

WESCO FINANCIAL CORP

Form 10-Q

November 05, 2007

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**SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

(Mark One)

**Quarterly report pursuant to section 13 or 15 (d) of the Securities Exchange Act of 1934  
For the Quarterly period ended September 30, 2007 or**

**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 1-4720  
**WESCO FINANCIAL CORPORATION**  
(Exact name of Registrant as Specified in its Charter)**

DELAWARE

95-2109453

(State or Other Jurisdiction of  
incorporation or organization)

(I.R.S. Employer Identification No.)

301 East Colorado Boulevard, Suite 300, Pasadena,  
California

91101-1901

(Address of Principal Executives Offices)

(Zip Code)

626/585-6700

(Registrant's Telephone Number, Including Area Code)

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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. Yes  No

Indicate by check mark whether 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.

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

**APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS  
DURING THE PRECEDING FIVE YEARS**

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15 (d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes  No

**APPLICABLE ONLY TO CORPORATE ISSUERS**

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. 7,119,807 as of November 1, 2007

**PART I. FINANCIAL INFORMATION**

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Reference is made to Item 7A, Quantitative and Qualitative Disclosures About Market Risk appearing on pages 34 and 35 of the Form 10-K Annual Report for the year ended December 31, 2006, filed by Wesco Financial Corporation (Wesco), for information on equity price risk and interest rate risk at Wesco. There have been no material changes through September 30, 2007 except for the purchase of marketable equity securities at an aggregate cost of \$584.9 million during the third quarter of 2007. As of September 30, 2007, Wesco's consolidated balance sheet contained \$1.76 billion of marketable equity securities.

The following table summarizes Wesco's equity price risk as of September 30, 2007. It shows the effects of a hypothetical 30% overall increase or decrease in market prices of marketable equity securities owned by the Wesco group on total recorded market value and, after tax effect, on Wesco's shareholders' equity at that date. (Amounts are in thousands.)

	September 30, 2007	
	Increase	Decrease
Market value of marketable equity securities		
As recorded	\$ 1,755,791	\$ 1,755,791
Hypothetical	2,282,528	1,229,054
Shareholders' equity		
As recorded	2,552,407	2,552,407
Hypothetical	\$ 2,894,786	\$ 2,210,028

The 30% hypothetical changes in market values assumed in preparing the table does not reflect what could be considered the best- or worst-case scenarios. Indeed, actual results could be much worse or better due both to the nature of equity markets and the concentration existing in Wesco's equity investment portfolio.

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**Item 4. Controls and Procedures.**

An evaluation was performed under the supervision and with the participation of the management of Wesco, including Charles T. Munger (Chief Executive Officer) and Jeffrey L. Jacobson (Chief Financial Officer), of the effectiveness of the design and operation of Wesco's disclosure controls and procedures as of December 31, 2006. Based on that evaluation, Messrs. Munger and Jacobson concluded that the Company's disclosure controls and procedures are effective in ensuring that information required to be disclosed by the Company in reports it files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported as specified in the rules and forms of the Securities Exchange Commission, and are effective to ensure that information required to be disclosed by Wesco in the reports it files or submits under the Exchange Act, as amended, is accumulated and communicated to Wesco's management, including Mr. Munger and Mr. Jacobson, as appropriate to allow timely decisions regarding required disclosure. There have been no changes in Wesco's internal controls over financial reporting during the quarter ended September 30, 2007 that have materially affected or are reasonably likely to materially affect the internal controls over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1A. Risk Factors**

Reference is made to Item 1A, Risk Factors, appearing on pages 15 through 18 of the Form 10-K Annual Report for the year ended December 31, 2006, filed by Wesco, for information regarding the most significant factors affecting Wesco's operations. There have been no material changes in these factors through September 30, 2007.

**Item 6. Exhibits**

- 31 (a) Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Chief Executive Officer)
- 31 (b) Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Chief Financial Officer)
- 32 (a) Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chief Executive Officer)
- 32 (b) Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chief Financial Officer)

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**WESCO FINANCIAL CORPORATION**  
**CONDENSED CONSOLIDATED BALANCE SHEET**

(Dollar amounts in thousands)

(Unaudited)

	Sept. 30, 2007	Dec. 31, 2006
<b>ASSETS</b>		
Cash and cash equivalents	\$ 969,459	\$ 1,257,351
Investments:		
Securities with fixed maturities	39,337	81,861
Marketable equity securities	1,755,791	1,040,550
Rental furniture	185,908	182,846
Goodwill of acquired businesses	266,607	266,607
Other assets	186,728	141,090
	<b>\$ 3,403,830</b>	<b>\$ 2,970,305</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Payable for securities	\$ 248,147	\$
Insurance losses and loss adjustment expenses		
Affiliated business	33,724	29,761
Unaffiliated business	54,353	48,549
Unearned insurance premiums		
Affiliated business	13,854	14,062
Unaffiliated business	18,995	15,298
Deferred furniture rental income and security deposits	21,327	20,440
Notes payable	39,800	38,200
Income taxes payable, principally deferred	365,496	355,399
Other liabilities	55,727	48,258
	<b>851,423</b>	<b>569,967</b>
Shareholders' equity:		
Capital stock and additional paid-in capital	33,324	33,324
Unrealized appreciation of investments, net of taxes	430,316	344,978
Retained earnings	2,088,767	2,022,036
Total shareholders' equity	<b>2,552,407</b>	<b>2,400,338</b>
	<b>\$ 3,403,830</b>	<b>\$ 2,970,305</b>

