CINCINNATI FINANCIAL CORP
Form 10-Q
April 30, 2008

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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 March 31, 2008.

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, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, non-accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company 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 April 24, 2008, there were 163,163,257 shares of common stock outstanding.

CINCINNATI FINANCIAL CORPORATION
FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 2008
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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)	March 31, 2008	December 31, 2007
ASSETS		
Investments		
Fixed maturities, at fair value (amortized cost: 2008 $5,924; 2007 $5,783)	**$ 5,965**	$ 5,848
(includes securities pledged to creditors: 2008 $622; 2007 $745)		
Equity securities, at fair value (cost: 2008 $2,749; 2007 $2,975)	**5,629**	6,249
Short-term investments, at fair value (amortized cost: 2008 $51; 2007 $101)	**51**	101
Other invested assets	**59**	63
Total investments	**11,704**	12,261
Cash and cash equivalents	**237**	226
Securities lending collateral invested	**619**	760
Investment income receivable	**118**	124
Finance receivable	**84**	92
Premiums receivable	**1,113**	1,107
Reinsurance receivable	**757**	754
Prepaid reinsurance premiums	**13**	13
Deferred policy acquisition costs	**472**	461
Land, building and equipment, net, for company use (accumulated depreciation: 2008 $284; 2007 $276)	**242**	239
Other assets	**49**	72
Separate accounts	**537**	528
Total assets	**$ 15,945**	$ 16,637
LIABILITIES		
Insurance reserves		
Loss and loss expense reserves	**$ 4,019**	$ 3,967
Life policy reserves	**1,505**	1,478
Unearned premiums	**1,585**	1,564
Securities lending payable	**635**	760
Other liabilities	**605**	574
Deferred income tax	**750**	977
Note payable	**69**	69
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	**537**	528

Total liabilities	**10,496**	10,708
Commitments and contingent liabilities (Note 6)		
SHAREHOLDERS EQUITY		
Common stock, par value $2 per share; (authorized: 2008 500 million shares, 2007 500 million shares; issued: 2008 196 million shares, 2007 196 million shares)	**393**	393
Paid-in capital	**1,055**	1,049
Retained earnings	**3,298**	3,404
Accumulated other comprehensive income	**1,880**	2,151
Treasury stock at cost (2008 33 million shares, 2007 30 million shares)	**(1,177)**	(1,068)
Total shareholders equity	**5,449**	5,929
Total liabilities and shareholders equity	**$ 15,945**	$ 16,637

Accompanying notes are an integral part of these statements.

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Cincinnati Financial Corporation And Subsidiaries
Condensed Consolidated Statements Of Operations

(In millions except per share data)	Three months ended March 31, 2008	2007
REVENUES		
Earned premiums		
Property casualty	**$ 751**	$ 785
Life	**29**	30
Investment income, net of expenses	**152**	148
Realized investment gains and losses	**(232)**	62
Other income	**4**	6
Total revenues	**704**	1,031
BENEFITS AND EXPENSES		
Insurance losses and policyholder benefits	**536**	484
Commissions	**150**	170
Other operating expenses	**91**	88
Taxes, licenses and fees	**21**	20
Increase in deferred policy acquisition costs	**(6)**	(15)
Interest expense	**12**	13
Total benefits and expenses	**804**	760
INCOME (LOSS) BEFORE INCOME TAXES	**(100)**	271
PROVISION (BENEFIT) FOR INCOME TAXES		
Current	**22**	77
Deferred	**(80)**	0
Total provision (benefit) for income taxes	**(58)**	77
NET INCOME (LOSS)	**$ (42)**	$ 194
PER COMMON SHARE		
Net income (loss) basic	**$ (0.26)**	$ 1.12
Net income (loss) diluted	**(0.26)**	1.11

Accompanying notes are an integral part of this statement.

