

WESCO FINANCIAL CORP

Form 10-Q

August 12, 2003

**Table of Contents**

**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 June 30, 2003 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 an accelerated filer (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 August 6, 2003

---

**TABLE OF CONTENTS**

CONDENSED CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

CONDENSED CONSOLIDATED BALANCE SHEET

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK ANALYSIS

SIGNATURES

EXHIBIT 31.1

EXHIBIT 31.2

EXHIBIT 32.1

EXHIBIT 32.2

---

**Table of Contents****PART I. FINANCIAL INFORMATION**

	<b>Page(s)</b>
Item 1. Financial Statements	
Condensed consolidated statement of income and retained earnings three- and six-month periods ended June 30, 2003 and June 30, 2002	4
Condensed consolidated balance sheet June 30, 2003 and December 31, 2002	5
Condensed consolidated statement of cash flows six-month periods ended June 30, 2003 and June 30, 2002	6
Notes to condensed consolidated financial statements	7-9
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	10-17
Item 3. Quantitative and Qualitative Disclosures About Market Risk	17

## Item 4. Controls and Procedures.

An evaluation was performed under the supervision and with the participation of the management of Wesco Financial Corporation (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 June 30, 2003. Based on that evaluation, Mr. Munger and Mr. Jacobson concluded that Wesco's disclosure controls and procedures are effective in ensuring that information required to be disclosed by Wesco 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 and Exchange Commission. There have been no material changes in Wesco's internal controls over financial reporting or in other factors reasonably likely to affect the internal controls over financial reporting during the quarter ended June 30, 2003.

**Table of Contents**

**PART II. OTHER INFORMATION**

Item 4. Submission of Matters to a Vote of Security-Holders

Following is a table showing the votes cast for, and withheld from voting for, each nominee at the annual meeting of shareholders of Wesco held May 7, 2003, at which meeting the shareholders elected the following Directors:

<b>Name</b>	<b>Favorable Votes</b>	<b>Votes Withheld</b>
Charles T. Munger	6,841,621	101,656
Robert H. Bird	6,839,611	103,666
Carolyn H. Carlburg	6,936,467	6,810
Robert E. Denham	6,777,642	165,635
Robert T. Flaherty	6,935,796	7,301
Peter D. Kaufman	6,938,426	4,851
Elizabeth Caspers Peters	6,935,401	7,876

Shareholders abstained from voting 180 shares with respect to Mr. Flaherty. There were no broker non-votes. No other matters were voted upon at the meeting.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

31.1 - Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Chief Executive Officer)

31.2 - Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Chief Financial Officer)

32.1 - Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chief Executive Officer)

32.2 - Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chief Financial Officer)

(b) Reports on Form 8-K Report dated May 9, 2003  
Item reported: 12

**Table of Contents**

**WESCO FINANCIAL CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENT OF**  
**INCOME AND RETAINED EARNINGS**  
(Dollar amounts in thousands except for amounts per share)  
(Unaudited)

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30, 2003</b>	<b>June 30, 2002</b>	<b>June 30, 2003</b>	<b>June 30, 2002</b>
<b>Revenues:</b>				
Sales and service revenues	\$ 103,745	\$ 111,928	\$ 209,437	\$ 223,893
Insurance premiums earned	22,480	13,192	56,513	26,091
Dividend and interest income	12,889	18,448	27,388	36,082
Realized investment gains	52,208		53,019	
Other	803	829	1,607	1,640
	<u>192,125</u>	<u>144,397</u>	<u>347,964</u>	<u>287,706</u>
<b>Costs and expenses:</b>				
Cost of products and services sold	35,785	39,305	74,020	78,657
Insurance losses, loss adjustment and underwriting expenses	15,937	12,919	42,481	24,847
Selling, general and administrative expenses	72,177	70,390	144,456	139,637
Interest expense	140	510	380	1,073
	<u>124,039</u>	<u>123,124</u>	<u>261,337</u>	<u>244,214</u>
Income before income taxes and minority interest	68,086	21,273	86,627	43,492
Provision for income taxes	(22,673)	(6,393)	(29,270)	(14,175)
Minority interest in loss of subsidiary	568		1,128	
	<u>45,981</u>	<u>14,880</u>	<u>58,485</u>	<u>29,317</u>
Retained earnings beginning of period	1,563,273	1,521,814	1,553,152	1,509,691
Cash dividends declared and paid	(2,386)	(2,315)	(4,769)	(4,629)
	<u>\$ 1,606,868</u>	<u>\$ 1,534,379</u>	<u>\$ 1,606,868</u>	<u>\$ 1,534,379</u>
<b>Amounts per capital share based on 7,119,807 shares outstanding throughout each period:</b>				
Net income	\$ 6.45	\$ 2.09	\$ 8.21	\$ 4.12
	<u>\$ .335</u>	<u>\$ .325</u>	<u>\$ .670</u>	<u>\$ .650</u>

