 basis points and 7 basis points, respectively. CFC Investment Company, a subsidiary of Cincinnati Financial Corporation, is a co-borrower under the agreement.

NOTE 2 Investments

Fixed maturities (bonds and redeemable preferred stocks), equity securities (common and non-redeemable preferred stocks) and short-term investments have been classified as available for sale and are stated at fair values at June 30, 2007, and December 31, 2006.

At June 30, 2007, unrealized investment gains before taxes in the investment portfolio totaled $4.809 billion and unrealized investment losses before taxes amounted to $122 million. The unrealized gains primarily were due to our long-term holdings of Fifth Third Bancorp (NASDAQ:FITB) common stock, which constituted 56.3 percent of total unrealized gains, and from our other common stock holdings, including ExxonMobil (NYSE:XOM), The Procter & Gamble Company (NYSE:PG) and PNC Financial Services Group (NYSE:PNC), each of which constituted at least 5 percent of total unrealized gains.

The change in unrealized gains and losses on investments, net of taxes, described in the following table, is included in shareholders equity as accumulated other comprehensive income. During the three and six months ended June 30, 2007, we recognized $3 million and $4 million in realized investment gains and losses related to current period changes in valuation of our hybrid securities. At June 30, 2007, we had $192 million of hybrid securities included in fixed maturities that now are accounted for under SFAS No. 155.

The change in fixed maturities unrealized gains and losses for the three and six months ended June 30, 2007 and 2006, was due primarily to interest-rate driven fair value fluctuations in the fixed maturity portfolio.

Equity securities unrealized gains declined for the three and six months ended June 30, 2007, primarily because of the sale of common stock holdings.

Equity securities unrealized gains declined for the three months ended June 30, 2006, primarily because of the decline in Fifth Third s market value. Equity securities unrealized gains declined for the six months ended June 30, 2006, primarily because of the sale of our holdings of ALLTEL Corporation (NYSE:AT) common stock, which was completed in January 2006.

(In millions)	Three months ended June 30, 2007	Three months ended June 30, 2006	Six months ended June 30, 2007	Six months ended June 30, 2006
Change in unrealized investment gains and losses and other summary:				
Fixed maturities	**$ (100)**	$ (82)	**$ (90)**	$ (160)
Equity securities	**(178)**	(258)	**(471)**	(681)
Adjustment to deferred acquisition costs and life policy reserves	**3**	3	**2**	6
Pension funded status	**1**	0	**1**	0
Other	**(4)**	0	**1**	1
Income taxes on above	**98**	118	**196**	303
Total	**$ (180)**	$ (219)	**$ (361)**	$ (531)

Realized gains and losses on investments are recognized in net income on a specific identification basis. See our 2006 Annual Report on Form 10-K, Item 1, Investments Segment, Page 14, for additional discussion of the investment portfolio. Other-than-temporary declines in the fair value of investments are recognized in net income as realized investment losses at the time when facts and circumstances indicate such write-downs are warranted.

Securities Lending Program

We participate in a securities lending program under which certain fixed maturities from our investment portfolio are loaned to other institutions for short periods of time. We require cash collateral in excess of the market value of the loaned securities. The collateral is invested in accordance with our guidelines in high-quality, short-duration instruments to generate additional investment income. The market value of the loaned securities is monitored on a daily basis and additional collateral is added or refunded as the market value of the loaned securities changes. The securities lending collateral is recognized as an asset, and classified as securities lending collateral, with a corresponding liability for the obligation to return the collateral.

We maintain the right and ability to redeem the securities loaned on short notice and continue to earn interest on the securities. We maintain effective control over the securities loaned, which are classified as invested assets on our consolidated balance sheets. At June 30, 2007, we had fixed maturities with a market value of $957 million on loan, with collateral held of $976 million. Interest income on collateral, net of fees, was $301,000 and $543,000 in the three and six months ended June 30, 2007, versus $152,000 and $275,000 in the comparable 2006 periods.

NOTE 3 Reinsurance

In the accompanying condensed consolidated statements of income, property casualty earned premiums and insurance losses consisted of the following:

(In millions)	Three months ended June 30, 2007	Three months ended June 30, 2006	Six months ended June 30, 2007	Six months ended June 30, 2006
Direct earned premiums	**$ 825**	$ 824	**$ 1,646**	$ 1,634
Assumed earned premiums	**5**	4	**11**	10
Ceded earned premiums	**(43)**	(35)	**(86)**	(73)

Net earned premiums	**$ 787**	$ 793	**$ 1,571**	$ 1,571
Direct incurred loss and loss expenses	**$ 501**	$ 544	**$ 978**	$ 1,034
Assumed incurred loss and loss expenses	**2**	3	**4**	7
Ceded incurred loss and loss expenses	**(48)**	(28)	**(69)**	(51)
Net incurred loss and loss expenses	**$ 455**	$ 519	**$ 913**	$ 990

For the three and six months ended June 30, 2007, direct earned premiums grew, while net earned premiums were flat or down slightly because the change in our reinsurance programs caused ceded earned premiums to increase. Direct losses and policyholder benefits declined because of the lower level of catastrophe losses. Ceded incurred loss and loss expenses were up from the comparable 2006 periods because of a single large commercial casualty loss.

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NOTE 4 Pension Plan

The measurement date for the company s pension plan is December 31. The following summarizes the components of net periodic costs for our qualified and supplemental pension plans:

(In millions)	Three months ended June 30, 2007	Three months ended June 30, 2006	Six months ended June 30, 2007	Six months ended June 30, 2006
Service cost	**$ 4**	$ 4	**$ 8**	$ 8
Interest cost	**4**	3	**8**	6
Expected return on plan assets	**(4)**	(3)	**(7)**	(6)
Amortization of actuarial gain, prior service cost and transition asset	**1**	1	**1**	1
Net periodic benefit cost	**$ 5**	$ 5	**$ 10**	$ 9

In the second quarter of 2007 we made a corrective contribution to the pension plan of $1 million, related to investment management fees and attributable earnings. We plan to contribute $9 million during the third quarter of 2007.

NOTE 5 Equity Compensation Plans

We currently have six equity compensation plans that together permit us to grant incentive stock options, non-qualified stock options, restricted stock, restricted stock units, stock appreciation rights and other stock-based awards. The 2006 Stock Compensation Plan also gives us the flexibility to make grants to associates of any type of stock-based awards subject to performance-based criteria to directly link compensation to performance. We currently grant incentive stock options, non-qualified stock options, restricted stock units and performance-based restricted stock units under our plans. One of our equity compensation plans permits us to grant common stock to our outside directors as discussed in our 2007 Proxy Statement.