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Cincinnati Financial Corporation And Subsidiaries
Condensed Consolidated Statements Of Shareholders Equity

(In millions)	Three months ended March 31, 2008	2007
COMMON STOCK		
Beginning of year	**$ 393**	$ 391
Stock options exercised	**0**	1
End of period	**393**	392
PAID-IN CAPITAL		
Beginning of year	**1,049**	1,015
Stock options exercised	**2**	7
Share-based compensation	**4**	5
End of period	**1,055**	1,027
RETAINED EARNINGS		
Beginning of year	**3,404**	2,786
Cumulative effect of change in accounting for hybrid financial securities	**0**	5
Cumulative effect of change in accounting for uncertain tax positions	**0**	(1)
Adjusted beginning of year	**3,404**	2,790
Net income (loss)	**(42)**	194
Dividends declared	**(64)**	(61)
End of period	**3,298**	2,923
ACCUMULATED OTHER COMPREHENSIVE INCOME		
Beginning of year	**2,151**	3,379
Cumulative effect of change in accounting for hybrid financial securities	**0**	(5)
Adjusted beginning of year	**2,151**	3,374
Other comprehensive income (loss), net	**(271)**	(181)
End of period	**1,880**	3,193
TREASURY STOCK		
Beginning of year	**(1,068)**	(763)
Purchase	**(109)**	(64)

End of period		**(1,177)**		(827)
Total shareholders equity	**$**	**5,449**	$	6,708
COMMON STOCK NUMBER OF SHARES OUTSTANDING				
Beginning of year		**166**		173
Purchase of treasury shares		**(3)**		(1)
End of period		**163**		172
COMPREHENSIVE INCOME (LOSS)				
Net income (loss)	**$**	**(42)**	$	194
Unrealized investment gains and losses during the period		**(418)**		(287)
Taxes on other comprehensive income		**147**		106
Total comprehensive income (loss)	**$**	**(313)**	$	13

Accompanying notes are an integral part of this statement.

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Cincinnati Financial Corporation And Subsidiaries
Condensed Consolidated Statements Of Cash Flows

(In millions)	Three months ended March 31, **2008**	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	**$ (42)**	$ 194
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation, amortization and other non-cash items	**8**	7
Realized investment losses (gains)	**232**	(62)
Share-based compensation	**4**	5
Interest credited to contract holders	**9**	6
Changes in:		
Investment income receivable	**6**	4
Premiums and reinsurance receivable	**(9)**	(88)
Deferred policy acquisition costs	**(6)**	(16)
Other assets	**3**	(5)
Loss and loss expense reserves	**52**	32
Life policy reserves	**22**	21
Unearned premiums	**21**	61
Other liabilities	**(62)**	(12)
Deferred income tax	**(80)**	0
Current income tax	**20**	71
Net cash provided by operating activities	**178**	218
CASH FLOWS FROM INVESTING ACTIVITIES		
Sale of fixed maturities	**18**	51
Call or maturity of fixed maturities	**615**	127
Sale of equity securities	**137**	93
Collection of finance receivables	**11**	12
Purchase of fixed maturities	**(700)**	(228)
Purchase of equity securities	**(123)**	(220)
Change in short-term investments, net	**51**	77
Investment in buildings and equipment, net	**(11)**	(17)
Investment in finance receivables	**(3)**	(6)
Change in other invested assets, net	**0**	(4)
Change in securities lending collateral invested	**126**	(984)
Net cash provided by (used in) investing activities	**121**	(1,099)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payment of cash dividends to shareholders	**(59)**	(58)
Purchase of treasury shares	**(97)**	(47)
Proceeds from stock options exercised	**2**	7
Contract holder funds deposited	**7**	8

