

WESCO FINANCIAL CORP

Form 10-Q

May 15, 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 March 31, 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

---

(Zip Code)

(Address of Principal Executives Offices)

---

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 May 8, 2003



**TABLE OF CONTENTS**

FINANCIAL STATEMENTS

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

CERTIFICATIONS

EXHIBIT 99.1

EXHIBIT 99.2

---

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

	<b>Page(s)</b>
Item 1.	Financial Statements
	Condensed consolidated statement of income and retained earnings three-month periods ended March 31, 2003 and March 31, 2002
	4
	Condensed consolidated balance sheet March 31, 2003 and December 31, 2002
	5
	Condensed consolidated statement of cash flows three-month periods ended March 31, 2003 and March 31, 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.

Within the 90 days prior to the date of filing this Quarterly Report on Form 10-Q, management of Wesco Financial Corporation (Wesco), including Charles T. Munger (Chief Executive Officer) and Jeffrey L. Jacobson (Chief Financial Officer), and management of each of Wesco's subsidiaries, evaluated the effectiveness of the design and operation of their disclosure controls and procedures. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer of Wesco concluded that the disclosure controls and procedures of Wesco and its subsidiaries are effective in timely alerting them to material information required to be included in the reports that Wesco files with the Securities and Exchange Commission. Subsequent to the date of their evaluations, there have been no significant changes in internal controls or in other factors that could significantly affect internal controls, including any corrective actions with regard to significant deficiencies and material weaknesses.

**Table of Contents**

**PART II. OTHER INFORMATION**

Item 6. Exhibits and Reports on Form 8-K

- (a) Exhibits:
  - 99.1 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chief Executive Officer)
  - 99.2 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chief Financial Officer)
- (b) Reports on Form 8-K None.

-3-

---

**Table of Contents**

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

	Three Months Ended	
	March 31, 2003	March 31, 2002
<b>Revenues:</b>		
Sales and service revenues	\$ 105,692	\$ 111,965
Insurance premiums earned	34,033	12,899
Dividend and interest income	14,499	17,634
Realized investment gains	811	
Other	804	811
	155,839	143,309
<b>Costs and expenses:</b>		
Cost of products and services sold	38,235	39,352
Insurance losses, loss adjustment and underwriting expenses	26,544	11,928
Selling, general and administrative expenses	72,279	69,247
Interest expense	240	563
	137,298	121,090
Income before income taxes and minority interest	18,541	22,219
Provision for income taxes	(6,597)	(7,782)
Minority interest in loss of subsidiary	560	
	12,504	14,437
Retained earnings beginning of period	1,553,152	1,509,691
Cash dividends declared and paid	(2,383)	(2,314)
	\$ 1,563,273	\$ 1,521,814
<b>Amounts per capital share based on 7,119,807 shares outstanding throughout each period:</b>		
Net income	\$ 1.76	\$ 2.03
	\$ .335	\$ .325

See notes beginning on page 7.

**Table of Contents**

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

	<u>March 31,</u> <u>2003</u>	<u>Dec. 31,</u> <u>2002</u>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 485,147	\$ 349,812
Investments:		
Securities with fixed maturities	713,892	827,537
Marketable equity securities	600,230	626,768
Rental furniture	185,920	187,480
Goodwill of acquired businesses	266,388	266,203
Other assets	149,024	149,175
	<u>2,400,601</u>	<u>2,406,975</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Insurance losses and loss adjustment expenses	\$ 85,651	\$ 73,065
Unearned insurance premiums	36,335	48,681
Deferred furniture rental income and security deposits	21,443	21,562
Notes payable	20,077	32,481
Income taxes payable, principally deferred	227,739	227,902
Other liabilities	57,663	45,122
	<u>448,908</u>	<u>448,813</u>
Minority shareholders' interest in net assets of subsidiary	1,882	
Shareholders' equity:		
Capital stock and additional paid-in capital	31,628	30,439
Unrealized appreciation of investments, net of taxes	354,910	374,571
Retained earnings	1,563,273	1,553,152
	<u>1,949,811</u>	<u>1,958,162</u>
	<u>\$2,400,601</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)

	Three Months Ended	
	March 31, 2003	March 31, 2002
Cash flows from operating activities, net	\$ 41,137	\$ 54,521
Cash flows from investing activities:		
Maturities and redemptions of securities with fixed maturities	101,458	135,274
Sales of securities with fixed maturities	10,611	
Purchases of securities with fixed maturities	(2,561)	(120,932)
Acquisitions of businesses, net of cash and cash equivalents acquired		(30,185)
Purchases of rental furniture	(16,975)	(10,270)
Other, net	6,848	(1,263)
Net cash flows from investing activities	99,381	(27,376)
Cash flows from financing activities:		
Net increase (decrease) in line of credit borrowings	(2,800)	19,857
Payment of cash dividends	(2,383)	(2,314)
Net cash flows from financing activities	(5,183)	17,543
Increase in cash and cash equivalents	135,335	44,688
Cash and cash equivalents beginning of period	349,812	120,784
Cash and cash equivalents end of period	\$485,147	\$ 165,472
Supplementary information:		
Interest paid during period	\$ 175	\$ 530
Income taxes recovered, net, during period	(3,882)	(1,441)
Noncash activities conversion of debt to equity by minority investors 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 March 31, 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). Relocation Central's operations, which have not been profitable to date, were partially financed through its issuance in 2001 of 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. This group of minority shareholders has an option to require CORT to purchase the shares in February 2004 for approximately \$6,000; this contingent liability has been included in other liabilities on the accompanying condensed consolidated balance sheet. CORT's benefit resulting from the conversion of Relocation Central's notes payable into common stock was approximately \$1,200, net of the liability to acquire shares, and is reflected as an increase in Wesco's additional paid-in capital on the same balance sheet.