See notes beginning on page 7.

**Table of Contents**

**WESCO FINANCIAL CORPORATION**  
**CONDENSED CONSOLIDATED BALANCE SHEET**  
(Dollar amounts in thousands)  
(Unaudited)

	June 30, 2003	Dec. 31, 2002
<b>ASSETS</b>		
Cash and cash equivalents	\$ 933,142	\$ 349,812
Investments:		
Securities with fixed maturities	293,545	827,537
Marketable equity securities	671,046	626,768
Rental furniture	184,285	187,480
Goodwill of acquired businesses	266,455	266,203
Other assets	126,477	149,175
	<u>\$2,474,950</u>	<u>\$2,406,975</u>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Insurance losses and loss adjustment expenses	\$ 90,629	\$ 73,065
Unearned insurance premiums	26,882	48,681
Deferred furniture rental income and security deposits	21,511	21,562
Notes payable	18,761	32,481
Income taxes payable, principally deferred	245,685	227,902
Other liabilities	56,324	45,122
	<u>459,792</u>	<u>448,813</u>
Minority shareholders' interest in net assets of subsidiary	<u>1,226</u>	<u></u>
Shareholders' equity:		
Capital stock and additional paid-in capital	31,628	30,439
Unrealized appreciation of investments, net of taxes	375,436	374,571
Retained earnings	1,606,868	1,553,152
	<u>2,013,932</u>	<u>1,958,162</u>
Total shareholders' equity	<u>\$2,474,950</u>	<u>\$2,406,975</u>

See notes beginning on page 7.



**Table of Contents**

**WESCO FINANCIAL CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS**  
(Dollar amounts in thousands)  
(Unaudited)

	<b>Six Months Ended</b>	
	<b>June 30, 2003</b>	<b>June 30, 2002</b>
Cash flows from operating activities, net	\$ 88,035	\$ 87,223
Cash flows from investing activities:		
Maturities and redemptions of securities with fixed maturities	193,908	221,245
Sales of securities with fixed maturities	351,180	
Purchases of securities with fixed maturities	(2,561)	(288,936)
Acquisitions of businesses, net of cash and cash equivalents acquired	(3,440)	(30,285)
Purchases of rental furniture	(32,304)	(25,643)
Other, net	(3,880)	(2,689)
Net cash flows from investing activities	502,903	(126,308)
Cash flows from financing activities:		
Net increase (decrease) in line of credit borrowings	(3,600)	8,326
Payment of cash dividends	(4,769)	(4,629)
Other, net	761	
Net cash flows from financing activities	(7,608)	3,697
Increase (decrease) in cash and cash equivalents	583,330	(35,388)
Cash and cash equivalents   beginning of period	349,812	120,784
Cash and cash equivalents   end of period	\$933,142	\$ 85,396
Supplementary information:		
Interest paid during period	\$ 415	\$ 1,065
Income taxes paid (recovered), net, during period	12,056	(16,632)
Noncash activities   conversion of debt to equity in subsidiary	9,808	

*See notes beginning on page 7.*

**Table of Contents**

**WESCO FINANCIAL CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
(Dollar amounts in thousands except for amounts per share)  
(Unaudited)

**Note 1**

In management's opinion, the condensed consolidated financial statements of Wesco Financial Corporation (Wesco) 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.