*See notes beginning on page 7.*

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**WESCO FINANCIAL CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENT OF**  
**INCOME AND RETAINED EARNINGS**

(Dollar amounts in thousands except for amounts per share)  
(Unaudited)

	Three Months Ended		Nine Months Ended	
	Sept. 30,	Sept. 30,	Sept. 30,	Sept. 30,
	2007	2006	2007	2006
Revenues:				
Furniture rentals	\$ 84,063	\$ 83,323	\$ 249,839	\$ 246,019
Sales and service revenues	33,895	35,745	100,369	107,972
Insurance premiums earned				
Affiliated business	8,790	7,069	23,863	20,565
Unaffiliated business	4,490	8,804	16,235	23,839
Dividend and interest income	24,461	22,071	70,403	61,582
Other	965	941	2,892	2,774
	156,664	157,953	463,601	462,751
Costs and expenses:				
Cost of products and services sold	37,036	39,519	109,421	117,180
Insurance losses and loss adjustment expenses				
Affiliated business	5,961	3,708	13,409	8,443
Unaffiliated business	4,693	6,540	6,572	14,982
Insurance underwriting expenses				
Affiliated business	2,116	1,976	5,309	4,941
Unaffiliated business	1,404	3,280	6,148	7,123
Selling, general and administrative expenses	69,040	67,073	209,662	201,067
Interest expense	641	775	1,828	2,033
	120,891	122,871	352,349	355,769
Income before income taxes	35,773	35,082	111,252	106,982
Income taxes	11,376	11,569	36,511	36,307
Net income	24,397	23,513	74,741	70,675
Retained earnings beginning of period	2,067,040	1,982,362	2,022,036	1,940,398
Cash dividends declared and paid	(2,670)	(2,599)	(8,010)	(7,797)
Retained earnings end of period	\$ 2,088,767	\$ 2,003,276	\$ 2,088,767	\$ 2,003,276

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Amounts per capital share based on 7,119,807  
shares outstanding throughout each period:

Net income	\$	3.43	\$	3.31	\$	10.50	\$	9.93
Cash dividends	\$	.375	\$	.365	\$	1.125	\$	1.095

*See notes beginning on page 7.*

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**WESCO FINANCIAL CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS**

(Dollar amounts in thousands)

(Unaudited)

	Nine Months Ended	
	Sept. 30, 2007	Sept. 30, 2006
Cash flows from operating activities, net	\$ 48,017	\$ 89,541
Cash flows from investing activities:		
Maturities and redemptions of securities with fixed maturities	47,549	28,390
Purchases of equity securities	(336,801)	(18,855)
Purchases of securities with fixed maturities	(3,889)	(21,691)
Purchases of rental furniture	(63,150)	(72,501)
Sales of rental furniture	47,695	53,569
Additions to condominium construction in process	(18,523)	(9,269)
Other, net	(2,380)	(2,137)
Net cash flows from investing activities	(329,499)	(42,494)
Cash flows from financing activities:		
Net increase in line of credit borrowings	1,600	7,900
Payment of cash dividends	(8,010)	(7,797)
Net cash flows from financing activities	(6,410)	103
Increase (decrease) in cash and cash equivalents	(287,892)	47,150
Cash and cash equivalents beginning of period	1,257,351	1,194,113
Cash and cash equivalents end of period	\$ 969,459	\$ 1,241,263
Supplementary information:		
Interest paid during period	\$ 1,777	\$ 1,642
Income taxes paid, net, during period	72,348	27,020

*See notes beginning on page 7.*

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**WESCO FINANCIAL CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Dollar amounts in thousands except for amounts per share)

(Unaudited)

**Note 1.**

The unaudited condensed consolidated financial statements of which these notes are an integral part include the accounts of Wesco Financial Corporation ( Wesco ) and its subsidiaries. In management s opinion, such statements reflect all adjustments (all of them of a normal recurring nature) necessary to a fair statement of interim results in accordance with accounting principles generally accepted in the United States of America.

Reference is made to the notes to Wesco s consolidated financial statements appearing on pages 46 through 58 of its 2006 Form 10-K Annual Report for other information deemed generally applicable to the condensed consolidated financial statements. In particular, Wesco s significant accounting policies and practices are set forth in Note 1 on pages 46 through 48.

