

WESCO FINANCIAL CORP

Form 10-Q

November 09, 2004

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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, 2004 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 o No o

### 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 2, 2004

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## PART I. FINANCIAL INFORMATION

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| <u>EXHIBIT 32(b)</u>  |                |

Reference is made to Item 7A, Quantitative and Qualitative Disclosures About Market Risk appearing on pages 29 and 30 of the Form 10-K Annual Report for the year ended December 31, 2003, 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, 2004.

#### 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 September 30, 2004. 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 changes in Wesco's internal controls over financial reporting during the quarter ended September 30, 2004 that have materially affected or are reasonably likely to materially affect the internal controls over financial reporting.

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**PART II. OTHER INFORMATION**

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)

**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>Nine Months Ended</b>  |                           |
|---|---------------------------|---------------------------|---------------------------|---------------------------|
|   | <b>Sept. 30,<br/>2004</b> | <b>Sept. 30,<br/>2003</b> | <b>Sept. 30,<br/>2004</b> | <b>Sept. 30,<br/>2003</b> |
| Revenues:   |                           |                           |                           |                           |
| Sales and service revenues                                  | \$ 106,080                | \$ 103,388                | \$ 310,501                | \$ 312,825                |
| Insurance premiums earned                                   | 10,695                    | 31,863                    | 44,283                    | 88,376                    |
| Dividend and interest income                                | 8,918                     | 8,585                     | 25,840                    | 35,973                    |
| Realized investment gains                                   |                           | 447                       |                           | 53,466                    |
| Other   | 797                       | 828                       | 2,420                     | 2,435                     |
|   | <u>126,490</u>            | <u>145,111</u>            | <u>383,044</u>            | <u>493,075</u>            |
| Costs and expenses:   |                           |                           |                           |                           |
| Cost of products and services sold                          | 37,955                    | 36,153                    | 110,312                   | 110,173                   |
| Insurance losses, loss adjustment and underwriting expenses | 11,909                    | 27,489                    | 32,190                    | 69,970                    |
| Selling, general and administrative expenses                | 63,768                    | 72,102                    | 194,934                   | 216,558                   |
| Interest expense  | 209                       | 210                       | 532                       | 590                       |
|   | <u>113,841</u>            | <u>135,954</u>            | <u>337,968</u>            | <u>397,291</u>            |
| Income before income taxes and minority interest            | 12,649                    | 9,157                     | 45,076                    | 95,784                    |
| Income taxes  | 3,605                     | 2,108                     | 13,273                    | 31,378                    |
| Minority interest in loss of subsidiary                     |                           | (88)                      |                           | (1,216)                   |
|   | <u>9,044</u>              | <u>7,137</u>              | <u>31,803</u>             | <u>65,622</u>             |
| Retained earnings beginning of period                       | 1,636,172                 | 1,606,868                 | 1,618,324                 | 1,553,152                 |
| Cash dividends declared and paid                            | (2,458)                   | (2,385)                   | (7,369)                   | (7,154)                   |
|   | <u>1,642,758</u>          | <u>1,611,620</u>          | <u>1,642,758</u>          | <u>1,611,620</u>          |
| Retained earnings end of period                             | <u>\$1,642,758</u>        | <u>\$1,611,620</u>        | <u>\$1,642,758</u>        | <u>\$1,611,620</u>        |

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

|                |                   |                   |                   |                   |
|----------------|-------------------|-------------------|-------------------|-------------------|
| Net income     | \$ 1.27           | \$ 1.00           | \$ 4.47           | \$ 9.21           |
|                | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| Cash dividends | \$ .345           | \$ .335           | \$ 1.035          | \$ 1.005          |
|                | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |

*See notes beginning on page 7.*

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

|  | <b>Sept. 30,<br/>2004</b> | <b>Dec. 31,<br/>2003</b> |
|--|---------------------------|--------------------------|
|  | <hr/>                     | <hr/>                    |
| <b>ASSETS</b>  |                           |                          |
| Cash and cash equivalents                              | \$1,168,308               | \$1,052,462              |
| Investments:   |                           |                          |
| Securities with fixed maturities                       | 104,924                   | 167,390                  |
| Marketable equity securities                           | 716,630                   | 754,634                  |
| Rental furniture                                       | 177,667                   | 163,699                  |
| Goodwill of acquired businesses                        | 266,607                   | 266,607                  |
| Other assets   | 119,805                   | 133,603                  |
|  | <hr/>                     | <hr/>                    |
|  | \$2,553,941               | \$2,538,395              |
|  | <hr/>                     | <hr/>                    |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>            |                           |                          |
| Insurance losses and loss adjustment expenses          | \$ 98,209                 | \$ 102,526               |
| Unearned insurance premiums                            | 24,118                    | 28,993                   |
| Deferred furniture rental income and security deposits | 20,186                    | 19,835                   |
| Notes payable  | 32,422                    | 12,679                   |
| Income taxes payable, principally deferred             | 248,969                   | 247,241                  |
| Other liabilities                                      | 53,783                    | 48,931                   |
|  | <hr/>                     | <hr/>                    |
|  | 477,687                   | 460,205                  |
|  | <hr/>                     | <hr/>                    |
| Shareholders' equity:                                  |                           |                          |
| Capital stock and additional paid-in capital           | 33,324                    | 33,324                   |
| Unrealized appreciation of investments, net of taxes   | 400,172                   | 426,542                  |
| Retained earnings                                      | 1,642,758                 | 1,618,324                |
|  | <hr/>                     | <hr/>                    |
| Total shareholders' equity                             | 2,076,254                 | 2,078,190                |
|  | <hr/>                     | <hr/>                    |
|  | \$2,553,941               | \$2,538,395              |
|  | <hr/>                     | <hr/>                    |

*See notes beginning on page 7.*





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(Dollar amounts in thousands)

(Unaudited)

|   | <b>Nine Months Ended</b>  |                           |
|---|---------------------------|---------------------------|
|   | <b>Sept. 30,<br/>2004</b> | <b>Sept. 30,<br/>2003</b> |
| Cash flows from operating activities, net                                     | \$ 121,360                | \$ 124,339                |
| Cash flows from investing activities:   |                           |                           |
| Maturities and redemptions of securities with fixed maturities                | 62,595                    | 270,457                   |
| Sales of securities with fixed maturities                                     |                           | 351,180                   |
| Purchases of securities with fixed maturities                                 | (2,907)                   | (2,830)                   |
| Acquisitions of businesses, net of cash and cash equivalents acquired         | (12,704)                  | (3,440)                   |
| Purchases of rental furniture   | (63,630)                  | (44,590)                  |
| Purchase of minority shareholders' interest in Relocation Central Corporation |                           | (5,609)                   |
| Other, net  | (1,242)                   | (3,392)                   |
| Net cash flows from investing activities                                      | (17,888)                  | 561,776                   |
| Cash flows from financing activities:   |                           |                           |
| Net increase in notes payable, principally line of credit                     | 19,743                    |                           |
| Payment of cash dividends   | (7,369)                   | (7,154)                   |
| Other, net  |                           | (300)                     |
| Net cash flows from financing activities                                      | 12,374                    | (7,454)                   |
| Increase in cash and cash equivalents   | 115,846                   | 678,661                   |
| Cash and cash equivalents beginning of period                                 | 1,052,462                 | 349,812                   |
| Cash and cash equivalents end of period                                       | \$ 1,168,308              | \$ 1,028,473              |
| Supplementary information:  |                           |                           |
| Interest paid during period   | \$ 153                    | \$ 484                    |
| Income taxes paid (recovered), net, during period                             | (2,633)                   | 12,012                    |
| Noncash activities conversion of debt to equity in subsidiary                 |                           | 9,808                     |

|   |                             |              |
|---|-----------------------------|--------------|
| Increase in additional paid-in capital due to subsidiary stock transactions | <u>                    </u> | <u>3,022</u> |
|---|-----------------------------|--------------|

*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

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.

Reference is made to the notes to Wesco 's consolidated financial statements appearing on pages 40 through 48 of its 2003 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 40 through 42.