Reference is made to the notes to Wesco's consolidated financial statements appearing on pages 42 through 50 of its 2002 Form 10-K Annual Report for other information deemed generally applicable to the condensed consolidated financial statements.

Wesco's management does not believe that any accounting pronouncements issued to date by the Financial Accounting Standards Board and required to be adopted after June 30, 2003 will have a material effect on reported shareholders' equity.

**Note 2**

In January 2001, Wesco's furniture rental subsidiary, CORT Business Services Corporation (CORT), formed a marketing subsidiary, Relocation Central Corporation (Relocation Central), which partially financed its start-up by issuing convertible notes primarily to unrelated parties. In February 2003, most note holders exercised their options to convert their notes into approximately 20% of Relocation Central's common stock. The minority shareholders also had an option to require CORT to purchase the shares in February 2004 for approximately \$6,000. Relocation Central's operations have not been profitable to date. In recording the retirement of such notes in the first quarter of 2003, the approximately \$6,000 contingent liability was included in other liabilities, and the approximately \$1,200 anticipated benefit from the conversion was treated as additional paid-in capital; the condensed consolidated balance sheet at June 30, 2003 reflects these amounts. In July 2003, the minority shareholders were permitted to exercise their put option early, and upon reacquisition of the shares CORT's ownership in Relocation Central increased to approximately 100%.

**Note 3**

Following is a summary of securities with fixed maturities:

	<b>June 30, 2003</b>		<b>December 31, 2002</b>	
	<b>Amortized Cost</b>	<b>Fair (Carrying) Value</b>	<b>Amortized Cost</b>	<b>Fair (Carrying) Value</b>
Mortgage-backed securities	\$ 268,249	\$ 280,605	\$ 463,176	\$ 484,760
Other	12,142	12,940	308,364	342,777
	<u>\$ 280,391</u>	<u>\$ 293,545</u>	<u>\$ 771,540</u>	<u>\$ 827,537</u>

# Table of Contents

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

	June 30, 2003		December 31, 2002	
	Cost	Quoted Market (Carrying) Value	Cost	Quoted Market (Carrying) Value
The Coca-Cola Company	\$ 40,761	\$334,412	\$ 40,761	\$315,893
The Gillette Company	40,000	203,904	40,000	194,304
Other	27,020	132,730	27,020	116,571
	<u>\$ 107,781</u>	<u>\$671,046</u>	<u>\$ 107,781</u>	<u>\$626,768</u>

There were no unrealized losses with respect to securities with fixed maturities or marketable equity securities at June 30, 2003 or December 31, 2002.

## Note 4

The following table sets forth Wesco's consolidated comprehensive income for the three- and six-month periods ended June 30, 2003 and 2002:

	Three Months Ended		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
Net income	\$45,981	\$14,880	\$58,485	\$29,317
Increase in unrealized appreciation of investments, net of income tax effect of \$11,212, \$12,453, \$570 and \$30,154	20,526	23,091	865	55,636
Comprehensive income	<u>\$66,507</u>	<u>\$37,971</u>	<u>\$59,350</u>	<u>\$84,953</u>

## Note 5

Federal and state environmental agencies have made claims relating to alleged contamination of soil and groundwater against Precision Steel's Precision Brand Products subsidiary (PBP) and various other businesses situated in a business park in Downers Grove, Illinois. The extent of PBP's liability has not yet been established. Nevertheless, PBP, along with the other businesses, is negotiating remedial actions with various governmental entities. In addition, PBP and other parties have been named in several civil lawsuits, including lawsuits by and on behalf of area residents, relating to this matter. Precision Steel and PBP have notified their insurers relative to the claims and litigation. Inasmuch as the claims and lawsuits are in early stages of development, the cost of the claims, including defense costs, cannot be reasonably estimated at this time. Management does not anticipate that the ultimate financial impact of these matters will be material in relation to Wesco's shareholders' equity, although it believes that the effect on consolidated net income in any given period could be material.