In July 2006, the Financial Accounting Standards Board (the FASB ) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* an interpretation of FASB Statement No. 109 ( FIN 48 ), which clarifies the accounting for uncertainty of income tax positions taken or expected to be taken in income tax returns when it is more likely than not that an examination of a company s tax returns will result in the assessment of additional taxes. FIN 48 requires the recognition in the financial statements of the impact of the tax position based on the technical merits of the position, as well as expanded disclosure, if applicable, in the notes to the company s financial statements. In connection with the implementation of FIN 48, a company is required to adjust its opening retained earnings balance for the aggregate impact of the uncertain tax positions that existed as of that date. Wesco s implementation of the provisions of FIN 48 as of the beginning of 2007 had no material impact on the accompanying condensed consolidated financial statements.

Wesco and its subsidiaries join with Berkshire Hathaway Inc., ( Berkshire ), Wesco s ultimate parent company, in the filing of consolidated federal income tax returns. Wesco s consolidated Federal income tax return liabilities have been settled with the Internal Revenue Service (the IRS ) through 1998. The IRS has completed its audit of the tax returns for the years 1999 through 2001 and has proposed adjustments to increase the tax liabilities related to Wesco. The examination is in the IRS appeals process. The IRS has also completed its audit of the tax returns for the years 2002 through 2004. Wesco management does not believe that the ultimate outcome of Federal income tax audits will materially affect Wesco s consolidated financial statements.

Wesco s management does not believe that any accounting pronouncements issued by the Financial Accounting Standards Board or other applicable authorities that are required to be adopted after September 30, 2007 are likely to have a material effect on Wesco s consolidated financial statements.

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**Table of Contents****Note 2.**

The following table sets forth Wesco's consolidated comprehensive income for the three- and nine-month periods ended September 30, 2007 and 2006:

	Three Months Ended		Nine Months Ended	
	Sept. 30, 2007	Sept. 30, 2006	Sept. 30, 2007	Sept. 30, 2006
Net income	\$ 24,397	\$ 23,513	\$ 74,741	\$ 70,675
Increase in unrealized appreciation of investments, net of income tax effect of \$41,551, \$24,977, \$44,955 and \$29,567	78,038	46,097	85,338	54,391
Comprehensive income	\$ 102,435	\$ 69,610	\$ 160,079	\$ 125,066

**Note 3.**

Following is a summary of securities with fixed maturities:

	Sept. 30, 2007	Dec. 31, 2006
Amortized cost	\$ 37,718	\$ 81,243
Gross unrealized gains	1,619	633
Gross unrealized losses		(15)
Fair value	\$ 39,337	\$ 81,861

Following is a summary of marketable equity securities (all common stocks):

	Sept. 30, 2007	Dec. 31, 2006
Total cost	\$ 1,095,952	\$ 511,004
Gross unrealized gains	659,839	529,546
Gross unrealized losses		
Fair value	\$ 1,755,791	\$ 1,040,550

Dollar amounts in thousands except for amounts per share

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**Note 4.**

Federal and state environmental agencies have made claims relating to alleged contamination of soil and groundwater with trichloroethylene and perchloroethylene against Precision Brand Products ( PBP ), whose results, like those of its parent, Precision Steel, are included in Wesco s industrial segment, and various other businesses situated in an industrial park in Downers Grove, Illinois. PBP, along with the other businesses, have been negotiating remedial actions with various governmental entities.

PBP, Precision Steel, and other parties were also named in several civil lawsuits relating to the foregoing matter. Each of these civil lawsuits was recently settled with the plaintiffs for amounts that are not material to Wesco.

Muniz v. Precision Brand Products, Inc., et. al., was a class action in the U.S. District Court for the Northern District of Illinois alleging diminution of property values. It was settled in the first quarter of 2007 for a total of \$15,750. PBP s share of that amount was \$1,812.

Bendik v. Precision Brand Products, Inc. and Precision Steel Warehouse, Inc. was a state court claim in the Circuit Court of Cook County, Illinois in which the plaintiff alleged that exposure to contaminants allegedly released by PBP and Precision Steel caused her to contract cancer. The case was settled in the third quarter of 2007 for \$2,662. PBP s and Precision Steel s share of that amount was \$600.

Pote v. Precision Brand Products, Inc. and Precision Steel Warehouse, Inc. was a wrongful death action brought in the same court as the Bendik matter alleging that soil and groundwater contaminants from the industrial park were responsible for Mr. Pote s death. The case was settled in the second quarter of 2007 for \$1,250. PBP s and Precision Steel s share of that amount was \$77.

PBP and Precision Steel are in various stages of negotiations with their insurers, who undertook the cost of their defenses and agreed to indemnify them within the policy limits in connection with these matters, but have reserved their rights retroactively to decline coverage and receive reimbursement of amounts paid.