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, 2004 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 subsidiary which partially financed its start-up by issuing convertible notes primarily to unrelated parties. During the year ended December 31, 2003 most of these notes were converted into equity of the subsidiary, after which the resulting minority interest was purchased at a discount from an agreed option price. These transactions resulted in an increase in additional paid-in capital of \$2,885. The minority interest in the net loss sustained by the subsidiary prior to the buyout, \$1,216 for the nine-month period ended September 30, 2003, including \$88 for the third quarter, is set out separately on the condensed consolidated statement of income.

## Note 3

Following is a summary of securities with fixed maturities:

|                            | September 30, 2004 |               | December 31, 2003 |               |
|----------------------------|--------------------|---------------|-------------------|---------------|
|                            | Amortized<br>Cost  | Fair<br>Value | Amortized<br>Cost | Fair<br>Value |
| Mortgage-backed securities | \$86,284           | \$ 91,177     | \$146,793         | \$154,623     |
| Other                      | 12,747             | 13,747        | 12,160            | 12,767        |
|                            | \$99,031           | \$104,924     | \$158,953         | \$167,390     |

Unrealized losses with respect to securities with fixed maturities amounted to \$22 at September 30, 2004, versus none at December 31, 2003.

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

|                          | <b>September 30, 2004</b> |                   | <b>December 31, 2003</b> |                   |
|--------------------------|---------------------------|-------------------|--------------------------|-------------------|
|                          | <b>Cost</b>               | <b>Fair Value</b> | <b>Cost</b>              | <b>Fair Value</b> |
| The Coca-Cola Company    | \$ 40,761                 | \$288,584         | \$ 40,761                | \$365,684         |
| The Gillette Company     | 40,000                    | 267,136           | 40,000                   | 235,072           |
| American Express Company | 20,687                    | 99,992            | 20,687                   | 93,716            |
| Wells Fargo & Company    | 6,333                     | 60,918            | 6,333                    | 60,162            |
|                          | <u>\$107,781</u>          | <u>\$716,630</u>  | <u>\$107,781</u>         | <u>\$754,634</u>  |

## Note 4

The following table sets forth Wesco's consolidated comprehensive income for the three- and nine-month periods ended September 30, 2004 and 2003:

|   | <b>Three Months Ended</b> |                       | <b>Nine Months Ended</b> |                       |
|---|---------------------------|-----------------------|--------------------------|-----------------------|
|   | <b>Sept. 30, 2004</b>     | <b>Sept. 30, 2003</b> | <b>Sept. 30, 2004</b>    | <b>Sept. 30, 2003</b> |
| Net income  | \$ 9,044                  | \$ 7,137              | \$ 31,803                | \$ 65,622             |
| Decrease in unrealized appreciation of investments, net of income tax effect of \$27,007, \$6,831, \$14,178 and \$6,262 | <u>(50,280)</u>           | <u>(12,744)</u>       | <u>(26,370)</u>          | <u>(11,879)</u>       |
| Comprehensive income (loss)   | <u>\$(41,236)</u>         | <u>\$ (5,607)</u>     | <u>\$ 5,433</u>          | <u>\$ 53,743</u>      |