Contract holder funds withdrawn		**(14)**		(17)
Change in securities lending payable		**(126)**		984
Other		**(1)**		(1)
Net cash provided by (used in) financing activities		**(288)**		876
Net increase (decrease) in cash and cash equivalents		**11**		**(5)**
Cash and cash equivalents at beginning of year		**226**		202
Cash and cash equivalents at end of period	**$**	**237**	$	197
Supplemental disclosures of cash flow information:				
Interest paid (net of capitalized interest: 2008 $1; 2007 $1)	**$**	**0**	$	0
Income taxes paid		**2**		5
Non-cash activities:				
Conversion of securities	**$**	**2**	$	17
Equipment acquired under capital lease obligations		**1**		0

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, 2007, 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 March 31, 2008, 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. These condensed consolidated financial statements should be read in conjunction with our consolidated financial statements included in our 2007 Annual Report on Form 10-K. The results of operations for interim periods do not necessarily indicate results to be expected for the full year.

Recent Accounting Pronouncements

SFAS No. 157, Fair Value Measurements

In February 2008, the Financial Accounting Standards Board (FASB) issued Statements of Financial Accounting Standard (SFAS) No. 157-2, Fair Value Measurement. SFAS No. 157-2 is an amendment of SFAS No. 157, issued in September 2006. SFAS No. 157 defines fair value, establishes a framework for measuring fair value, establishes a fair value hierarchy based on the quality of inputs used to measure fair value and enhances disclosure about fair value measurements.

SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, with early adoption permitted provided that the entity has not yet issued financial statements for that fiscal year, including any interim periods. The provisions of SFAS No. 157 are to be applied prospectively, except that provisions related to block discounts and existing derivative financial instruments measured under EITF 02-3 are to be applied as a one-time cumulative effect adjustment to opening retained earnings in the year of adoption. We partially adopted SFAS No. 157 in the first quarter of 2008. We elected to defer adoption of SFAS No. 157-2 until January 1, 2009, for nonfinancial assets and nonfinancial liabilities, as permitted under the amendment. We did not have a cumulative-effect adjustment to beginning retained earnings as a result of the adoption of SFAS No. 157.

SFAS No. 159, Fair Value Option for Financial Assets and Financial Liabilities including an amendment of SFAS No. 115

In February 2007, the FASB issued SFAS No. 159, Fair Value Option for Financial Assets and Financial Liabilities including an amendment of SFAS No. 115. SFAS No. 159 permits an entity to choose to measure many financial instruments and certain other items at fair value (on an instrument-by-instrument basis) at specified election dates. The objective is to improve financial reporting by providing an entity with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. We have not elected to value any assets or liabilities (not otherwise measured at fair value) under SFAS No. 159. We continue to evaluate the impact of adopting SFAS No. 159 in the future.

SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of SFAS No. 133

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of SFAS No. 133. SFAS No. 161 requires that objectives for using derivative instruments be disclosed in terms of underlying risk and accounting designation. SFAS No. 161 also requires cross-referencing within the footnotes to assist the users of financial statements in identifying significant information regarding derivative instruments. The effective date of SFAS No. 161 is the company s fiscal year beginning January 1, 2009. Management has not yet completed an assessment of the impact of SFAS No. 161.

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Subsequent Events

Catastrophe losses   On April 9, 2008, storms affecting our policyholders in Arkansas, resulting in approximately $20 million of pretax catastrophe losses, which will be included in second-quarter 2008 results. This estimate does not take into account any catastrophe activity that may occur in the remainder of the second quarter of 2008 or potential development from events in prior periods.

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 March 31, 2008, and December 31, 2007.

At March 31, 2008, unrealized investment gains before taxes totaled $3.057 billion and unrealized investment losses in the investment portfolio amounted to $136 million. The unrealized gains largely were due to long term gains from our holdings of Fifth Third Bancorp common stock, which contributed 40.0 percent of those gains, and from our other common stock holdings, including ExxonMobil (NYSE:XOM), PNC Financial Services Group, Inc. (NYSE:PNC) and The Procter & Gamble Company (NYSE:PG), which each contributed at least 5 percent of those gains.