A total of 22,237,750 shares is authorized to be granted under the plans. At June 30, 2007, 10,502,851 shares were available for future issuance under the plans. We currently issue new shares for option exercises.

Our pre-tax and after-tax share-based compensation costs are summarized below:

(In millions)	Three months ended June 30, 2007	Three months ended June 30, 2006	Six months ended June 30, 2007	Six months ended June 30, 2006
Share-based compensation cost	**$ 3**	$ 4	**$ 8**	$ 11
Income tax benefit	**1**	1	**2**	3
Share-based compensation cost after tax	**$ 2**	$ 3	**$ 6**	$ 8

Stock Options

Stock options are granted to associates at an exercise price that is not less than fair market value on the date of grant and are exercisable over 10 year periods. The stock options generally vest ratably over a three-year period. In determining the share-based compensation amounts for 2007, the fair value of each option granted in 2007 was estimated on the date of grant using the binomial option-pricing model with the following weighted average assumptions used for grants in 2007:

	Six months ended June 30, 2007	Six months ended June 30, 2006

Weighted average expected term	**5-7 years**	5-7 years
Expected volatility	**18.29- 24.14%**	20.25 - 27.12%
Dividend yield	**3.33%**	3.22%
Risk-free rates	**4.8-4.81%**	4.5-4.61%

As of June 30, 2007, there was $20 million of unrecognized compensation cost related to non-vested awards, which is expected to be recognized over a weighted average period of 2 years.

Here is a summary of option information:

(Dollars in millions, shares in thousands)	Shares	Weighted-average exercise price	Aggregate intrinsic value
2007			
Outstanding at beginning of year	**10,667**	**$36.03**	
Granted/reinstated	**582**	**44.79**	
Exercised	**(401)**	**27.52**	
Forfeited/revoked	**(73)**	**39.38**	
Outstanding at end of period	**10,775**	**36.79**	**$ 74**
Options exercisable at end of period	**8,875**	$**35.19**	**$ 74**
Weighted-average fair value of options granted during the period		**9.43**	

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(Shares in thousands)

	Options outstanding			Options exercisable	
Range of exercise prices	Shares	Weighted-average remaining contractual life	Weighted-average exercise price	Shares	Weighted-average exercise price
$20.00 to $24.99	2	0.15 yrs	$ 24.14	2	$ 24.14
$25.00 to $29.99	870	2.53 yrs	27.06	870	27.06
$30.00 to $34.99	4,447	3.71 yrs	32.68	4,447	32.68
$35.00 to $39.99	1,906	4.85 yrs	38.45	1,906	38.45
$40.00 to $44.99	2,237	7.23 yrs	42.38	1,203	41.52
$45.00 to $49.99	1,313	8.55 yrs	45.26	447	45.26
Total	10,775	5.14 yrs	36.79	8,875	35.19

Restricted Stock Units

In January 2007, the compensation committee granted service-based and performance-based restricted stock units. The service-based restricted stock units will vest at the end of the three-year vesting period. The performance-based restricted stock units granted in 2007 will vest on March 1, 2010, if certain performance targets are attained. As of June 30, 2007, management assumed for accounting purposes that performance targets used for the 2007 awards would be met, which resulted in the inclusion of costs for these awards in share-based compensation for the three and six months ended June 30, 2007.

The fair value of the restricted stock unit awards was determined based on the fair value on the date of grant less the present value of the dividends that holders of restricted stock units will not receive on the restricted stock units during the vesting period.

Restricted stock unit awards in 2007 were:

(Shares in thousands)	Service-based nonvested shares	Weighted-average grant date fair value	Performance-based nonvested shares	Weighted-average grant date fair value
Nonvested at January 1, 2007	0	$ 0.00	0	$ 0.00
Granted	168	40.74	35	40.74
Vested	0	0.00	0	0.00
Forfeited	(3)	40.74	0	0.00
Nonvested at June 30, 2007	165	40.74	35	40.74

NOTE 6 Commitments And Contingent Liabilities

Legal issues are part of the normal course of business for all companies. As such, we have various litigation and claims against us in process and pending. Having analyzed our current understanding of the facts and circumstances of those claims with our legal counsel, we believe the outcomes of normal insurance matters will not have a material effect on our consolidated financial position, results of operations or cash flows. We further believe that the outcomes of non-insurance matters will be covered by insurance coverage or will not have a material effect on our consolidated financial position, results of operations or cash flows.

NOTE 7 Segment Information

We operate primarily in two industries, property casualty insurance and life insurance. We regularly review four different reporting segments to make decisions about allocating resources and assessing performance:

- Commercial lines property casualty insurance
- Personal lines property casualty insurance
- Life insurance
- Investment operations

We report as Other the non-investment operations of the parent company and its subsidiaries CFC Investment Company and CinFin Capital Management Company (excluding client investment activities), as well as other income of our insurance subsidiary. See our 2006 Annual Report on Form 10-K for a description of revenue, income or loss before income taxes and identifiable assets for each segment.

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Segment information is summarized in the following table:

(In millions)	Three months ended June 30, 2007	Three months ended June 30, 2006	Six months ended June 30, 2007	Six months ended June 30, 2006
Revenues:				
Commercial lines insurance				
Commercial casualty	**$ 209**	$ 208	**$ 418**	$ 405
Commercial property	**125**	123	**248**	244
Commercial auto	**110**	112	**223**	224
Workers compensation	**95**	90	**187**	178
Specialty packages	**37**	35	**73**	71
Surety and executive risk	**24**	24	**47**	45
Machinery and equipment	**7**	7	**14**	14
Total commercial lines insurance	**607**	599	**1,210**	1,181
Personal lines insurance				
Personal auto	**86**	98	**174**	199
Homeowner	**72**	74	**144**	146
Other personal lines	**22**	22	**43**	45
Total personal lines insurance	**180**	194	**361**	390
Life insurance	**36**	30	**68**	58
Investment operations	**443**	154	**653**	952
Other	**4**	4	**9**	7
Total	**$ 1,270**	$ 981	**$ 2,301**	$ 2,588
Income (loss) before income taxes:				
Insurance underwriting results:				
Commercial lines insurance	**$ 90**	$ 58	**$ 157**	$ 114
Personal lines insurance	**0**	(15)	**14**	(8)
Life insurance	**0**	2	**5**	2
Investment operations	**429**	141	**625**	925
Other	**(11)**	(11)	**(22)**	(24)
Total	**$ 508**	$ 175	**$ 779**	$ 1,009