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## Note 5

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

|   | Three Months Ended |                   | Nine Months Ended |                   |
|---|--------------------|-------------------|-------------------|-------------------|
|   | Sept. 30,<br>2004  | Sept. 30,<br>2003 | Sept. 30,<br>2004 | Sept. 30,<br>2003 |
| Insurance segment:  |                    |                   |                   |                   |
| Revenues  | \$ 19,409          | \$ 40,267         | \$ 69,544         | \$ 123,917        |
| Net income  | 5,660              | 9,066             | 26,419            | 36,594            |
| Assets at end of period   | 1,979,392          | 1,904,529         | 1,979,392         | 1,904,529         |
|   | <u>          </u>  | <u>          </u> | <u>          </u> | <u>          </u> |
| Furniture rental segment:   |                    |                   |                   |                   |
| Revenues  | \$ 90,463          | \$ 91,900         | \$ 264,298        | \$ 277,927        |
| Net income (loss)   | 3,232              | (1,601)           | 3,836             | (5,256)           |
| Assets at end of period   | 251,871            | 256,857           | 251,871           | 256,857           |
|   | <u>          </u>  | <u>          </u> | <u>          </u> | <u>          </u> |
| Industrial segment:   |                    |                   |                   |                   |
| Revenues  | \$ 15,607          | \$ 11,523         | \$ 46,203         | \$ 34,951         |
| Net income (loss)   | 33                 | (720)             | 1,245             | (760)             |
| Assets at end of period   | 20,306             | 18,493            | 20,306            | 18,493            |
|   | <u>          </u>  | <u>          </u> | <u>          </u> | <u>          </u> |
| Goodwill of acquired businesses,<br>included in assets at end of period | \$ 266,607         | \$ 266,455        | \$ 266,607        | \$ 266,455        |
|   | <u>          </u>  | <u>          </u> | <u>          </u> | <u>          </u> |
| Realized investment gains:  |                    |                   |                   |                   |
| Before taxes (included in revenues)                                     | \$                 | \$ 447            | \$                | \$ 53,466         |
| After taxes (included in net income)                                    |                    | 291               |                   | 34,753            |
|   | <u>          </u>  | <u>          </u> | <u>          </u> | <u>          </u> |
| Other items unrelated to business<br>segments:                          |                    |                   |                   |                   |
| Revenues  | \$ 1,011           | \$ 974            | \$ 2,999          | \$ 2,814          |
| Net income  | 119                | 101               | 303               | 291               |
| Assets at end of period   | 35,765             | 29,474            | 35,765            | 29,474            |
|   | <u>          </u>  | <u>          </u> | <u>          </u> | <u>          </u> |
| Consolidated totals:  |                    |                   |                   |                   |
| Revenues  | \$ 126,490         | \$ 145,111        | \$ 383,044        | \$ 493,075        |
| Net income  | 9,044              | 7,137             | 31,803            | 65,622            |

|                         |                  |                  |                  |                  |
|-------------------------|------------------|------------------|------------------|------------------|
| Assets at end of period | <u>2,553,941</u> | <u>2,475,808</u> | <u>2,553,941</u> | <u>2,475,808</u> |
|-------------------------|------------------|------------------|------------------|------------------|

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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 19 through 30 of the Form 10-K Annual Report filed by Wesco Financial Corporation (Wesco) for the year 2003 for information deemed generally appropriate to an understanding of the accompanying unaudited 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 balance sheet at September 30, 2004, with relatively little debt and no hedging or off-balance sheet financing. Liquidity, which has traditionally been high, has been even higher than usual due principally to sales, in the first half of 2003, and ongoing maturities and early redemptions of fixed-maturity investments in 2003 and 2004, and reinvestment of the proceeds in lower-yielding cash equivalents pending redeployment.

*Results of Operations*

Investment gains were realized in 2003 for the first time in three years. No investment gains or losses were realized in the first nine months of 2004. As is usual for Wesco, realization of the 2003 gains had little effect on shareholders equity, because the gains had essentially been reflected, net of taxes, in the unrealized appreciation component of shareholders' equity. Decisions to sell investments at Wesco are made without regard to the effect on periodic earnings, and the amounts and timing of realizations have no predictive or practical analytic value.

Consolidated net income included \$0.3 million and \$34.8 million of after-tax realized investment gains in the third quarter and the first nine months of 2003. Consolidated earnings before such after-tax gains increased in the 2004 periods from the comparable 2003 figures. Improved results of the furniture rental and industrial segments more than offset a reduction in earnings of the insurance segment caused by unfavorable comparative underwriting results and a shift from long-term to lower-yielding short-term fixed-maturity investments and cash equivalents.

FINANCIAL CONDITION

Wesco's shareholders' equity at September 30, 2004 was approximately \$2.08 billion (\$292 per share), essentially unchanged from the figure at December 31, 2003. An increase in retained earnings, resulting from net income less dividends paid, was substantially offset by a reduction in the unrealized appreciation



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component of shareholders' equity. Unrealized appreciation, which is recorded using current market quotations, could differ substantially from net gains ultimately realized.