Included in other liabilities on the accompanying condensed consolidated balance sheet is \$1,087 as of September 30, 2007, representing the remaining unpaid balance as of that date, resulting from provisions previously recorded by PBP, representing PBP s estimated share of costs of remediation agreed to with governmental entities and other parties, and related expenses, as well as estimated costs and expenses associated with matters discussed above (the allowance for environmental costs ). Management anticipates that additional provisions may be required with respect to the Federal and state claims summarized above, in addition to the previously recorded amount included in the allowance for environmental costs. However, as of September 30, 2007, it was not possible to reasonably estimate the amount, if any, of additional costs or a range of costs that may be required in connection with these matters, or any related benefit from insurance indemnification. Although it is not expected that the ultimate impact of such future costs will be material in relation to Wesco s shareholders equity, the effect on industrial segment and consolidated net income in any given period could be material.

Dollar amounts in thousands except for amounts per share

**Table of Contents****Note 5.**

Following is condensed consolidated financial information for Wesco, by business segment:

	Three Months Ended		Nine Months Ended	
	Sept. 30, 2007	Sept. 30, 2006	Sept. 30, 2007	Sept. 30, 2006
Insurance segment:				
Revenues	\$ 37,444	\$ 37,686	\$ 109,660	\$ 105,233
Net income	16,832	15,529	54,910	48,058
Assets at end of period	2,776,257	2,295,562	2,776,257	2,295,562
Furniture rental segment:				
Revenues	\$ 102,522	\$ 103,307	\$ 303,044	\$ 304,945
Net income	7,368	7,645	18,904	21,281
Assets at end of period	255,950	265,551	255,950	265,551
Industrial segment:				
Revenues	\$ 15,436	\$ 15,771	\$ 47,164	\$ 49,056
Net income	176	270	911	1,209
Assets at end of period	23,572	19,452	23,572	19,452
Goodwill of acquired businesses (included in assets)				
	\$ 266,607	\$ 266,607	\$ 266,607	\$ 266,607
Other items unrelated to business segments:				
Revenues	\$ 1,262	\$ 1,189	\$ 3,733	\$ 3,517
Net income	21	69	16	127
Assets at end of period	81,444	58,121	81,444	58,121
Consolidated totals:				
Revenues	\$ 156,664	\$ 157,953	\$ 463,601	\$ 462,751
Net income	24,397	23,513	74,741	70,675
Assets at end of period	3,403,830	2,905,293	3,403,830	2,905,293

Dollar amounts in thousands except for amounts per share

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WESCO FINANCIAL CORPORATION  
MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Reference is made to Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations appearing on pages 22 through 36 of the Form 10-K Annual Report filed by Wesco Financial Corporation (Wesco) for the year 2006 for information deemed generally appropriate to an understanding of the accompanying condensed consolidated financial statements. The information set forth in the following paragraphs updates such discussion. Further, in reviewing the following paragraphs, attention is directed to the accompanying unaudited condensed consolidated financial statements.

OVERVIEW

*Financial Condition*

Wesco continues to have a strong consolidated balance sheet at September 30, 2007, with relatively little debt and no hedging. Liquidity, which has traditionally been high, has been higher than usual for the past several years due principally to sales, maturities and redemptions of fixed-maturity investments, and reinvestment of the proceeds, mainly in cash equivalents pending redeployment. In the third quarter of 2007, \$585 million was invested in marketable equity securities. Of that amount, \$248 million is reflected on the condensed consolidated balance sheet as a liability for securities purchased. The Company's consolidated balance sheet also reflects marketable equity securities of \$1.756 billion as of September 30, 2007, versus \$1.041 billion as of December 31, 2006, stated at fair value.

*Results of Operations*

Consolidated after-tax earnings improved for the third quarter and first nine months of 2007 from the figures reported for the 2006 periods as a result of increased investment income of the insurance businesses, partially offset by several factors, including, increased operating expenses of the furniture rental business, as the Company's CORT Business Services Corporation subsidiary expands and redirects the marketing of its rental relocation services from targeting individuals to targeting corporate clients, and decreased underwriting income of the insurance businesses.

FINANCIAL CONDITION

Wesco's shareholders' equity at September 30, 2007 was \$2.55 billion (\$358 per share), up from \$2.40 billion (\$337 per share) at December 31, 2006. Shareholders' equity included \$430 million at September 30, 2007, and \$345 million at December 31, 2006, representing appreciation in market value of investments, which is credited directly to shareholders' equity, net of taxes, without being reflected in earnings. Because unrealized appreciation is recorded using market quotations, gains or losses ultimately realized upon sale of investments could differ substantially from recorded unrealized appreciation.

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Wesco's consolidated cash and cash equivalents, held principally by its insurance businesses, amounted to \$970 million at September 30, 2007, versus \$1.26 billion held at December 31, 2006. Included in the September figure was \$248 million, paid for securities purchased, early in October.