	June 30, 2007	December 2006

Identifiable assets:		
Property casualty insurance	**$ 2,288**	$ 2,220
Life insurance	**945**	886
Investment operations	**13,766**	13,820
Other	**1,265**	296
Total	**$ 18,264**	$ 17,222

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion highlights significant factors influencing the consolidated results of operations and financial position of Cincinnati Financial Corporation (CFC). It should be read in conjunction with the consolidated financial statements and related notes included in our 2006 Annual Report on Form 10-K. Unless otherwise noted, A.M. Best Co., a leading insurance industry statistical, analytical and financial strength rating organization, is the source of industry data. Data from A.M. Best is presented on a statutory basis. When we provide our results on a comparable statutory basis, we label it as such; all other company data is presented on a GAAP basis.

We present per share data on a diluted basis unless otherwise noted, adjusting those amounts for all stock splits and dividends. Dollar amounts are rounded to millions; calculations of percent changes are based on whole dollar amounts or dollar amounts rounded to the nearest thousand.

Safe Harbor Statement

This is our Safe Harbor statement under the Private Securities Litigation Reform Act of 1995. Our business is subject to certain risks and uncertainties that may cause actual results to differ materially from those suggested by the forward-looking statements in this report. Some of those risks and uncertainties are discussed in our 2006 Annual Report on Form 10-K, Item 1A, Risk Factors, Page 20. Although we often review or update our forward-looking statements when events warrant, we caution our readers that we undertake no obligation to do so.

Factors that could cause or contribute to such differences include, but are not limited to:

- Unusually high levels of catastrophe losses due to risk concentrations, changes in weather patterns, environmental events, terrorism incidents or other causes

- Increased frequency and/or severity of claims

- Inaccurate estimates or assumptions used for critical accounting estimates

- Events or actions, including unauthorized intentional circumvention of controls, that reduce the company s future ability to maintain effective internal control over financial reporting under the Sarbanes-Oxley Act of 2002

- Changing consumer buying habits and consolidation of independent insurance agencies that could alter our competitive advantages

- Events or conditions that could weaken or harm the company s relationships with its independent agencies and hamper opportunities to add new agencies, resulting in limitations on the company s opportunities for growth, such as:
  - o Downgrade of the company s financial strength ratings
  - o Concerns that doing business with the company is too difficult or
  - o Perceptions that the company s level of service, particularly claims service, is no longer a distinguishing characteristic in the marketplace
- Delays or inadequacies in the development, implementation, performance and benefits of technology projects and enhancements

- Ability to obtain adequate reinsurance on acceptable terms, amount of reinsurance purchased, financial strength of reinsurers and the potential for non-payment or delay in payment by reinsurers

- Increased competition that could result in a significant reduction in the company s premium growth rate

- Underwriting and pricing methods adopted by competitors that could allow them to identify and flexibly price risks, which could decrease our competitive advantages

Personal lines pricing and loss trends that lead management to conclude that this segment could not attain sustainable profitability, which could prevent the capitalization of policy acquisition costs

Actions of insurance departments, state attorneys general or other regulatory agencies that:

- Restrict our ability to exit or reduce writings of unprofitable coverages or lines of business
- Place the insurance industry under greater regulatory scrutiny or result in new statutes, rules and regulations
- Increase our expenses

- o Add assessments for guaranty funds, other insurance related assessments or mandatory reinsurance arrangements; or that impair our ability to recover such assessments through future surcharges or other rate changes
- o Limit our ability to set fair, adequate and reasonable rates
- o Place us at a disadvantage in the marketplace or
- o Restrict our ability to execute our business model, including the way we compensate agents

Sustained decline in overall stock market values negatively affecting the company s equity portfolio and book value; in particular a sustained decline in the market value of Fifth Third shares, a significant equity holding

Recession or other economic conditions or regulatory, accounting or tax changes resulting in lower demand for insurance products

Events, such as the sub-prime mortgage lending crisis, that lead to a significant decline in the value of a particular security or group of securities and impairment of the asset(s)

Prolonged low interest rate environment or other factors that limit the company s ability to generate growth in investment income or interest-rate fluctuations that result in declining values of fixed-maturity investments

Adverse outcomes from litigation or administrative proceedings

Investment activities or market value fluctuations that trigger restrictions applicable to the parent company under the Investment Company Act of 1940

Events, such as an epidemic, natural catastrophe, terrorism or construction delays, that could hamper our ability to assemble our workforce at our headquarters location

Further, the company s insurance businesses are subject to the effects of changing social, economic and regulatory environments. Public and regulatory initiatives have included efforts to adversely influence and restrict premium rates, restrict the ability to cancel policies, impose underwriting standards and expand overall regulation. The company also is subject to public and regulatory initiatives that can affect the market value for its common stock, such as recent measures affecting corporate financial reporting and governance. The ultimate changes and eventual effects, if any, of these initiatives are uncertain.

Introduction

Corporate Financial Highlights

Income Statement and Per Share Data

	Three months ended June 30,			Six months ended June 30,		
(Dollars in millions except share data)	**2007**	2006	Change %	**2007**	2006	Change %
Income statement data						
Earned premiums	**$ 822**	$ 822	(0.1)	**$ 1,637**	$ 1,627	0.6
Investment income, net of expenses	**150**	143	5.0	**298**	281	6.1
Realized investment gains and losses (pretax)	**293**	11	2,482.0	**355**	671	(47.2)
Total revenues	**1,270**	981	29.4	**2,301**	2,588	(11.1)
Net income	**351**	132	164.7	**545**	684	(20.4)

Per share data (diluted)						
Net income	**2.02**	0.76	165.8	**3.13**	3.90	(19.7)
Cash dividends declared	**0.355**	0.335	6.0	**0.710**	0.670	6.0
Weighted average shares outstanding	**173,423,572**	175,022,367	(0.9)	**173,871,612**	175,615,017	(1.0)

For the three and six months ended June 30, 2007, two of the primary drivers of total revenues consolidated property casualty written premiums and pretax investment income - were at levels that caused us to modestly lower our full-year 2007 targets for these measures. We discuss these changes in Measuring Our Success in 2007 and Beyond, Page 16. Below we discuss the third component of revenues, realized investment gains and losses.