At September 30, 2004, Wesco's consolidated cash and cash equivalents totaled \$1.17 billion, up from \$1.05 billion at December 31, 2003. The \$116 million increase resulted mainly from operating cash flow from Wesco's insurance businesses plus maturities and early redemptions of fixed-income securities, reduced by purchases of rental furniture.

Wesco's consolidated borrowings totaled \$32.4 million at September 30, 2004 versus \$12.7 million at December 31, 2003. The increased borrowings related to a revolving line of credit used in the furniture rental business.

Management continues to believe that the Wesco group has adequate liquidity and financial resources to provide for any contingent needs that may arise.

**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.*)

|  | <b>Three Months Ended</b> |                           | <b>Nine Months Ended</b>  |                           |
|--|---------------------------|---------------------------|---------------------------|---------------------------|
|  | <b>Sept. 30,<br/>2004</b> | <b>Sept. 30,<br/>2003</b> | <b>Sept. 30,<br/>2004</b> | <b>Sept. 30,<br/>2003</b> |
| Insurance segment:                           |                           |                           |                           |                           |
| Underwriting gain (loss)                     | \$ ( 799)                 | \$ 2,855                  | \$ 7,834                  | \$11,985                  |
| Investment income                            | 6,459                     | 6,211                     | 18,585                    | 24,609                    |
| Furniture rental segment                     | 3,232                     | (1,601)                   | 3,836                     | (5,256)                   |
| Industrial segment                           | 33                        | (720)                     | 1,245                     | (760)                     |
| Nonsegment items other than investment gains | 119                       | 101                       | 303                       | 291                       |
| Realized investment gains                    |                           | 291                       |                           | 34,753                    |
|  | <hr/>                     | <hr/>                     | <hr/>                     | <hr/>                     |
| Consolidated net income                      | \$9,044                   | \$ 7,137                  | \$31,803                  | \$65,622                  |
|  | <hr/>                     | <hr/>                     | <hr/>                     | <hr/>                     |

**Table of Contents***Insurance Segment*

The insurance segment comprises 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., Wesco's ultimate parent company. 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 |                   | Nine Months Ended |                   |
|------------------------------|--------------------|-------------------|-------------------|-------------------|
|                              | Sept. 30,<br>2004  | Sept. 30,<br>2003 | Sept. 30,<br>2004 | Sept. 30,<br>2003 |
| Premiums written             | \$ 13,725          | \$ 31,828         | \$ 39,409         | \$ 66,543         |
| Premiums earned              | \$ 10,695          | \$ 31,863         | \$ 44,283         | \$ 88,376         |
| Underwriting gain (loss)     | \$ (1,230)         | \$ 4,392          | \$ 12,051         | \$ 18,438         |
| Dividend and interest income | 8,707              | 8,381             | 25,243            | 35,518            |
| Income before income taxes   | 7,477              | 12,773            | 37,294            | 53,956            |
| Income taxes                 | 1,817              | 3,707             | 10,875            | 17,362            |
| Segment net income           | \$ 5,660           | \$ 9,066          | \$ 26,419         | \$ 36,594         |

Reinsurance premiums written for the third quarters of 2004 and 2003 totaled \$8.9 million and \$27.3 million, and for the nine-month periods ended September 30, 2004 and 2003 were \$24.0 million and \$51.8 million. All other premiums written for each period were attributable to KBS primary insurance.

Reinsurance earned premiums for the third quarters of 2004 and 2003 were \$5.5 million and \$26.8 million, and for the first nine months of 2004 and 2003 totaled \$29.1 million and \$73.2 million. The balance of earned premiums for each period was attributable to KBS.

At September 30, 2004, Wes-FIC's in-force reinsurance business consists of: (1) a contract under which Wes-FIC participates in various pools of aviation-related risks, and (2) a multi-year contract covering certain multi-line property and casualty risks of a large, unaffiliated insurer. Each of these arrangements is administered by a Berkshire affiliate, which also participates with Wes-FIC in the underlying risks as an insurer.