**Table of Contents**

## Note 6

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30, 2003</b>	<b>June 30, 2002</b>	<b>June 30, 2003</b>	<b>June 30, 2002</b>
<b>Insurance segment:</b>				
Revenues	\$ 35,246	\$ 31,465	\$ 83,650	\$ 61,860
Net income	12,716	12,643	27,528	25,201
Assets at end of period	1,894,283	1,852,665	1,894,283	1,852,665
<b>Furniture rental segment:</b>				
Revenues	\$ 92,657	\$ 99,509	\$ 186,027	\$ 199,701
Net income (loss)	(633)	1,988	(3,655)	3,742
Assets at end of period	266,667	301,566	266,667	301,566
<b>Industrial segment:</b>				
Revenues	\$ 11,093	\$ 12,432	\$ 23,428	\$ 24,212
Net income (loss)	(103)	128	(40)	124
Assets at end of period	19,317	19,219	19,317	19,219
Goodwill of acquired businesses, at end of period	\$ 266,455	\$ 264,930	\$ 266,455	\$ 264,930
<b>Realized investment gains:</b>				
Before taxes (included in revenues)	\$ 52,208	\$	\$ 53,019	\$
After taxes (included in net income)	33,935		34,462	
<b>Other items unrelated to business segments:</b>				
Revenues	\$ 921	\$ 991	\$ 1,840	\$ 1,933
Net income	66	121	190	250
Assets at end of period	28,228	25,840	28,228	25,840
<b>Consolidated totals:</b>				
Revenues	\$ 192,125	\$ 144,397	\$ 347,964	\$ 287,706
Net income	45,981	14,880	58,485	29,317
Assets at end of period	2,474,950	2,464,220	2,474,950	2,464,220

**Table of Contents**

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 21 through 29 of the Form 10-K Annual Report filed by Wesco Financial Corporation (Wesco) for the year 2002 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 condensed consolidated financial statements.

FINANCIAL CONDITION

Wesco's shareholders' equity at June 30, 2003 was approximately \$2.01 billion (\$283 per share), compared to \$1.96 billion (\$275 per share) at December 31, 2002. At each date shareholders' equity included \$375 million of after-tax unrealized appreciation in market value of investments. Because unrealized appreciation is recorded based upon current market quotations, gains or losses ultimately realized upon sale of investments could differ substantially from recorded unrealized appreciation.

At June 30, 2003, Wesco's consolidated cash and cash equivalents totaled \$933.1 million, up from \$349.8 million at December 31, 2002. The \$583.3 million increase resulted primarily as a result of sales, maturities and early redemptions of fixed-income securities as well as operating cash flow from Wesco's insurance businesses.

Wesco's consolidated notes payable totaled \$18.8 million at June 30, 2003 versus \$32.5 million at December 31, 2002. The decrease resulted principally from the conversion of convertible debt of a subsidiary of CORT to equity by note holders.

Wesco's management continues to believe that the Wesco group has adequate liquidity and financial resources to provide for contingent needs.

RESULTS OF OPERATIONS

The following summary sets forth the contribution to Wesco's consolidated net income of each business segment—insurance, furniture rental and industrial—as well as activities not considered related to such segments. (Amounts are in thousands, *all after income tax effect*.)

**Table of Contents**

	Three Months Ended		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
Insurance segment	\$ 12,716	\$ 12,643	\$ 27,528	\$ 25,201
Furniture rental segment	(633)	1,988	(3,655)	3,742
Industrial segment	(103)	128	(40)	124
Nonsegment items other than investment gains	66	121	190	250
Income before investment gains	12,046	14,880	24,023	29,317
Realized investment gains	33,935		34,462	
Consolidated net income	\$ 45,981	\$ 14,880	\$ 58,485	\$ 29,317

*Insurance Segment*

The insurance segment comprises Wesco-Financial Insurance Company ( Wes-FIC ) and The Kansas Bankers Surety Company ( KBS ). Following is a summary of the results of segment operations, which represent essentially the combination of underwriting results with dividend and interest income. (Amounts are in thousands.)