For the three months ended June 30, 2007, the proceeds from the sale of certain significant equity holdings led to an increase in realized investment gains. Higher realized investment gains were the primary reason for the increase in revenues, net income and net income per share for the three month period. We discuss the equity sales in Investments Results of Operations, Page 30. Those sales raised realized investment gains and revenues for the three months ended June 30, 2007, by $283 million and net income and net income per share by $187 million, or $1.08 per share.

For the six months ended June 30, 2007, lower realized investment gains were the primary reason for the decline in revenues, net income and net income per share. Investment gains were below the year-ago period primarily because of the sale of our holdings of Alltel Corporation (NYSE:AT) common stock in the first

three months of 2006. That sale raised realized investment gains and revenues for the six months ended June 30, 2006, by $647 million and net income and net income per share by $412 million, or $2.34 per share.

Realized investment gains and losses are integral to our financial results over the long term, but we have substantial discretion in the timing of investment sales and, therefore, the gains or losses that will be recognized in any period. That discretion generally is independent of the insurance underwriting process. Also, applicable accounting standards require us to recognize gains and losses from certain changes in fair values of securities without actual realization of those gains and losses.

Net income per share for the three and six months ended June 30, 2007, benefited from declines in diluted weighted average shares outstanding from the year-earlier periods. Weighted average shares outstanding may fluctuate from period to period because we regularly repurchase shares under board authorizations, and we issue shares when associates exercise stock options.

The board of directors is committed to steadily increasing cash dividends and periodically authorizing stock dividends and splits. Cash dividends declared per share rose 6.0 percent in the three and six months ended June 30, 2007. The board also is committed to share repurchase. Although no shares were repurchased in the three months ended June 30, 2007, we purchased 1.49 million shares at a total cost of $64 million in the three months ended March 31, 2007. In the first six months of 2006, we repurchased 2 million shares at a cost of $88 million.

Balance Sheet Data and Performance Measures

(Dollars in millions except share data)	**At June 30, 2007**	At December 31, 2006
Balance sheet data		
Invested assets	**$13,712**	$ 13,759
Total assets	**18,264**	17,222
Short-term debt	**49**	49
Long-term debt	**791**	791
Shareholders equity	**6,826**	6,808
Book value per share	**39.74**	39.38
Debt-to-capital ratio	**11.0%**	11.0%

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	**2007**	2006
Performance measures				
Comprehensive income	$ **171**	$ (86)	$ **184**	$ 153
Return on equity, annualized	**20.7%**	8.6%	**16.0%**	22.5%
Return on equity, annualized, based on comprehensive income	**9.8**	(5.6)	**5.3**	5.1

Invested assets were slightly below the level at year-end 2006 primarily because of a decline in the market value of our equity portfolio. Total assets rose over the year-end 2006 level primarily because of the securities lending collateral asset of $976 million.

Comprehensive income is net income plus the year-over-year change in accumulated other comprehensive income. In the three months ended June 30, 2007, comprehensive income rose because of higher net income and reduced unrealized gains in the investment portfolio.

Return on equity was higher in the three months ended June 30, 2007, primarily because of the higher level of realized gains on investments. Return on equity was lower for the six-month period because realized gains on investments

were lower. Return on equity based on comprehensive income was higher in the three months ended June 30, 2007, because of higher net income and reduced unrealized gains in the investment portfolio.
Our ratio of long-term debt to capital (long-term debt plus shareholders equity) was essentially unchanged at June 30, 2007.

Property Casualty Highlights

	Three months ended June 30,			Six months ended June 30,		
(Dollars in millions)	**2007**	2006	Change %	**2007**	2006	Change %
Property casualty highlights						
Written premiums	**$ 810**	$ 814	(0.5)	**$1,656**	$1,643	0.8
Earned premiums	**787**	793	(0.8)	**1,571**	1,571	0.0
Underwriting profit	**90**	43	107.8	**171**	106	62.5
GAAP combined ratio	**88.6%**	94.5%		**89.1%**	93.3%	
Statutory combined ratio	**87.7**	93.7		**87.7**	91.7	

The trend in overall **written and earned premium** growth rates reflects the heightened competition as well as the competitive strategies we discussed in our 2006 Annual Report on Form 10-K, Item 1, Commercial Lines and Personal Lines Property Casualty Insurance Segments, Page 9 and Page 11.

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Our consolidated property casualty insurance **underwriting profit** rose for the three and six months ended June 30, 2007, primarily due to lower catastrophe losses. Our combined ratio reflected those trends. (The combined ratio is the percentage of each premium dollar incurred for claims plus all expenses the lower the ratio, the better the performance. An underwriting profit results when the combined ratio is under 100 percent. A combined ratio above 100 indicates that a carrier is paying out more in claims and expenses than it is collecting in premiums.)

Measuring Our Success in 2007 And Beyond

We use a variety of metrics to measure the success of our strategies:

Maintaining our strong relationships with our established agencies, writing a significant portion of each agency s business and attracting new agencies In 2007, we expect to continue to rank No. 1 or No. 2 by premium volume in approximately 75 percent or more of the locations that have marketed our products for more than five years.

We expect to improve service to our agencies by subdividing or creating four field territories in 2007. At June 30, 2007, we had 104 field marketing territories, up from 102 at the end of 2006 and 100 at the end of 2005. We continually study the regulatory and competitive environment in states where we could decide to actively market our property casualty products. In June 2007, we made our first agency appointment in eastern Washington state. We expect to appoint our first agency in New Mexico in the third quarter. We anticipate that agencies in these states will begin actively marketing our products in the third quarter of 2007.

At June 30, 2007, our 1,072 agency relationships had 1,297 reporting agency locations marketing our insurance products, compared with 1,066 agency relationships with 1,289 reporting agency locations at year-end 2006. We also seek to increase overall premiums by expanding our agency force within our current marketing territories. Our objective is to appoint approximately 55 to 60 additional sales offices, or points of distribution, each year. During the first six months of 2007, we had a net increase of eight reporting agency locations. We made 29 new agency appointments during the period, including 22 that were new relationships. These were offset by changes in agency structures and the cancellation of nine agency relationships. We are very careful to protect the franchise for current agencies when selecting and appointing new agencies.