Wesco's consolidated borrowings totaled \$39.8 million at September 30, 2007 versus \$38.2 million at December 31, 2006. The increase in borrowings related to a revolving credit facility used in the furniture rental business. In addition to the recorded debt, the liability for unpaid losses and loss adjustment expenses of Wesco's insurance businesses totaled \$88.1 million at September 30, 2007, versus \$78.3 million at December 31, 2006. In addition to this recorded debt, Wesco and its subsidiaries have operating lease and other contractual obligations which, at September 30, 2007, were essentially unchanged from the \$147.4 million included in the table of off-balance sheet arrangements and contractual obligations appearing on page 32 of its Form 10-K Annual Report for the year ended December 31, 2006.

**RESULTS OF OPERATIONS**

Wesco's reportable business segments are organized in a manner that reflects how Wesco's top management views those business activities. Wesco's management views insurance businesses as possessing two distinct operations underwriting and investing, and believes that underwriting gain or loss is an important measure of their financial performance. Underwriting gain or loss represents the simple arithmetic difference between the following line items appearing on the consolidated statement of income: (1) insurance premiums earned, less (2) insurance losses and loss adjustment expenses, and insurance underwriting expenses. Management's goal is to generate underwriting gains over the long term. Underwriting results are evaluated without allocation of investment income.

The condensed consolidated income statement appearing on page 5 has been prepared in accordance with generally accepted accounting principles (GAAP). Revenues, including realized net investment gains, if any, are followed by costs and expenses, and a provision for income taxes, to arrive at net income. The following summary sets forth the after-tax contribution to GAAP net income of each business segment—insurance, furniture rental and industrial—as well as activities not considered related to such segments. Realized net investment gains, if any, are excluded from segment activities, consistent with the way Wesco's management views the business operations. (Amounts are in thousands, *all after income tax effect.*)

	Three Months Ended		Nine Months Ended	
	Sept. 30, 2007	Sept. 30, 2006	Sept. 30, 2007	Sept. 30, 2006
Insurance segment:				
Underwriting gain (loss)	\$ (581)	\$ 240	\$ 5,629	\$ 5,795
Investment income	17,413	15,289	49,281	42,263
Furniture rental segment	7,368	7,645	18,904	21,281
Industrial segment	176	270	911	1,209
Nonsegment items	21	69	16	127
Consolidated net income	\$ 24,397	\$ 23,513	\$ 74,741	\$ 70,675

**Table of Contents***Insurance Segment*

The insurance segment is comprised of Wesco-Financial Insurance Company ( Wes-FIC ) and The Kansas Bankers Surety Company ( KBS ). Their operations are conducted or supervised by wholly owned subsidiaries of Berkshire Hathaway Inc. ( Berkshire ), Wesco 's ultimate parent company. Following is a summary of the results of segment operations, which represents the combination of underwriting results with dividend and interest income. (Amounts are in thousands.)

	Three Months Ended		Nine Months Ended	
	Sept. 30, 2007	Sept. 30, 2006	Sept. 30, 2007	Sept. 30, 2006
Insurance premiums written				
Reinsurance	\$ 9,787	\$ 12,904	\$ 26,849	\$ 28,424
Primary	4,354	4,319	14,382	14,860
Total	\$ 14,141	\$ 17,223	\$ 41,231	\$ 43,284
Insurance premiums earned				
Reinsurance	\$ 8,406	\$ 10,688	\$ 25,610	\$ 28,581
Primary	4,874	5,185	14,488	15,823
Total	13,280	15,873	40,098	44,404
Insurance losses, loss adjustment expenses and underwriting expenses	14,174	15,504	31,438	35,489
Underwriting gain (loss), before income taxes				
Reinsurance	(1,419)	(694)	1,731	3,992
Primary	525	1,063	6,929	4,923
Total	(894)	369	8,660	8,915
Income taxes	(313)	129	3,031	3,120
Underwriting gain (loss)	\$ (581)	\$ 240	\$ 5,629	\$ 5,795

At September 30, 2007, in-force reinsurance business consisted of the participation in three pools of aviation-related risks: hull and liability pools, each to the extent of 16.67%, and a workers' compensation pool to the extent of 5%. In 2006, in-force reinsurance consisted of participation in the same pools of aviation-related risks, with the participation in the hull and liability pools at the 12.5% level. Wes-FIC 's reinsurance activities have fluctuated from period to period as participations in reinsurance contracts have become available both through insurance subsidiaries of Berkshire, and otherwise.

The nature of Wes-FIC 's participation in the aviation-related reinsurance contracts requires that estimates be made not only as to losses and expenses incurred, but also as to premiums written, due to a time lag in reporting by the ceding pools. Reinsurance premiums written for the 2007 periods decreased by \$3.1 million (24.2%) for the third quarter, and \$1.6 million (5.5%) for the first nine months, from the comparable figures reported for the corresponding 2006 periods. These results occurred despite the 33.3% increase in the percentage by which Wes-FIC has participated in the hull and liability pools during 2007. As competition has intensified in the aviation market, the pools have experienced greater pricing pressure, and have continued to exercise underwriting discipline by not writing policies where pricing was deemed inadequate with respect to the risks assumed.