	Three Months Ended		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
Premiums written	\$ 13,028	\$ 19,746	\$ 34,715	\$ 33,238
Premiums earned	\$ 22,480	\$ 13,192	\$ 56,513	\$ 26,091
Underwriting gain	\$ 6,557	\$ 273	\$ 14,046	\$ 1,244
Dividend and interest income	12,766	18,273	27,137	35,769
Income before income taxes	19,323	18,546	41,183	37,013
Income tax provision	(6,607)	(5,903)	(13,655)	(11,812)
Segment net income	\$ 12,716	\$ 12,643	\$ 27,528	\$ 25,201

Premiums written for the second quarters of 2003 and 2002 included \$8.3 million and \$14.7 million written by Wes-FIC. Premiums written for the six-month periods ended June 30, 2003 and 2002 included \$24.5 million and \$22.7 million written by Wes-FIC. The remainder for each period was attributable to KBS.

Earned premiums for the second quarters of 2003 and 2002 included \$17.4 million and \$8.5 million attributable to Wes-FIC. Earned premiums for the first six months of 2003 and 2002 included \$46.4 million and \$16.9 million attributable to Wes-FIC. The balance for each period was attributable to KBS.

At June 30, 2003, Wes-FIC's in-force reinsurance business consists principally of a contract that commenced in 2001 under which it assumes aviation risks, as well as a four-year contract for property and casualty exposures assumed from an unaffiliated insurer. Aviation-risk premiums written in 2003 exceeded those written in the corresponding 2002 periods. The aviation business is managed by another insurance subsidiary of Berkshire Hathaway Inc. ( Berkshire ). Other Berkshire affiliates directly participate in the aviation-risk pools, and those affiliates and Wes-FIC

## Edgar Filing: WESCO FINANCIAL CORP - Form 10-Q

reinsure all members of the pools. Other property/casualty premiums written by Wes-FIC decreased in the 2003 periods compared to those of the corresponding 2002

-11-

---

**Table of Contents**

periods; the decrease was attributed principally to tighter underwriting standards in 2003 with respect to the subject business. The increases in Wes-FIC's earned premiums for the 2003 periods compared to those of the corresponding 2002 periods were attributable mainly to the increase in aviation premiums written over the past twelve months.

The underwriting gain for the quarter ended June 30, 2003 amounted to \$6.6 million, versus \$.3 million for the second quarter of 2002. The underwriting gain for the first six months of 2003 was \$14.0 million, versus \$1.2 million for the first six months of 2002. The underwriting gains reported for the 2003 periods were principally attributable to Wes-FIC; its business benefited mainly from improved pricing and risk selection, and lower levels of aviation losses. The underwriting gains for the corresponding 2002 periods were attributed to the profitable underwriting results of KBS; Wes-FIC had underwriting losses of \$2.0 million for the second quarter and \$2.7 million for the first six months of 2002. Both Wes-FIC and KBS, as a matter of policy, accept volatility in their underwriting results in the hope of achieving higher profitability over the long term.

Dividend and interest income earned by the insurance segment declined for the second quarter and six-month period ended June 30, 2003 from the corresponding prior year figures as proceeds from sales and paydowns of higher-yielding, long-term investments were reinvested in short-term investments whose rates have continued to deteriorate.

The income tax provision of the insurance segment generally fluctuates somewhat as a percentage of its pre-tax income mainly due to changes in the relationship of substantially tax-exempt components of income to total pre-tax income.

*Furniture Rental Segment*

The furniture rental segment consists of CORT Business Services Corporation ( CORT ) and its subsidiary, Relocation Central Corporation ( Relocation Central ). Following is a summary of segment operating results. (Amounts are in thousands.)

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30, 2003</b>	<b>June 30, 2002</b>	<b>June 30, 2003</b>	<b>June 30, 2002</b>
<b>Revenues:</b>				
Furniture rentals	\$ 71,123	\$ 79,848	\$ 142,981	\$ 160,529
Furniture sales	17,119	18,216	34,560	36,469
Apartment locator fees	4,415	1,445	8,486	2,703
<b>Total revenues</b>	<b>92,657</b>	<b>99,509</b>	<b>186,027</b>	<b>199,701</b>
Cost of rentals, sales and fees	26,415	29,174	54,386	58,732
Selling, general and administrative expenses	69,363	67,515	138,876	134,043
Interest expense	141	460	378	972
	<b>95,919</b>	<b>97,149</b>	<b>193,640</b>	<b>193,747</b>
Income (loss) before income taxes and minority interest	(3,262)	2,360	(7,613)	5,954
Income tax (provision) benefit	2,061	(372)	2,830	(2,212)
Minority interest in net loss of Relocation Central	568		1,128	
<b>Segment net income (loss)</b>	<b>\$ (633)</b>	<b>\$ 1,988</b>	<b>\$ (3,655)</b>	<b>\$ 3,742</b>