In 2007, we expect to make further progress in our efforts to improve service to and communication with our agencies through our expanding portfolio of software. We discuss our technology plans for 2007 in our 2006 Annual Report on Form 10-K, Item 1, Technology Solutions, Page 4. Recent activities include:

o Commercial Lines Technology WinCPP® is our commercial lines premium quoting system. WinCPP is available in all of our agency locations in 32 of the 33 states in which we actively market insurance and provides quoting capabilities for nearly 100 percent of our new and renewal commercial lines business. We have introduced agency interface technology for WinCPP: CinciBridge allows automated movement of key underwriting data from an agent s management system to WinCPP, reducing agents data entry and allowing seamless quoting and rating capabilities.

  e-CLAS® is our Web-based policy processing system. e-CLAS now is available in 11 states representing 57 percent of our Businessowner Policies (BOP) and Dentist s Package Policies (DBOP) premiums, which are part of the Specialty Packages commercial line of business. During 2007, we expect to roll out e-CLAS to additional states for these policy types. CinciBridge agency interface technology also has been rolled out in all states using e-CLAS.

  To respond to agency needs, we have begun a project to allow agencies to select direct bill as an option for policyholders. Our first step will be to make the direct bill option available for policies issued through e-CLAS by year-end 2007.

iView is our commercial lines policy imaging and workflow system. At June 30, 2007, 80 percent of non-workers compensation commercial lines policy files are administered and stored electronically in iView. We expect more than 90 percent of non-workers compensation commercial lines policy files to be stored in iView by year-end 2007.

- Personal Lines Technology Diamond, our personal lines policy processing system, now is available in 16 states representing approximately 97 percent of our personal lines premium volume. Roll out to Arkansas is planned for later this year and to additional states next year.

  In 2006, we introduced PL-efiles, a policy imaging system, to our personal lines operations. Through June 30, 2007, we had transitioned more than 45 percent of our Diamond personal lines files to PL-efiles.

- Claims Technology CMS is our claims file management system used by our claims associates. Agency access to selected CMS information is planned for 2007.

- o Surety and Executive Risk Technology CinciBond® is an automated system to process license and permit surety bonds. It has been introduced to agents in 10 states representing 803 agency reporting locations. In 2007, we will roll out CinciBond to additional states and, in 2008, we will add other surety bond types.

Over the years, we have been able to increase our share of our agencies business by making available insurance products that meet the needs of the individuals and businesses in their communities. In recent years, our agents have indicated their desire to have Cincinnati available as a market for commercial accounts that require the flexibility of excess and surplus lines coverage.

Generally, excess and surplus lines insurance carriers provide insurance that is unavailable to businesses in the standard market due to market conditions or due to characteristics of the insured that are caused by nature, the insured s history or the nature of the insured s business.

We believe excess and surplus lines will contribute to our long-term objectives. Among the potential benefits, we would gain opportunities to compete for additional accounts by having more flexibility in pricing and policy terms and conditions.

In the first half of 2007, we completed the due diligence necessary to enter the excess and surplus lines market, meeting with business partners and regulators in various states. In the third quarter, we will be filing the necessary applications in Delaware for incorporation of a new subsidiary, to be named The Cincinnati Specialty Underwriters Insurance Company. At the same time, we will be forming a wholly owned brokerage subsidiary that will provide exclusive access for our independent agencies to our excess and surplus lines products. Our interdepartmental team is identifying the excess and surplus lines and classes of business that we will target, developing underwriting guidelines and establishing rate ranges for this business. The team also has selected a policy administration system and begun the process of hiring additional, experienced staff. We continue to target roll out to our independent agencies and the first contributions to premiums in 2008.

Achieving above-industry-average growth in property casualty statutory net written premiums and maintaining industry-leading profitability by leveraging our regional franchise and proven agency-centered business strategy Considering market conditions and results for the first six months of 2007, we are revising our full-year 2007 property casualty growth and profitability targets.

Written premiums We now believe our 2007 consolidated property casualty written premiums may be unchanged from 2006. We had previously estimated that written premium growth would be in the low single digits in 2007. Net written premiums rose 0.8 percent in the first six months of 2007 and 3.3 percent for full-year 2006.

Legislative and regulatory developments continue in 2007 to add to the uncertainty that already exists for the insurance industry in Florida. We are not seeking new policyholder relationships from our Florida agencies. This status, which extends to most of our lines of property casualty insurance, may result in lower 2007 growth. We have resumed excluding wind coverage from policies located within the Florida wind pool area. This permits us to reduce our exposure to hurricane catastrophe losses for those risks located closest to the coast, in accordance with Florida rules and regulations. We hope the Florida insurance environment will improve so that we may resume writing all lines of new business from our Florida agencies. We will continue to monitor Florida s insurance environment for signs of improvement.

Overall industry premiums are projected to be flat in 2007. Net written premiums for the commercial lines industry are expected to decline 1.0 percent in 2007; the personal lines sector is expected to grow 1.2 percent; and the reinsurance sector is expected to grow 18.6 percent.

Combined ratio We now believe that the full-year 2007 combined ratio could be at or below 95 percent on either a GAAP or statutory basis, below our previous estimate of a combined ratio at or below 97 percent. The GAAP combined ratio was 89.1 percent in the first six months of 2007 and 94.3 percent for full-year 2006. Our revised target reflects four assumptions:

- Catastrophe losses contributing up to 4.5 percentage points to the combined ratio, down from our previous assumption of 5.0 percent. We think this is an appropriate estimate based on our reinsurance treaty retention and catastrophe loss experience in recent years. During July 2007, we had no material catastrophe loss activity.
- Savings from favorable reserve development slightly above our historical norms. Savings from favorable development on prior period reserves averaged about 2 percentage points between 2000 and 2003. Between 2004 and 2006, the average rose to approximately 5 percentage points.
- Loss ratio deterioration as pricing becomes even more competitive and loss severity increases.
- Higher other underwriting expenses as we continue to invest in people and technology. We believe the consolidated property casualty 2007 underwriting expense ratio could be approximately 31.5 percent.

A.M. Best projected industry average 2007 combined ratio would be 96.8 percent. They estimated that the first-quarter commercial lines industry combined ratio was 90.4 percent, the personal lines sector ratio was 94.5 percent and the reinsurance sector ratio was 89.3 percent.

Pursuing a total return investment strategy that generates both strong investment income growth and capital appreciation Taking results for the first six months of 2007 into consideration, we also are revising our full-year 2007 investment income growth target. In 2007, we now are estimating pretax investment income growth of approximately 6 percent. We previously had estimated it would be in the range of 6.5 percent to 7.0 percent. We are lowering our target because of the mix of fixed-maturity investments we are purchasing. In recent years, a growing percentage of our fixed-maturity investments have been in tax-advantaged bonds, such as municipal bonds, which have a lower gross yield than taxable bonds.