The change in unrealized gains and losses on investments, net of taxes, described in the following table, is included in other comprehensive income and shareholders equity. During the three months ended March 31, 2008, we recognized $2 million in realized investment losses related to current period changes in valuation of our hybrid securities. At March 31, 2008, we had $130 million of hybrid securities included in fixed maturities that now are accounted for under SFAS No. 155.

The change for the three months ended March 31, 2008, was due primarily to market-driven fluctuations in the fixed maturity portfolio. Fixed maturities unrealized gains and losses were essentially unchanged in the three months ended March 31, 2007.

Equity securities unrealized gains declined for the three months ended March 31, 2008, primarily because of market value declines of our financial sector holdings. Equity securities unrealized gains declined for the three months ended March 31, 2007, primarily because of the decline in the market value of Fifth Third since December 31, 2006, and realized gains from equity sales.

(In millions)	Three months ended March 31, **2008**	2007
Change in unrealized investment gains and losses and other summary:		
Fixed maturities	**$ (25)**	$ 10
Equity securities	**(393)**	(293)
Adjustment to deferred acquisition costs and life policy reserves	**1**	(1)
Pension obligations	**1**	0
Other	**(2)**	5
Income taxes on above	**147**	98
Total	**$ (271)**	$ (181)

Realized gains and losses on investments are recognized in net income on a specific identification basis. See our 2007 Annual Report on Form 10-K, Item 1, Investments Segment, Page 15, 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.

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Securities Lending Program

In 2006, we began actively participating in a securities lending program under which certain fixed-maturity securities 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 received 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. As this program is accounted for as a secured borrowing, the collateral is recognized as an asset, and classified as securities lending collateral invested, 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 collateral securities. Although the securities loaned have been pledged and effectively secure the cash collateral we receive, we maintain effective control over our securities, which we continue to classify as invested assets on our consolidated balance sheets. At March 31, 2008, we had $622 million in securities on loan. Interest income on collateral, net of fees, was $378,000 for the first three months of 2008, compared with $242,000 in the first three months of 2007.

A portion of the securities lending collateral invested was placed in asset-backed commercial paper (ABCP) programs during 2007 by our lending agent. Due to the ABCP market disruption, in 2007, maturities on two of our investments were extended beyond their original stated maturity dates. In the first three months of 2008, one of these investments was resolved with no loss to us. The other investment was in a short-term fund backed by collateralized mortgage obligations. As of the quarter end, this fund was dissolved, which resulted in the underlying CMOs being placed in the lending program as a direct collateral investment. We recorded an evaluation adjustment of $16 million to reflect the March 31, 2008 market values of these securities. Excluding that investment, all securities lending program collateral investments now are in overnight securities.

NOTE 3 Reinsurance

Our statements of operations include earned property casualty insurance premiums on assumed and ceded business:

	Three months ended March 31,			
(In millions)		**2008**		2007
Direct earned premiums	$	**791**	**$**	821
Assumed earned premiums		**2**		7
Ceded earned premiums		**(42)**		(43)
Net earned premiums	$	**751**	**$**	785

Our statements of operations include incurred property casualty insurance loss and loss expenses on assumed and ceded business:

	Three months ended March 31,			
(In millions)		**2008**		2007
Direct incurred loss and loss expenses	$	**525**	**$**	477
Assumed incurred loss and loss expenses		**(1)**		1
Ceded incurred loss and loss expenses		**(23)**		(20)
Net incurred loss and loss expenses	$	**501**	**$**	458

Our statements of operations include earned life insurance premiums on assumed and ceded business:

(In millions)	Three months ended March 31, 2008	2007
Direct earned premiums	$ **42**	$ 41
Assumed earned premiums	**0**	0
Ceded earned premiums	**(13)**	(11)
Net earned premiums	$ **29**	$ 30

Our statements of operations include life insurance contract holder benefits incurred on assumed and ceded business:

(In millions)	Three months ended March 31, 2008	2007
Direct contract holders benefits incurred	$ **40**	$ 37
Assumed contract holders benefits incurred	**0**	0
Ceded contract holders benefits incurred	**(5)**	(10)
Net contract holders benefits incurred	$ **35**	$ 27

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NOTE 4 Pension Plans

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

(In millions)	Three months ended March 31, **2008**	2007
Service cost	**$ 4**	$ 4
Interest cost	**4**	4
Expected return on plan assets	**(4)**	(4)
Amortization of actuarial gain, prior service cost and transition asset	**1**	1
Net periodic benefit cost	**$ 5**	$ 5

We made no contribution to the pension plans in the first quarter of 2008. We continuing to anticipate contributing $10 million during 2008 to our qualified pension plan as indicated in our 2007 Annual Report on Form 10-K.

NOTE 5 Equity Compensation Plans

We currently have five 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 Cincinnati Financial Corporation 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, service-based 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 2008 Proxy Statement.

A total of 22,237,750 shares are authorized to be granted under the shareholder-approved plans. At March 31, 2008, 9,959,746 shares were available for future issuance under the plans. We currently issue new shares for option exercises.

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

(In millions)	Three months ended March 31, **2008**	2007
Share-based compensation cost	**$ 4**	$ 5
Income tax benefit	**1**	1
Share-based compensation cost after tax	**$ 3**	$ 4

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 2008, the fair value of each option granted in 2008 was estimated on the date of grant using the binomial option-pricing model with the following weighted average assumptions used for grants in 2008:

	Three months ended March 31, **2008**	2007

Weighted average expected term	**7-8 years**	5-7 years
Expected volatility	**20.58-24.67%**	18.29 24.14%
Dividend yield	**3.99-4.15%**	3.33%
Risk-free rates	**3.29-3.66%**	4.8-4.81%

As of March 31, 2008, there was $24 million of unrecognized compensation cost related to non-vested awards that is expected to be recognized over a weighted average period of 2.2 years.

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Here is a summary of option information:

(Shares in thousands)	Shares	Weighted-average exercise price	Aggregate intrinsic value
2008			
Outstanding at beginning of year	10,480	$ 36.86	
Granted/reinstated	767	38.79	
Exercised	(70)	31.57	
Forfeited/revoked	(613)	39.84	
Outstanding at end of period	10,564	36.87	$ 32
Options exercisable at end of period	8,997	$ 35.97	$ 32
Weighted-average fair value of options granted during the period		7.44	

(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
$25.00 to $29.99	822	1.83 yrs	$ 26.97	822	$ 26.97
$30.00 to $34.99	4,224	3.01 yrs	32.72	4,224	32.72
$35.00 to $39.99	2,283	6.66 yrs	38.53	1,519	38.40
$40.00 to $44.99	1,944	7.37 yrs	42.55	1,567	42.01
$45.00 to $49.99	1,291	7.79 yrs	45.26	865	45.26
Total	10,564	5.09 yrs	36.87	8,997	35.97

Restricted Stock Units

Service-based and performance-based restricted stock units are granted to associates at fair market value on the date of grant. Service-based restricted stock units cliff vest at the end of three years, while performance-based restricted stock units vest on the first day of March after a three-calendar year performance period, if certain performance targets are attained. As of March 31, 2008, management assumed for accounting purposes that performance targets used for the 2008 awards would be met, which resulted in the inclusion of costs for these awards in share-based compensation for the three months ended March 31, 2008.

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 shares underlying the restricted stock units during the vesting period.

Here is a summary of restricted stock unit information:

	Service - based nonvested	Weighted - average grant-date fair	Performance - based nonvested	Weighted - average grant-date fair

(Shares in thousands)	shares	value	shares	value
Nonvested at January 1, 2008	162	$ 40.74	35	$ 40.74
Granted	227	34.70	44	33.21
Vested	0	40.74	0	0.00
Forfeited	(3)	38.07	0	0.00
Nonvested at March 31, 2008	386	37.20	79	36.52

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 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 Income Taxes

We adopted the provisions of FIN 48 on January 1, 2007. As of December 31, 2007, we had a gross unrecognized tax benefit (FIN 48 liability) of $14.2 million. Details regarding our FIN 48 liability are found in our 2007 Annual Report on Form 10-K, Item 8, Note 10 of the Consolidated Financial Statements, Page 98.