Reinsurance premiums written in the first nine months of 2004 declined \$27.8 million (54%) from the 2003 level. The decline reflected a significant reduction in business accepted under the multi-line contract due principally to the imposition of tighter underwriting standards. Also, prices in certain aviation markets declined, resulting in fewer

opportunities in 2004 to write business at prices considered acceptable. Thus, premium volume under the aviation contract declined in 2004. Reinsurance premiums in the fourth quarter of 2004 may decline from the corresponding 2003 amounts.

For the third quarter of 2004, reinsurance generated an underwriting loss of \$2.6 million, versus an underwriting gain of \$2.3 million for the third quarter of 2003. Underwriting gains of \$1.4 million and \$2.1 million were attributable to KBS for these respective periods. Underwriting results for the first nine months of 2004 and 2003 included gains of \$6.5 million and \$13.3 million attributable to reinsurance contracts and \$5.5 million and \$5.1 million attributable to KBS. Not only did reinsurance earned premiums for the 2004 periods decline, but the third quarter underwriting results in 2004 were also affected by increased aviation loss activity, including estimated losses of \$0.5 million related to the hurricanes that struck the Southeastern United States

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during the quarter. Nevertheless, the aviation reinsurance business generated net underwriting gains for the nine-month periods ended September 30, 2004 and 2003. KBS's underwriting results fluctuated mainly due to the timing of losses. Underwriting results remained good in both 2004 and 2003. Wesco's insurers cede minimal amounts of business, and as a result underwriting results may be volatile. Management accepts volatility provided the prospects of long-term profitability remain favorable.

Dividend and interest income earned by the insurance segment declined for the first nine months of 2004 from the corresponding prior year figure principally because proceeds from sales and early redemptions of long-term, fixed maturity investments were reinvested in lower-yielding short-term investments and cash equivalents. This shift occurred since the end of 2002, principally during the first half of 2003. For the third quarter of 2004, dividend and interest income increased slightly over the corresponding 2003 amount due mainly to an increase in short-term interest rates.

*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>Nine Months Ended</b>  |                           |
|---|---------------------------|---------------------------|---------------------------|---------------------------|
|   | <b>Sept. 30,<br/>2004</b> | <b>Sept. 30,<br/>2003</b> | <b>Sept. 30,<br/>2004</b> | <b>Sept. 30,<br/>2003</b> |
| Revenues:   |                           |                           |                           |                           |
| Furniture rentals                                       | \$69,430                  | \$69,482                  | \$203,745                 | \$212,463                 |
| Furniture sales   | 17,827                    | 17,964                    | 51,656                    | 52,524                    |
| Apartment locator fees                                  | 3,206                     | 4,454                     | 8,897                     | 12,940                    |
|   | <u>          </u>         | <u>          </u>         | <u>          </u>         | <u>          </u>         |
| Total revenues  | <u>90,463</u>             | <u>91,900</u>             | <u>264,298</u>            | <u>277,927</u>            |
| Cost of rentals, sales and fees                         | 24,640                    | 26,482                    | 72,547                    | 80,868                    |
| Selling, general and administrative expenses            | 60,619                    | 68,221                    | 185,784                   | 207,097                   |
| Interest expense  | 208                       | 212                       | 531                       | 590                       |
|   | <u>          </u>         | <u>          </u>         | <u>          </u>         | <u>          </u>         |
|   | <u>85,467</u>             | <u>94,915</u>             | <u>258,862</u>            | <u>288,555</u>            |
| Income (loss) before income taxes and minority interest | 4,996                     | (3,015)                   | 5,436                     | (10,628)                  |
| Income tax provision (benefit)                          | 1,764                     | (1,326)                   | 1,600                     | (4,156)                   |
| Minority interest in net loss of Relocation Central     |                           | (88)                      |                           | (1,216)                   |
|   | <u>          </u>         | <u>          </u>         | <u>          </u>         | <u>          </u>         |

|                           |          |            |          |            |
|---------------------------|----------|------------|----------|------------|
| Segment net income (loss) | \$ 3,232 | \$ (1,601) | \$ 3,836 | \$ (5,256) |
|---------------------------|----------|------------|----------|------------|