We do not establish annual capital appreciation targets. Over the long term, our target is to have the equity portfolio outperform the Standard & Poor s 500 Index, a common benchmark of market performance. In the first six months of 2007, our equity portfolio s total return was 0.3 percent compared with a 7.0 percent return for the Index. Over the five years ended June 30, 2007, our compound annual equity portfolio return was 1.4 percent compared with 10.7 percent for the Index. Our equity portfolio performance reflected the decline in the market value of our holdings of Fifth Third common stock, which generated a negative annualized return of 7.0 percent for the five-year period ended June 30, 2007.

Increasing the total return to shareholders through a combination of higher earnings per share, growth in book value and increasing dividends We do not announce annual targets for earnings per share or book value. Over the long term, we look for our earnings per share growth to outpace that of a peer group of national and regional property casualty insurance companies. Long-term book value growth should exceed that of our equity portfolio.

The board of directors is committed to steadily increasing cash dividends and periodically authorizing stock dividends and splits. In February 2007, the board increased the indicated annual dividend rate 6.0 percent, marking the 47th consecutive year of increases in our indicated dividend rate. We believe our record of dividend increases is matched by only 11 other publicly traded corporations.

Over the long term, we seek to increase earnings per share, book value and dividends at a rate that would allow total return to our shareholders to exceed that of the Standard & Poor s Composite 1500 Property Casualty Insurance Index. Over the 2002 to 2006 period, our total return to shareholders of 49.4 percent was below the 71.4 percent return for that Index.

Maintaining financial strength by keeping the ratio of debt to capital below 15 percent and purchasing reinsurance to provide investment flexibility Based on our present capital requirements, we do not anticipate a material increase in debt levels during 2007. As a result, we believe our debt-to-capital ratio will remain approximately 11 percent. We discuss our outstanding debt in Capital Resources, Page 33.

In December 2006, we finalized our property casualty reinsurance program for 2007, updating it to maintain the balance between the cost of the program and the level of risk we retain. Under the new program, our 2007 reinsurance premiums are expected to be approximately $22 million higher than in 2006. We provide more detail on our reinsurance programs in our 2006 Annual Report on Form 10-K, Item 7, 2007 Reinsurance Programs, Page 69. For the first six months of 2007, the increase in premiums we are paying for reinsurance lowered consolidated property casualty written premium growth rate by approximately 0.5 percentage points.

Our property casualty and life operations are awarded insurer financial strength ratings. These ratings assess an insurer s ability to meet its financial obligations to policyholders and do not necessarily address matters that may be important to shareholders.

As of August 7, 2007, our financial strength ratings were unchanged from those reported in our 2006 Annual Report on Form 10-K.

	Parent Company Senior Debt Rating	Property Casualty Insurance Subsidiaries Financial Strength Ratings			Life Insurance Subsidiary Financial Strength Ratings			Outlook
				Rating Tier			Rating Tier	
A. M. Best Co.	aa-	A++	Superior	1 of 16	A+	Superior	2 of 16	Stable
Fitch Ratings	A+	AA	Very Strong	4 of 21	AA	Very Strong	4 of 21	Stable
Moody s Investors Services	A2	Aa3	Excellent	4 of 12	na	na	na	Stable
Standard & Poor s Ratings Services	A	AA-	Very Strong	4 of 21	AA-	Very Strong	4 of 21	Stable

Two of the ratings organizations affirmed the company s ratings since our Quarterly Report on Form 10-Q for the period ended March 31, 2007:

- On May 21, 2007, A.M. Best affirmed its A++ (Superior) financial strength rating for The Cincinnati Insurance Companies property casualty group and its A+ (Superior) rating for The Cincinnati Life Insurance Company. A.M. Best also affirmed its issuer credit ratings of aa+ for the property casualty group, aa- for senior debt of parent Cincinnati Financial Corporation and aa- for the life insurance subsidiary.

- On July 23, 2007, Standard & Poor s Ratings Services affirmed the AA- (Very Strong) financial strength ratings of each of our insurance companies and Cincinnati Financial s counterparty credit rating of A (Strong), all with a stable outlook.

We believe that our property catastrophe reinsurance program provides adequate protection for large loss events. Our strong capital position would allow the payment of claims if an event exceeded our reinsurance program. Currently participating on our property per risk and casualty per-occurrence programs are Hannover Reinsurance Company, Munich Reinsurance America, Partner Reinsurance Company of the U.S. and Swiss Reinsurance America Corporation and its subsidiaries, all of which have A.M. Best insurer financial strength ratings of A (Excellent) or A+ (Superior).

Statutory surplus for our property casualty insurance subsidiary was $4.937 billion at June 30, 2007, compared with $4.750 billion at December 31, 2006. The ratio of the property casualty subsidiary s common stock to statutory surplus was 90.9 percent at June 30, 2007, compared with 96.7 percent at year-end. Life statutory surplus was $491 million at June 30, 2007, compared with $479 million at December 31, 2006. The ratio of the life insurance subsidiary s common stock to statutory adjusted capital and surplus was 77.4 percent at June 30, 2007, compared with 88.8 percent at year-end.

Factors supporting our outlook for 2007 are discussed below in the Results of Operations for each of the four business segments.

Results of Operations

The consolidated results of operations reflect the operating results of each of our four segments along with the parent company and other non-insurance activities. The four segments are:

Commercial lines property casualty insurance
Personal lines property casualty insurance
Life insurance
Investments operations

See Item 1, Note 7 of the Condensed Consolidated Financial Statements, Page 11, for discussion of the calculations of segment data. The following sections review results of operations for each of the four segments.