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Earned reinsurance premiums decreased \$2.3 million (21.4%) for the third quarter of 2007, and \$3.0 million (10.4%) for the first nine months, as compared with premiums earned for the corresponding periods of 2006. Premiums are amortized into income ratably over the coverage period, and, therefore, there is often a difference in the relative fluctuation in written versus earned premiums from period to period.

Written primary insurance premiums increased \$35 thousand (0.8%) for the third quarter of 2007, but decreased \$0.5 million (3.2%) for the first nine months, from the corresponding 2006 amounts. KBS has experienced intensified price competition during approximately the past two years, and has reacted through the exercise of underwriting discipline. It does not write business when pricing is deemed inadequate with respect to risks assumed.

Earned primary insurance premiums decreased \$0.3 million (6.0%) for the third quarter of 2007, and \$1.3 million (8.4%) for the first nine months, from those of the corresponding 2006 periods. Not only has there been an increase in KBS's cost of reinsurance, but premiums are amortized into income ratably over the coverage period, and, therefore, there is often a difference in the relative fluctuation in written versus earned premiums from period to period.

Management believes that underwriting gain or loss is an important measure of financial performance of insurance companies. The sum of insurance losses and loss adjustment expenses, and underwriting expenses, divided by premiums, gives the combined ratio. A combined ratio of less than 100% connotes an underwriting profit and a combined ratio of greater than 100% connotes an underwriting loss. The ratio is figured on a pre-tax basis.

Underwriting results of Wesco's insurance segment have generally been favorable, but have fluctuated from period to period for various reasons, including competitiveness of pricing in terms of premiums charged for risks assumed, and volatility of losses incurred. The pre-tax underwriting *loss* from reinsurance activities increased by \$0.7 million for the third quarter of 2007 from that of the corresponding 2006 quarter. For the first nine months, the pre-tax underwriting *gain* from reinsurance activities decreased by \$2.3 million from the corresponding 2006 figure. The combined ratios from reinsurance activities were 116.8% and 106.5% for the third quarters of 2007 and 2006, and 93.2% and 86.2% for the respective nine-month periods. These underwriting results reflect not only higher levels of claims recorded in the third quarters of each year, but also the detrimental effects caused by the softening of premium rates and, for the 2007 periods, the higher level of participation in the hull and liability contracts. It should be noted that the profitability of a reinsurance or insurance arrangement is better assessed after all losses and expenses have been realized, perhaps many years after the coverage period, rather than for any given quarterly reporting period.

Combined ratios from primary insurance were 89.2% and 79.5% for the third quarters of 2007 and 2006, and 79.5% and 68.9% for the respective nine-month periods. The combined ratio for the first nine months of 2007 reflects favorable reserve development of \$0.9 million, net, recorded in the second quarter. That figure was attributable to \$1.9 million of favorable development following a court decision relating to a loss recorded in 2005, partially offset by unfavorable development of \$1.0 million relating to a claim originally reported to KBS in 2003.

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Wesco's insurers retain most of their business and cede modest amounts of business to reinsurers; consequently, underwriting results may be volatile. Instead of paying reinsurers large amounts to minimize risks associated with significant losses, management accepts volatility in underwriting results provided the prospects of long-term underwriting profitability remain favorable.

Following is a summary of investment income produced by Wesco's insurance segment (in thousands of dollars).

	Three Months Ended		Nine Months Ended	
	Sept. 30, 2007	Sept. 30, 2006	Sept. 30, 2007	Sept. 30, 2006
Investment income, before taxes	\$ 24,163	\$ 21,813	\$ 69,561	\$ 60,829
Income taxes	6,750	6,524	20,280	18,566
Investment income, after taxes	\$ 17,413	\$ 15,289	\$ 49,281	\$ 42,263

Investment income of the insurance segment comprises dividends and interest earned principally from the investment of shareholder capital (including reinvested earnings) as well as float (principally premiums received before payment of related claims and expenses).

Pre-tax investment income increased \$2.4 million (10.8%) for the third quarter of 2007, from the corresponding 2006 figure, principally as a result of increased dividend income. Pre-tax investment income increased \$8.7 million (14.4%) for the first nine months of 2007, reflecting mainly increased interest earned on short-term investments during the first half of 2007, due principally to higher interest rates earned on short-term investments, as well as increased dividend income for the nine-month period.

The income tax provisions, expressed as percentages of pre-tax investment income, shown in the foregoing table, amounted to 27.9% and 29.9% for the third quarters of 2007 and 2006, and 29.2% and 30.5% for the respective nine-month periods. These fluctuations reflect the relation of dividend income, which is substantially exempt from income taxes, to interest income, which is fully taxable.

Management continues to seek to invest cash balances in the purchase of businesses and in long-term equity holdings.