Wesco and its subsidiaries join with Berkshire Hathaway Inc. (Berkshire) and its other subsidiaries in the filing of consolidated federal income tax returns. Because Relocation Central had operating losses in 2001 and 2002, it received federal tax benefits in cash from Berkshire (approximately \$3,000 in each year). However, effective with the conversion of notes into equity in 2003, Relocation Central has become ineligible to continue to be included in the Berkshire consolidated return group. No tax benefit has been anticipated in mitigation of its operating loss for the portion of the first quarter of 2003 following the note conversion because of the uncertainty as to whether Relocation Central will be able to utilize post-conversion tax-loss carryforwards in its stand-alone income tax returns.

**Table of Contents**

## Note 3

Following is a summary of securities with fixed maturities:

	March 31, 2003		December 31, 2002	
	Amortized Cost	Fair (Carrying) Value	Amortized Cost	Fair (Carrying) Value
Mortgage-backed securities	\$361,065	\$378,412	\$463,176	\$484,760
Other	300,594	335,480	308,364	342,777
	<u>\$661,659</u>	<u>\$713,892</u>	<u>\$771,540</u>	<u>\$827,537</u>

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

	March 31, 2003		December 31, 2002	
	Cost	Quoted Market (Carrying) Value	Cost	Quoted Market (Carrying) Value
The Coca-Cola Company	\$ 40,761	\$291,683	\$ 40,761	\$315,893
The Gillette Company	40,000	198,016	40,000	194,304
Other	27,020	110,531	27,020	116,571
	<u>\$107,781</u>	<u>\$600,230</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 March 31, 2003 or December 31, 2002.

## Note 4

The following table sets forth Wesco's consolidated comprehensive income (loss) for the three-month periods ended March 31, 2003 and 2002:

	Three Months Ended	
	March 31, 2003	March 31, 2002
Net income	\$ 12,504	\$14,437
Increase (decrease) in unrealized appreciation of investments, net of income tax effect of \$10,642 and (\$17,701)	(19,661)	32,545
Comprehensive income (loss)	<u>\$ (7,157)</u>	<u>\$46,982</u>



**Table of Contents**

## Note 5

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

	Three Months Ended	
	March 31, 2003	March 31, 2002
<b>Insurance segment:</b>		
Revenues	\$ 48,404	\$ 30,395
Net income	14,812	12,558
Assets at end of period	1,821,442	1,802,541
<b>Furniture rental segment:</b>		
Revenues	\$ 93,370	\$ 100,192
Net income (loss)	(3,022)	1,754
Assets at end of period	268,225	315,193
<b>Industrial segment:</b>		
Revenues	\$ 12,335	\$ 11,780
Net income (loss)	63	(4)
Assets at end of period	19,366	18,893
Goodwill of acquired businesses, at end of period	\$ 266,388	\$ 264,839
<b>Realized investment gains:</b>		
Before taxes (included in revenues)	\$ 811	\$
After taxes (included in net income)	527	
<b>Other items unrelated to business segments:</b>		
Revenues	\$ 919	\$ 942
Net income	124	129
Assets at end of period	25,180	25,364
<b>Consolidated totals:</b>		
Revenues	\$ 155,839	\$ 143,309
Net income	12,504	14,437
Assets at end of period	2,400,601	2,426,830

**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 March 31, 2003 was approximately \$1.95 billion (\$274 per share), compared to \$1.96 billion (\$275 per share) at December 31, 2002. The 2003 figure included \$355 million of after-tax unrealized appreciation in market value of investments, versus \$375 million at December 31, 2002. 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 March 31, 2003, Wesco's consolidated cash and cash equivalents totaled \$485.1 million, up from \$349.8 million at December 31, 2002. The \$135.3 million increase resulted primarily as a result of maturities and early redemptions of fixed-income securities as well as operating cash flow from Wesco's insurance businesses.

Wesco's consolidated borrowings totaled \$21.4 million at March 31, 2003 versus \$32.5 million at December 31, 2002. The decreased borrowings 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	
	March 31, 2003	March 31, 2002
Insurance segment	\$ 14,812	\$ 12,558
Furniture rental segment	(3,022)	1,754
Industrial segment	63	(4)
Nonsegment items other than investment gains	124	129
	<u>11,977</u>	<u>14,437</u>
Income before investment gains	11,977	14,437
Realized investment gains	527	
	<u>12,504</u>	<u>14,437</u>
Consolidated net income	\$ 12,504	\$ 14,437

*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	
	March 31, 2003	March 31, 2002
Premiums written	\$ 21,687	\$ 13,492
Premiums earned &	\$ 34,033	\$ 12,899