Consolidated Property Casualty Insurance Results of Operations

	Three months ended June 30,			Six months ended June 30,		
(Dollars in millions)	**2007**	2006	Change %	**2007**	2006	Change %
Written premiums	**$ 810**	$ 814	(0.5)	**$ 1,656**	$ 1,643	0.8
Earned premiums	**$ 787**	$ 793	(0.8)	**$ 1,571**	$ 1,571	0.0
Loss and loss expenses excluding catastrophes	**444**	455	(2.3)	**898**	887	1.3
Catastrophe loss and loss expenses	**11**	64	(82.2)	**15**	103	(85.9)
Commission expenses	**151**	147	2.2	**312**	305	2.3
Underwriting expenses	**89**	79	11.5	**169**	162	4.1

Policyholder dividends	**2**	5	(50.3)	**6**	8	(31.4)
Underwriting profit	**$ 90**	$ 43	107.8	**$ 171**	$ 106	62.5
Ratios as a percent of earned premiums:						
Loss and loss expenses excluding catastrophes	**56.5%**	57.3%		**57.2%**	56.5%	
Catastrophe loss and loss expenses	**1.4**	8.0		**0.9**	6.5	
Loss and loss expenses	**57.9%**	65.3%		**58.1%**	63.0%	
Commission expenses	**19.2**	18.6		**19.8**	19.4	
Underwriting expenses	**11.2**	9.9		**10.8**	10.4	
Policyholder dividends	**0.3**	0.7		**0.4**	0.5	
Combined ratio	**88.6%**	94.5%		**89.1%**	93.3%	

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In addition to the factors discussed in our 2006 Annual Report on Form 10-K, Item 7, Commercial Lines and Personal Lines Insurance Results of Operations, Page 42 and Page 49, growth and profitability for the property casualty insurance operations were affected by:

New business written directly by agencies was $81 million in the three months ended June 30, 2007, compared with $94 million in the year ago period. New business written directly by agencies was $161 million in the six months ended June 30, 2007, compared with $170 million in the year ago period. New business levels reflected market conditions for commercial and personal lines as well as the advantages of our agency relationship strategy and changes made to our personal lines pricing in mid-2006.

Catastrophe losses contributed 1.4 percentage points to the combined ratio in the three months ended June 30, 2007, compared with 8.0 points in the comparable 2006 period. Catastrophe losses contributed 0.9 percentage points in the six months ended June 30, 2007, compared with 6.5 points a year ago. In the first six months of 2007, we incurred $32 million of pretax catastrophe losses caused by nine weather events during the period, mitigated by $17 million of reduced catastrophe loss estimates for prior years, in particular an October 2006 hail storm. The following table shows catastrophe losses incurred, net of reinsurance, for these periods as well as the effect of development on prior period catastrophes.

(In millions)			Three months ended June 30,			Six months ended June 30,		
Dates	Cause of loss	Region	Commercial lines	Personal lines	Total	Commercial lines	Personal lines	Total
2007								
Jan. 12-15	Wind, hail, ice, snow	Midwest	**$ 0**	**$ 0**	**$ 0**	**$ 3**	**$ 0**	**$ 3**
Feb. 14-15	Wind, hail, ice, snow	Mid-Atlantic	**0**	**0**	**0**	**2**	**1**	**3**
Feb. 23-25	Wind, hail, ice, snow	Midwest	**0**	**0**	**0**	**3**	**0**	**3**
Mar. 1-2	Wind, hail, flood	South	**0**	**(1)**	**(1)**	**6**	**1**	**7**
Apr. 13-16	Wind, hail, flood	Northeast	**2**	**2**	**4**	**2**	**2**	**4**
May 4-8	Wind, hail, flood	Midwest	**3**	**0**	**3**	**3**	**0**	**3**
May 21-24	Wind, hail, flood	Midwest, South	**1**	**0**	**1**	**1**	**0**	**1**
Jun. 7-9	Wind, hail, flood	Midwest	**2**	**3**	**5**	**2**	**3**	**5**
Jun. 20-22	Wind, hail	Midwest	**0**	**3**	**3**	**0**	**3**	**3**
Development on 2006 and prior catastrophes			**(3)**	**(1)**	**(4)**	**(6)**	**(11)**	**(17)**
Calendar year incurred total			**$ 5**	**$ 6**	**$ 11**	**$ 16**	**$ (1)**	**$ 15**
2006								
Mar. 11-13	Wind, hail	Midwest, Mid-Atlantic	$ (1)	$ 0	$ (1)	$ 27	$ 10	$ 37
Apr. 2-3	Wind, hail	Midwest, South	13	6	19	13	6	19
Apr. 6-8	Wind, hail, tornados	Midwest, South	10	17	27	10	17	27
Apr. 13-15	Wind, hail, tornados	Midwest	5	6	11	5	6	11
Apr. 23-25	Wind, hail	Midwest, South	2	1	3	2	1	3
Jun. 18-22	Wind, hail, flood	Midwest	4	2	6	4	2	6
Jun. 25-28	Wind, flood	Northeast	2	0	2	2	0	2
Development on 2005 and prior catastrophes			(1)	(2)	(3)	0	(2)	(2)
Calendar year incurred total			$ 34	$ 30	$ 64	$ 63	$ 40	$ 103

Savings from favorable development on prior period reserves reduced the combined ratio by a total of 5.6 percentage points in the three months ended June 30, 2007, and 4.8 percentage points in the six-month period, including 1.1 percentage points from $17 million of savings from favorable development on prior period catastrophe loss reserves. In the three months ended June 30, 2006, savings reduced the combined ratio by 2.2 percentage points, while reserve strengthening added 0.1 percentage points to the ratio in the six months ended June 30, 2006.

The discussions of property casualty insurance segments provide additional detail regarding these factors.

Commercial Lines Insurance Results of Operations

Overview

Performance highlights for the commercial lines segment include:

Premiums Our commercial lines written premiums rose 1.7 percent and 2.8 percent in the three and six months ended June 30, 2007, as competition in our markets continued to increase. We have been careful to maintain our underwriting discipline for both renewal and new business. Year-over-year premium comparisons also reflect higher reinsurance premiums. We believe that our written premium growth rate continues to exceed the average for the overall commercial lines industry.

New commercial lines business written directly by agencies declined 16.9 percent for the three months ended June 30, 2007, to $71 million from $86 million. New business declined 8.1 percent for the six months ended June 30, 2007, to $143 million from $156 million.

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A.M. Best estimated that industry commercial lines net written premiums would be flat in 2007 after rising approximately 1.0 percent in 2006. They estimated that industry commercial lines net written premiums declined 2.1 percent in the first three months of 2007.

Combined ratio Our commercial lines combined ratio improved in the three and six months ended June 30, 2007, primarily due to a significantly lower level of catastrophe losses. Savings from favorable development on prior period reserves rose in the three- and six-month periods. Higher commissions and other underwriting expenses offset a portion of the savings.

We continue to focus on sound underwriting fundamentals and seek to obtain adequate premiums per policy. On an ongoing basis, we monitor loss patterns and structure our products and our pricing accordingly. We discuss large losses and other factors affecting the combined ratio beginning on Page 22. We discuss reserve development for commercial lines of business below.