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During the current quarter, there were no material changes to the amount of our unrecognized tax benefits nor to any assumptions regarding the amount of our FIN 48 liability that may be effectively settled with the IRS in the next 12 months related to tax years 2002 to 2004. At this time, we can neither estimate the settlement date, nor quantify an estimated range for any potential change of the unrecognized tax benefits, relating to tax years 2005 and 2006.

NOTE 8 SFAS No. 157, Fair Value Measurements

We adopted SFAS No. 157 in the first quarter of 2008. Our investment portfolio will be subject to SFAS No. 157 disclosure for interim reporting. Our year-end 2008 reporting will include disclosure for the investment portfolio as well as the fair value measurement framework for all SFAS No. 107 disclosures.

Fair Value Hierarchy

In accordance with SFAS No. 157, we categorized our financial instruments, based on the priority of the observable and market-based data for valuation technique, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices with readily available independent data in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable market inputs (Level 3).

When various inputs for measurement fall within different levels of the fair value hierarchy, the lowest level input that has a significant impact on fair value measurement is used.

Financial instruments are categorized based upon the following characteristics or inputs to the valuation techniques:

Level 1 Financial assets and liabilities for which inputs are observable and are obtained from reliable quoted prices for identical assets or liabilities in actively traded markets. This is the most reliable fair value measurement and includes, for example, active exchange-traded equity securities.

Level 2 Financial assets and liabilities for which values are based on quoted prices in markets that are not active or for which values are based on similar assets and liabilities that are actively traded. Also includes pricing models which the inputs are corroborated by market data.

Level 3 Financial assets and liabilities for which values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. Level 3 inputs include the following:

- Quotes from brokers or other external sources that are not considered binding;
- Quotes from brokers or other external sources where it can not be determined that market participants would in fact transact for the asset or liability at the quoted price;
- Quotes from brokers or other external sources where the inputs are not deemed observable.

We will conduct a thorough review of fair value hierarchy classifications on a quarterly basis. Reclassification of certain financial instruments may occur when input observability changes. As noted below in the Level 3 disclosure table, reclassifications are reported as transfers in/out of the Level 3 category as of the beginning of the quarter in which the reclassification occurred. Reclassification of securities from Level 3 to Level 2 occurred in the first quarter of 2008 due to an increase in observable data and pricing.

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The following table illustrates the fair value hierarchy for those assets measured at fair value on a recurring basis as of March 31, 2008. We do not have any material liabilities carried at fair value.

(In millions)	Asset Fair Value Measurements at Reporting Date Using Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Available for sale securities:				
Taxable fixed maturities	$ 634	$ 2,642	$ 54	$ 3,330
Taxable fixed maturities separate accounts	64	452	3	519
Tax-exempt fixed maturities	0	2,630	5	2,635
Common equities	5,295	0	59	5,354
Preferred equities	0	215	60	275
Short-term investments	0	51	0	51
Top Hat Plan	5	1	0	6
ABCP, Securities lending collateral	0	55	0	55
Total	$ 5,998	$ 6,046	$ 181	$ 12,225

Level 3 Assets

Each financial instrument that was deemed to have significant unobservable inputs when determining valuation is identified in the table below by security type with a summary of changes in fair value for the quarter-ended March 31, 2008.