**Table of Contents**

Reference is made to the discussion of the furniture rental business included in Item 1 of Wesco's 2002 annual report on Form 10-K for information on Relocation Central, considered as still in a start-up phase, and whose operations generated pre-tax losses of \$12.8 million for the year ended December 31, 2002 and \$10.8 million for the year ended December 31, 2001. Following the acquisition of its largest competitor in December 2002, which brought to it mainly additional apartment locator fees and further geographical expansion, Relocation Central's operating losses increased sharply. As explained in Note 2 to the accompanying condensed consolidated financial statements, there was an approximately 20% minority interest in Relocation Central's equity from February through June 2003, thereby reducing the impact of its losses on CORT.

Relocation Central's revenues, consisting of apartment locator fees, amounted to \$4.4 million for the second quarter of 2003 and \$1.4 million for the second quarter of 2002, and \$8.5 million and \$2.7 million for the respective six-month periods. Costs incurred in generating those fees totaled \$3.8 million for the 2003 quarter and \$2.4 million for the 2002 quarter, and \$8.3 million and \$4.7 million for the respective six-month periods. Other operating expenses, including interest, totaled \$4.6 million for the 2003 quarter and \$1.7 million for the 2002 quarter, and \$9.1 million and \$3.7 million for the six-month periods. Relocation Central's loss before income taxes and minority interest was thus \$4.0 million for the second quarter of 2003 compared to \$2.7 million for the corresponding 2002 quarter, and \$8.9 million and \$5.7 million for the first six-months of 2003 and 2002.

Excluding Relocation Central's loss before income taxes and minority interest, furniture segment income before income taxes and minority interest was \$0.8 million for the second quarter of 2003, versus \$5.1 million for the comparable 2002 period, and \$1.3 million for the first six months of 2003, versus \$11.7 million for the corresponding six-month period of 2002. The following three paragraphs analyze and discuss these non-Relocation Central (i.e., CORT parent company) figures.

Furniture rental revenues for the second quarter of 2003 declined \$8.7 million, or 10.9%, from those of the second quarter of 2002, and \$17.5 million, or 10.9% for the first six months. Apart from revenues from trade shows in each period, rental revenues for the 2003 quarter declined approximately 12% from those reported for the second quarter of 2002, and 11% for the first six months of 2003 from those reported for the corresponding 2002 period. The number of furniture leases currently in effect has continued a downward trend begun in late 2000, reflecting unabated weakness of the economy, notably in the high-technology sector. Rental revenues on a per-unit basis began to improve toward the end of 2002 due mainly to price increases. The decreases in furniture sales revenues of 6.0% for the second quarter and 5.2% for the first six months of 2003 from those reported for the comparable 2002 periods were attributed to various factors, principally increased selling prices combined with the weaker economy.

Cost of furniture rentals and sales amounted to 25.6% of related revenues for the quarter ended June 30, 2003, versus 27.3% for the comparable quarter of 2002, and 25.9% and 27.4% for the first six months of 2003 and 2002. The improved cost percentages for the 2003 periods reflected improved furniture rental and selling prices as well as lower depreciation expense. CORT's purchases of new product have been generally declining in recent years; it depreciates its rental furniture under the declining balance method, whereby recorded depreciation is higher in the first year and declines in each successive year.

Selling, general and administrative (SG&A) expenses of CORT at the parent company level were \$64.8 million for the second quarter of 2003, down 1.7% from the \$65.9 million incurred for the second quarter of

**Table of Contents**

2002, and \$129.8 million for the first six months of 2003, down 0.7% from the \$130.7 million incurred for the first six months of 2002. The 2003 improvements represent progress made by CORT's management in reducing such expenses. As CORT completes the combination of Globe Furniture Rental operations, which it acquired early in 2002, with its own, and as it continues its efforts to reduce other SG&A expenses, its management anticipates further reductions in SG&A expenses for 2003.