Our commercial lines statutory combined ratio was 84.4 percent and 85.4 percent in the three and six months ended June 30, 2007, compared with 89.6 percent and 90.8 percent in the comparable 2006 periods. Beginning in 2007, we are including stock option expense in the calculation of statutory income. By comparison, A.M. Best estimated the industry commercial lines combined ratio was 90.4 percent in the first three months of 2007. A.M. Best also estimated the industry commercial lines combined ratio would be approximately 98 percent in 2007, rising from approximately 94.3 percent in 2006.

Commercial Lines Results

	Three months ended June 30,			Six months ended June 30,		
(Dollars in millions)	**2007**	2006	Change %	**2007**	2006	Change %
Written premiums	**$ 613**	$ 603	1.7	**$ 1,306**	$ 1,271	2.8
Earned premiums	**$ 607**	$ 599	1.3	**$ 1,210**	$ 1,181	2.5
Loss and loss expenses excluding catastrophes	**330**	334	(1.1)	**673**	658	2.3
Catastrophe loss and loss expenses	**5**	34	(84.9)	**16**	63	(75.0)
Commission expenses	**112**	105	6.2	**235**	222	5.9
Underwriting expenses	**68**	63	5.6	**123**	116	5.7
Policyholder dividends	**2**	5	(50.3)	**6**	8	(31.4)
Underwriting profit	**$ 90**	$ 58	54.8	**$ 157**	$ 114	38.5
Ratios as a percent of earned premiums:						
Loss and loss expenses excluding catastrophes	**54.5%**	55.7%		**55.7%**	55.8%	
Catastrophe loss and loss expenses	**0.8**	5.6		**1.3**	5.3	
Loss and loss expenses	**55.3%**	61.3%		**57.0%**	61.1%	
Commission expenses	**18.5**	17.6		**19.4**	18.8	
Underwriting expenses	**11.0**	10.5		**10.2**	9.8	

Policyholder dividends	**0.4**	0.9	**0.4**	0.7
Combined ratio	**85.2%**	90.3%	**87.0%**	90.4%

Loss and Loss Expenses

Loss and loss expenses include both net paid losses and reserve changes for unpaid losses as well as the associated loss expenses. The change in the loss and loss expense ratio in the three and six months ended June 30, 2007, was due to:

- Catastrophe losses Catastrophe losses contributed 0.8 and 1.3 percentage points to the commercial lines loss and loss expense ratio in the three and six months ended June 30, 2007, compared with 5.6 and 5.3 points in the comparable three and six months of 2006. See Page 20 for details on catastrophe losses for the first six months of 2007 and 2006.
- Loss reserve development Savings from favorable development on prior period reserves reduced the loss and loss expense ratio by 7.0 and 4.8 percentage points in the three and six months ended June 30, 2007, including 0.5 points in each period from favorable loss development on prior period catastrophe loss reserves. In the comparable three and six months of 2006, savings reduced the ratio by 2.9 and 0.1 percentage points, respectively.
- Market conditions During the second quarter of 2007, agents reported that pricing pressure continued to increase on renewal business and that new business pricing was requiring even more flexibility and more careful risk selection. We continue to use credits more frequently than we did in 2006 to retain renewals of quality business and earn new business. Our experience remains that the larger the account, the higher the credits, with variations by geographic region and class of business. Our field marketing representatives continue to report pricing down about 10 percent to 15 percent on average to write the same piece of new business we would have quoted a year ago. By comparison, 5 percent to 10 percent rate declines seem to be typical for renewal business.

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Loss severity We continue to monitor loss severity data as various factors, such as higher initial reserve levels, normal loss cost inflation and higher settlement expenses, have resulted in higher new losses and case reserve increases greater than $250,000 in each of the past five quarters. In the three months ended June 30, 2007, however, these losses were below the year-ago level for all commercial business lines except commercial auto. In total, commercial lines new losses and reserve increases greater than $250,000 were 19.1 percent and 20.5 percent of earned premiums in the three and six months ended June 30, 2007, compared with 20.6 percent and 19.2 percent in the comparable three and six months of 2006.

New losses greater than $1 million frequently are the result of severe injuries to individuals covered by our policies. We continue to analyze factors that could be contributing to a rise in severe injuries. Overall, our analysis continues to indicate no unexpected concentration of these losses and reserve increases by risk category, geographic region, policy inception, agency or field marketing territory.

Commercial Lines Losses by Size

	Three months ended June 30,			Six months ended June 30,		
(Dollars in millions)	**2007**	2006	Change %	**2007**	2006	Change %
Losses $1 million or more	**$ 36**	$ 40	(9.6)	**$ 81**	$ 70	15.7
Losses $250 thousand to $1 million	**34**	39	(13.9)	**71**	67	6.1
Development and case reserve increases of $250,000 or more	**46**	45	2.2	**95**	90	6.4
Other losses excluding catastrophes	**137**	146	(6.1)	**278**	300	(7.8)
Total losses incurred excluding catastrophe losses	**253**	270	(6.4)	**525**	527	(0.5)
Catastrophe losses	**5**	34	(84.9)	**16**	63	(75.0)
Total losses incurred	**$ 258**	$ 304	(15.0)	**$ 541**	$ 590	(8.4)
Ratios as a percent of earned premiums:						
Losses $1 million or more	**5.9%**	6.6%		**6.7%**	5.9%	
Losses $250 thousand to $1 million	**5.6**	6.5		**5.9**	5.7	
Development and case reserve increases of $250,000 or more	**7.6**	7.5		**7.9**	7.6	
Other losses excluding catastrophes	**22.7**	24.5		**22.9**	25.5	
Loss ratio excluding catastrophe losses	**41.8**	45.1		**43.4**	44.7	
Catastrophe losses	**0.8**	5.6		**1.3**	5.3	
Total loss ratio	**42.6%**	50.7%		**44.7%**	50.0%	

Commission Expenses

Commercial lines commission expense as a percent of earned premium rose in the three and six months ended June 30, 2007, largely due to higher contingent commissions compared with the year-ago periods. Profit-sharing, or contingent, commissions are calculated on the profitability of an agency s aggregate book of business, taking into account longer-term profit, with a percentage for prompt payment of premiums and other criteria, and reward the agency s efforts. These profit-based commissions generally fluctuate with our loss and loss expenses.

Underwriting Expenses

Non-commission underwriting and policyholder dividend expense growth for the three and six months ended June 30, 2007, was similar to that of earned premiums.

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