	Asset Fair Value Measurements Using Significant Unobservable Inputs (Level 3)					
(In millions)	Taxable fixed maturities	Taxable fixed maturities separate accounts	Tax-exempt fixed maturities	Common equities	Preferred equities	Total (Level 3)
Beginning balance	$ 85	$ 3	$ 5	$ 59	$ 58	$ 210
Total gains or losses (realized/unrealized)						
Included in earnings (or changes in net assets)	0	0	0	0	(6)	(6)
Included in other comprehensive income	(2)	0	0	0	3	1
Purchases, sales, issuances, and settlements	(15)	0	0	0	5	(10)
	(14)	0	0	0	0	(14)

Transfers in and/or out of Level 3						
Ending balance	$ 54	$ 3	$ 5	$ 59	$ 60	$ 181
The amount of total gains or losses for the period included in realized investment gains and losses (or changes in invested assets) attributable to the change in unrealized gains or losses relating to assets still held at the reporting date	$ (2)				$ (3)	$ (5)

Level 3 taxable fixed-maturity securities declined primarily because of a $14 million transfer from the Level 3 fair value hierarchy to Level 2. This was the result of the use of observable inputs at March 31, 2008, compared with unobservable inputs at December 31, 2007. Level 3 preferred stock changed to reflect $6 million in other-than-temporary impairment charges.

NOTE 9 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. Beginning in the first quarter of 2008, we also are including results of The Cincinnati Specialty Underwriters Insurance Company and CSU Producer Resources in Other. See our 2007 Annual Report on Form 10-K, Item 8, Note 17, Segment Information, Page 105, 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 March 31, **2008**	2007
Revenues:		
Commercial lines insurance		
Commercial casualty	**$ 190**	$ 209
Commercial property	**122**	123
Commercial auto	**101**	113
Workers compensation	**94**	92
Specialty packages	**35**	36
Surety and executive risk	**25**	24
Machinery and equipment	**7**	7
Total commercial lines insurance	**574**	604
Personal lines insurance		
Personal auto	**83**	88
Homeowner	**72**	71
Other personal lines	**22**	22
Total personal lines insurance	**177**	181
Life insurance	**30**	31
Investment operations	**(80)**	210
Other	**3**	5
Total	**$ 704**	$ 1,031
Income (loss) before income taxes:		
Insurance underwriting results:		
Commercial lines insurance	**$ 29**	$ 67
Personal lines insurance	**(18)**	14
Life insurance	**(1)**	5
Investment operations	**(96)**	196
Other	**(14)**	(11)
Total	**$ (100)**	$ 271
Identifiable assets:		
Property casualty insurance	**$ 2,225**	$ 2,269
Life insurance	**1,033**	944
Investment operations	**11,763**	13,688
Other	**924**	1,320

Total	**$ 15,945**	$ 18,221

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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 2007 Annual Report on Form 10-K. Unless otherwise noted, the industry data is prepared by A.M. Best Co., a leading insurance industry statistical, analytical and financial strength rating organization. Information 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 in accordance with accounting principles generally accepted in the United States of America (GAAP).

Historically, we presented per share data on a diluted basis unless otherwise noted, adjusting those amounts for all stock splits and dividends. Due to the net loss in the first quarter of 2008, basic and diluted per share data are equal for the first quarter of 2008. Dollar amounts are rounded to millions; calculations of percent changes are based on whole dollar amounts or dollar amounts rounded to the nearest thousand. Certain percentage changes are identified as not meaningful (nm).

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 2007 Annual Report on Form 10-K, Item 1A, Risk Factors, Page 21. Although we often review and 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
- 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
- Securities laws that could limit the manner, timing and volume of our investment transactions
- Recession or other economic conditions or regulatory, accounting or tax changes resulting in lower demand for insurance products
- Events, such as the subprime mortgage lending crisis, that lead to:
  - Significant decline in the value of a particular security or group of securities, such as our financial sector holdings, and impairment of the asset(s)
  - Significant decline in investment income due to reduced or eliminated dividend payouts from a particular security or group of securities
- 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
- 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
- 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:
  - Downgrade of the company s financial strength ratings
  - Concerns that doing business with the company is too difficult or