**Table of Contents***Furniture Rental Segment*

The furniture rental segment consists of CORT Business Services Corporation ( CORT ). Following is a summary of segment operating results. (Amounts are in thousands.)

	Three Months Ended		Nine Months Ended	
	Sept. 30, 2007	Sept. 30, 2006	Sept. 30, 2007	Sept. 30, 2006
Revenues:				
Furniture rentals	\$ 84,063	\$ 83,323	\$ 249,839	\$ 246,019
Furniture sales	16,253	17,920	47,695	53,569
Service fees	2,206	2,064	5,510	5,357
Total revenues	102,522	103,307	303,044	304,945
Cost of rentals, sales and fees	23,917	26,225	69,878	76,817
Selling, general and administrative expenses	66,016	64,059	200,421	191,057
Interest expense	641	775	1,828	2,033
	90,574	91,059	272,127	269,907
Income before income taxes	11,948	12,248	30,917	35,038
Income taxes	4,580	4,603	12,013	13,757
Segment net income	\$ 7,368	\$ 7,645	\$ 18,904	\$ 21,281

Furniture rental revenues for the third quarter of 2007 increased \$0.7 million (0.9%) from those of the third quarter of 2006, and for the first nine months of 2007, by \$3.8 million (1.6%) from those of the first nine months of 2006. Excluding \$8.5 million and \$7.3 million of rental revenues from trade shows and from locations not in operation throughout each of the three-month periods, and \$31.1 million and \$25.9 million of similar revenues for each of the nine-month periods, rental revenues were relatively unchanged from those of the third quarter and nine-month periods of last year. The number of furniture leases outstanding at the end of the third quarter of 2007 was 4.9% lower than at the end of the third quarter of 2006. The decrease in the number of outstanding leases continues a trend that developed late in 2006, believed to be due principally to non-renewals of leases generated in the aftermath of hurricanes Katrina and Rita, increased interest rates and energy prices, and customer uncertainty as to future economic conditions. Despite the continued decline in the number of furniture leases outstanding, the furniture rental revenues have grown due mainly to an increase in tradeshow demand and improved pricing.

Furniture sales revenues for the third quarter of 2007 decreased \$1.7 million (9.3%) from those of the third quarter of 2006, and for the first nine months of 2007, by \$5.9 million (11.0%) from those of the first nine months of 2006. The decreases are believed to be attributed principally to the continued softening of the housing market and higher energy prices that have contributed to an industry-wide decline in retail furniture sales.

Service fees for the third quarter and first nine months of 2007 were relatively unchanged from those reported for the third quarter and first nine months of 2006. Traditionally, the furniture segment has concentrated the marketing efforts of its relocation services towards individual residential customers. Late last year, CORT began a new initiative to expand the variety of its relocation services, and it redirected the thrust of this activity towards providing these services to corporate relocation departments for their relocating employees in need of temporary or longer-term housing. Management is hopeful that the expansion of facilities and personnel devoted to the relocation service as well as the change in focus of its relocation activities will result in profitable long-term revenue growth.

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Cost of rentals, sales and fees amounted to 23.3% and 23.1% of revenues for the third quarter and first nine months of 2007, versus 25.4% and 25.2% for the corresponding periods of 2006. The decrease in costs as a percentage of revenues was due principally to a shift in revenue mix, with a larger percentage of revenue coming from furniture rental, which has a higher margin than furniture sales.

Selling, general, administrative and interest expenses ( operating expenses ) for the third quarter of 2007 increased \$1.8 million (2.8%) from those reported for the third quarter of 2006, and \$9.2 million (4.7%) from those reported for the first nine months of 2006. The increase in operating expenses in 2007 was due principally to an increase in personnel devoted to the rental relocation service as CORT redirects its marketing efforts to target corporate clients, and other related expenses.

Operating expenses as a percentage of revenues increased from 62.8% for the third quarter and 63.3% for the first nine months of 2006, to 65.0% for the third quarter and 66.7% for the first nine months of 2007. The increases were principally attributable to the increased operating expenses and the softness of retail revenues.

Income before income taxes for the furniture rental segment amounted to \$11.9 million for the third quarter and \$30.9 million for the first nine months of 2007, versus \$12.2 million for the third quarter and \$35.0 million for the first nine months of 2006. The 2.5% decrease in pre-tax operating results for the third quarter, and 11.8% decrease for the first nine months of 2007, were principally attributable to the significant increases in personnel-related expenses, offset somewhat by increased gross profits resulting from changes in revenue mix.

*Industrial Segment*

Following is a summary of the results of operations of the industrial segment, which consists of the businesses of Precision Steel Warehouse, Inc. and its subsidiaries. (Amounts are in thousands.)