*Industrial Segment*

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

	Three Months Ended		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
Revenues, principally sales and services	\$ 11,093	\$ 12,432	\$ 23,428	\$ 24,212
Income (loss) before income taxes	\$ (278)	\$ 215	\$ (172)	\$ 208
Income tax (provision) benefit	175	(87)	132	(84)
Segment net income (loss)	\$ (103)	\$ 128	\$ (40)	\$ 124

Industrial segment revenues for the second quarter of 2003 decreased \$1.3 million, or 10.8%, from those reported for the second quarter of 2002, and \$.8 million, or 3.2% for the first six months of 2003 from those reported for the corresponding six-month period last year. Pounds of steel products sold in the second quarter of 2003 decreased 17.8% from those of last year's second quarter and 7.4% for the 2003 six-month period, from those of the corresponding period of 2002. Precision Steel is continuing to suffer from extraordinary competitive pressures, as well as from a prolonged downturn in domestic manufacturing activity attributable both to ongoing weakness in the economy and the shift by many manufacturers from domestic to overseas production facilities. In terms of pounds, steel products sold in the second quarter of 2003 were lower than in any other quarter in recent years except for the fourth quarter of 2001. Not only has there been a reduction in the number of orders placed, but there has also been a trend towards smaller-sized orders.

Income or loss before income taxes and net income or loss of the industrial segment are dependent not only on revenues, but also on operating expenses and the cost of products sold. The latter, as a percentage of revenues, amounted to 84.5% and 81.6% for the second quarters of 2003 and 2002, and 83.9% and 82.4% for the corresponding six-month periods. The recent increase in cost percentage, combined with decreased revenues, has resulted in fewer dollars of gross profit. Another factor in the deterioration of pre-tax income or loss has been management's policy of maintaining service at a high level rather than slashing fixed operating expenses.

See Note 5 to the accompanying condensed consolidated financial statements for information relating to environmental claims and lawsuits pending against a Precision Steel subsidiary and other businesses. The financial impact cannot be reasonably estimated at this time, but it may well be material in one or more reporting periods in relation to segment net income and, less likely, Wesco's consolidated net income.

**Table of Contents***Unrelated to Business Segment Operations*

Set forth below is a summary of items increasing (decreasing) Wesco's consolidated net income that are viewed by management as unrelated to the operations of the insurance, furniture rental and industrial segments. (Amounts are in thousands.)

	Three Months Ended		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
Realized investment gains, before income tax effect	\$ 52,208	\$	\$ 53,019	\$
Income tax provision	(18,273)		(18,557)	
Realized investment gains	\$ 33,935	\$	\$ 34,462	\$
Other nonsegment items, net, before income tax effect	\$ 95	\$ 152	\$ 210	\$ 317
Income tax provision	(29)	(31)	(20)	(67)
	\$ 66	\$ 121	\$ 190	\$ 250

Wesco's consolidated earnings for the second quarter and first six months of 2003 contained realized investment gains, after taxes, of \$33.9 million and \$34.5 million. No gains or losses were realized in the first six months of 2002. Investment gains or losses, when they occur, are classified by Wesco as nonsegment items; they tend to fluctuate in amount from period to period, and their amounts and timing have no predictive or practical analytical value.

Other nonsegment items comprise mainly rental income from owned commercial real estate, plus dividend and interest income from investments owned outside the insurance segment, less expenses relating to real estate and other activities.

\* \* \* \* \*

Wesco's effective consolidated income tax rate typically fluctuates from period to period for various reasons, such as the inclusion in consolidated revenues of significant, varying amounts of dividend income, which is substantially exempt from income taxes. The respective income tax provisions, expressed as percentages of income before income taxes, amounted to 33.3% and 30.1% for the quarters ended June 30, 2003 and June 30, 2002, and 33.8% and 32.6% for the respective six-month periods.

**CRITICAL ACCOUNTING POLICIES**

Wesco's consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States (GAAP). The more important accounting principles and policies followed by Wesco are set forth in the notes to Wesco's consolidated financial statements appearing on pages 42 through 50 of its 2002 Form 10-K Annual Report. Following are the accounting principles and policies considered by Wesco's management to be critical to its determination of consolidated financial position and results of operations.