- Perceptions that the company s level of service, particularly claims service, is no longer a distinguishing characteristic in the marketplace

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- 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
  - 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
  - Limit our ability to set fair, adequate and reasonable rates
  - Place us at a disadvantage in the marketplace or
  - Restrict our ability to execute our business model, including the way we compensate agents
- Adverse outcomes from litigation or administrative proceedings
- Unforeseen departure of certain executive officers or other key employees due to retirement, health or other causes that could interrupt progress toward important strategic goals or diminish the effectiveness of certain longstanding relationships with insurance agents and others
- 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 March 31,		
(Dollars in millions except share data)	**2008**	2007	Change %
Income statement data			
Earned premiums	**$ 780**	$ 815	(4.2)
Investment income, net of expenses	**152**	148	2.6

Realized investment gains and losses (pretax)	**(232)**	62	nm
Total revenues	**704**	1,031	(31.7)
Net income (loss)	**(42)**	194	nm
Per share data (diluted)			
Net income (loss)	**(0.26)**	1.11	nm
Cash dividends declared	**0.39**	0.355	9.9
Weighted average shares outstanding	**165,105,311**	174,274,157	(5.3)

Revenues declined significantly because of realized investment losses reported for the three months ended March 31, 2008, as discussed in Investments Results of Operations, Page 28. The other two primary components of revenues earned premiums and investment income generally were in line with expectations described in our 2007 Annual Report on Form 10-K. The realized investment losses also were the reason for the **net loss** for the three months ended March 31, 2008.

Realized investment gains and losses are recognized on the sales of investments or as otherwise required by GAAP, including non-cash charges to lower the carrying value of securities. We have substantial discretion in the timing of investment sales and that timing generally is independent of the insurance underwriting process. GAAP accounting standards also require us to recognize in income the gains or losses from certain changes in market (fair) values of securities without actual realization of those gains or losses.

During the three months ended March 31, 2008, we repurchased 2.93 million shares of our common stock at a cost of $109 million. As a result of repurchases, average weighted shares outstanding declined 4.7 percent compared with a year ago.

The board of directors is committed to steadily increasing cash dividends and periodically authorizing stock dividends and splits. Cash dividends declared per share rose 9.9 percent in the three months ended March 31, 2008.

Balance Sheet Data and Performance Measures

(Dollars in millions except share data)	**At March 31, 2008**	At December 31, 2007
Balance sheet data		
Invested assets	**$ 11,704**	$ 12,261
Total assets	**15,945**	16,637
Short-term debt	**69**	69
Long-term debt	**791**	791
Shareholders equity	**5,449**	5,929
Book value per share	**33.40**	35.70
Debt-to-capital ratio	**13.6%**	12.7%

	Three months ended March 31, **2008**	2007
Performance measures		
Comprehensive income (loss)	**$ (313)**	$ 13
Return on equity, annualized	**(3.0)%**	11.5%
Return on equity, annualized, based on comprehensive income (loss)	**(22.1)**	0.8

Invested assets, total assets and shareholders equity were less than year-end 2007 primarily because of continued declines in the market value of our equity portfolio. As a result, our ratio of total debt to capital (total debt plus shareholders equity) rose.

Comprehensive income is net income plus the year-over-year change in accumulated other comprehensive income. In the three months ended March 31, 2008, we recorded a comprehensive loss because of the combination of the net loss and unrealized losses in the investment portfolio. In the three months ended March 31, 2007, we recorded comprehensive income because net income offset unrealized losses in the investment portfolio.

Return on equity reflected the net loss in the first three months of 2008 compared with net income in the first three months of 2007. Return on equity based on comprehensive income showed results similar to comprehensive income, as described above.

Combined Property Casualty Insurance Highlights

Three months ended March 31,

(Dollars in millions)	**2008**	2007	Change %
Combined property casualty highlights			
Written premiums	**$776**	$846	(8.3)
Earned premiums	**751**	785	(4.3)
Underwriting profit			