	Three Months Ended		Nine Months Ended	
	Sept. 30, 2007	Sept. 30, 2006	Sept. 30, 2007	Sept. 30, 2006
Revenues	\$ 15,436	\$ 15,771	\$ 47,164	\$ 49,056
Income before income taxes	\$ 281	\$ 449	\$ 1,512	\$ 1,859
Income taxes	105	179	601	650
Segment net income	\$ 176	\$ 270	\$ 911	\$ 1,209

Reference is made to pages 29 and 30 of Wesco's 2006 Annual Report on Form 10-K for information about Wesco's industrial segment, including the challenges affecting the domestic steel service industry since approximately 2000.

Industrial segment revenues decreased \$0.3 million (2.1%) for the third quarter of 2007, and \$1.9 million (3.9%) for the first nine months, as compared with revenues of the corresponding 2006 periods. In the first quarter of 2006, Precision Steel's Precision Brand Products subsidiary made an extraordinarily large sale of toolroom supplies to a single customer. Excluding that transaction, industrial segment

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revenues decreased \$1.0 million (2.1%) for the first nine months of 2007 from those of the corresponding 2006 period. Sales volume, in terms of pounds sold, decreased 12.7% for the third quarter of 2007, and 17.1% for the first nine months, from sales volume of the corresponding 2006 periods. The relative stability of revenues for the current periods, as compared with those of the corresponding periods last year, has been attributable principally to ongoing increases, approximating 19%, in average selling prices per pound over the past eighteen months.

As explained in Note 4 to the accompanying condensed consolidated financial statements, Precision Steel and a subsidiary are involved in an environmental matter, the ultimate cost of which is difficult to estimate. Segment operating results for the first nine months of 2006 reflect a charge for estimated costs relating to this matter of \$0.8 million (\$0.5 million, after taxes), recorded in the second quarter. No similar costs were incurred in the 2007 periods.

Income before income taxes of the industrial segment decreased \$0.2 million for the third quarter of 2007, and \$0.3 million for the first nine months, from the corresponding 2006 figures. Excluding the aforementioned litigation-related expense recorded in the second quarter of 2006, income before income taxes of the industrial segment decreased \$1.1 million for the first nine months of 2007, from the pre-tax figure for last year's first nine months. The decreases in pre-tax and net income for the 2007 periods resulted principally from the decreases in gross profit as a percentage of revenues, from 15.7% for the third quarter and 17.7% for the first nine months of 2006, to 15.0% and 16.2% for the corresponding periods of 2007, and, for the 9-month period, to the absence in 2007 of a very large sale of toolroom supplies as occurred in the first quarter of 2006.

\* \* \* \* \*

**OFF-BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS**

Reference is made to page 32 of Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, of the Form 10-K Annual Report filed by Wesco for the year ended December 31, 2006, for a table summarizing the contractual obligations associated with ongoing business activities of Wesco and its subsidiaries, some of which are off-balance sheet, and involve cash payments in periods after yearend 2006. At September 30, 2007, there have been no material changes in contractual obligations, including off-balance sheet arrangements, of Wesco or its subsidiaries from those reported as of December 31, 2006.

**CRITICAL ACCOUNTING POLICIES AND PRACTICES**

Reference is made to pages 32 to 34 of Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, of the Form 10-K Annual Report filed by Wesco for the year ended December 31, 2006 for the accounting policies and practices considered by Wesco's management to be critical to its determination of consolidated financial position and results of operations, as well as to Note 1 to Wesco's consolidated financial statements appearing on pages 46 through 48 thereof for a description of the significant policies and practices followed by Wesco (including those deemed critical) in preparing its consolidated financial statements. There have been no changes in significant policies and practices through September 30, 2007.

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**FORWARD-LOOKING STATEMENTS**

Certain representations of management stated in this report or elsewhere constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, as contrasted with statements of historical fact. Forward-looking statements include statements which are predictive in nature, or which depend upon or refer to future events or conditions, or which include words such as *expects, anticipates, intends, plans, believes, estimates, may, or could*, or which involve hypothetical events. Forward-looking statements are based on information currently available and are subject to various risks and uncertainties that could cause actual events or results to differ materially from those characterized as being likely or possible to occur. Such statements should be considered judgments only, not guarantees, and Wesco's management assumes no duty, nor has it any specific intention, to update them.

Actual events and results may differ materially from those expressed or forecasted in forward-looking statements due to a number of factors. The principal important risk factors that could cause Wesco's actual performance and future events and actions to differ materially from those expressed in or implied by such forward-looking statements include, but are not limited to, changes in market prices of Wesco's significant equity investments, the occurrence of one or more catastrophic events such as acts of terrorism, hurricanes, or other events that cause losses insured by Wesco's insurance subsidiaries, changes in insurance laws or regulations, changes in income tax laws or regulations, and changes in general economic and market factors that affect the prices of investment securities or the industries in which Wesco and its affiliates do business.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**WESCO FINANCIAL CORPORATION**

Date: November 2, 2007

By: /s/ Jeffrey L. Jacobson  
Jeffrey L. Jacobson  
Vice President and  
Chief Financial Officer  
(principal financial officer)