**Table of Contents**

In preparing the consolidated financial statements management is required to make estimates and assumptions based on evaluation of facts and circumstances using information currently available. For example, the process of establishing loss reserves for property and casualty reinsurance and insurance is subject to considerable estimation error due to the inherent uncertainty in projecting the claim amounts that will be reported and ultimately paid over many years. Although the amounts of assets, liabilities, revenues and expenses included in the consolidated financial statements may differ significantly from those that might result from use of estimates and assumptions based on facts and circumstances not yet available, Wesco's management does not believe such differences would have a material adverse effect on reported shareholders' equity.

A significant amount of judgment is required in performing the periodic impairment tests of goodwill of acquired businesses required under Statement of Financial Accounting Standards No. 142. Such tests include determining or reviewing the estimated fair value of Wesco's reporting units. Fair value refers to the amount for which the entire reporting unit may be bought or sold. There are several methods of estimating reporting-unit values, including market quotations, asset and liability fair values, discounted cash flows, and multiples of earnings or revenues. If the carrying amount of a reporting unit, including goodwill, were to exceed the estimated fair value, then individual assets, including identifiable intangible assets, and liabilities of the reporting unit would be estimated at fair value; the excess of the carrying amount over the estimated fair value would be charged off as an impairment loss.

The appropriate classifications of investments in securities with fixed maturities and marketable equity securities are established at the time of purchase and reevaluated as of each balance sheet date. There are three permissible classifications: held-to-maturity, trading, and, when neither of those classifications is applicable, available-for-sale. In recent years Wesco's management has classified all of its equity and fixed-maturity investments as available-for-sale; they are carried at fair value, with unrealized gains and losses, net of deemed applicable income taxes, reported as a separate component of shareholders' equity.

Liabilities for insurance losses and loss adjustment expenses as of any balance sheet date represent estimates of the ultimate amounts payable under property and casualty reinsurance and insurance contracts related to losses occurring on or before the balance sheet date. As of that date, some incurred claims have not yet been reported (and some of these may not be reported for many years); the liability for unpaid losses must include significant estimates for these claims. Additionally, reported claims are in various stages of the settlement process. Each claim is settled individually based upon its merits, and some take years to settle, especially if legal action is involved. Actual ultimate claims amounts are likely to differ from amounts recorded at the balance sheet date. Changes in estimates are recorded as a component of losses incurred in the period of change.

Insurance premiums are recognized as earned revenues in proportion to the insurance protection provided, which in most cases is pro rata over the term of each contract. Unearned insurance premiums are deferred in the liability section of the consolidated balance sheet. Certain costs of acquiring premiums are deferred in other assets on the consolidated balance sheet, and charged to income as the premiums are earned.

Furniture rentals are recognized as revenue in the month due; rentals received in advance are deferred in the liability section of the consolidated balance sheet. Related costs comprise the main element of cost of products and services sold on the consolidated income statement and include depreciation expense, repairs and maintenance and inventory losses. Rental furniture consists principally of residential and office furniture which is available for rental or, if no longer up to rental standards, for sale. It is carried on the consolidated balance sheet at cost, less accumulated depreciation calculated primarily on a declining-balance basis over 3 to 5 years.

**Table of Contents**

using estimated salvage values of 25 to 40 percent of original cost.

**FORWARD-LOOKING STATEMENTS**

Certain written or oral 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 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 securities or the industries in which Wesco and its affiliates do business, especially those affecting the property and casualty insurance industry.

**QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK ANALYSIS**

Reference is made to Item 7A, Quantitative and Qualitative Disclosures About Market Risk appearing on pages 29 through 31 of Wesco's 2002 Form 10-K Annual Report for information on equity price risk and interest rate risk at Wesco. There have been no material changes through June 30, 2003.

**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: August 12, 2003

By: /s/ Jeffrey L. Jacobson

\_\_\_\_\_  
Jeffrey L. Jacobson  
Vice President and  
Chief Financial Officer  
(principal financial officer)