Furniture rental revenues for the third quarter of 2004 were approximately unchanged from those of the third quarter of 2003, and declined \$8.7 million, or 4.1%, for the first nine months, from those of the comparable period of 2003. Excluding \$6.3 million and \$4.9 million of rental revenues from trade shows and locations not in operation throughout each of the three-month periods, and \$20.8 million and \$18.2 million of similar revenues for each of the nine-month periods, rental revenues for 2004 compared to 2003 declined approximately 2.0% for the third quarter and 6.1 % for the first nine months, despite price increases of 4% to 5% in the fourth quarter of 2003. While the number of furniture leases at September 30, 2004 was approximately 30% below the peak level attained in late 2000, the downward trend is showing signs of reversing. At September 30, 2004, the number of leases had increased by approximately 5% over the

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comparable yearend 2003 figure.

Apartment locator fees for the third quarter of 2004 all generated by Relocation Central decreased \$1.2 million, or 28%, from those of the third quarter last year, and, for the first nine months of 2004, decreased \$4.0 million, or 31% from those reported for the first nine months of 2003. Since late in 2003, Relocation Central's operations have been undergoing reorganization in order to reduce operating losses. Some of its walk-in facilities have been merged into CORT's facilities, and others have been closed, resulting in significant cost and expense reductions. The reduction in Relocation Central's revenues has been more than offset by a reduction in its costs and expenses, discussed below.

Cost of rentals, sales and fees amounted to 27.2% and 27.4% of total revenues for the third quarter and first nine months of 2004 versus 28.8% and 29.1% for the corresponding periods of 2003. The decreases in cost percentages for the 2004 periods reflected improved rental margins, as well as lower depreciation expense and lower apartment locator lead acquisition costs. Purchases of new inventory increased slightly in recent periods after declining generally for several years; rental furniture is depreciated under the declining balance method, whereby recorded depreciation is higher in the first year and declines in each successive year. Costs of generating apartment locator fees were \$2.4 million in the third quarter and \$7.5 million in the first nine months of 2004, down from \$3.8 million and \$12.1 million in the comparable periods of 2003. Excluding such costs, costs of furniture rentals and sales were 25.5% in both the third quarter and first nine months of 2004, and 26.0% and 25.9% in the corresponding periods of 2003.

Selling, general, administrative and interest expenses ( operating expenses ) for the segment were \$60.8 million for the third quarter of 2004 and \$186.3 million for the first nine months, down 11.1% and 10.3% from the \$68.4 million and \$207.7 million incurred in the comparable periods of 2003. A contributing factor of the improvement in segment operating expenses was the previously discussed reorganization of the apartment locator operation; as a result, apartment locator-related expenses declined to \$2.6 million for the third quarter and \$9.7 million for the first nine months of 2004, from \$3.7 million and \$12.9 million in the third quarter and first nine months of 2003. Excluding such expenses, segment operating expenses amounted to \$58.2 million and \$176.6 million in the 2004 periods, down \$6.5 million and \$18.2 million, or 10.0% and 9.3%, from the \$64.7 million and \$194.8 million incurred in the comparable 2003 periods. Further reductions in segment operating expenses are anticipated as additional efficiencies are realized from the reorganization of the apartment locator operation as well as from ongoing efforts to control expenses in the furniture rental and sales operations.

Income or loss before income taxes and minority interest for the furniture rental segment amounted to income of \$5.0 million for the third quarter and \$5.4 million for the first nine months of 2004 and losses of \$3.0 million and \$10.6 million for the corresponding periods of 2003. The improvement in the operating results in 2004 is attributable mainly to the aforementioned reductions in operating expenses.

The minority interest in net loss of Relocation Central of \$0.1 million for the third quarter and \$1.2 million for the nine-month period ended September 30, 2003 relates to a period of several months during which minority shareholders held an approximately 20% equity interest in Relocation Central. (See further explanation in Note 2 to the accompanying condensed consolidated financial statements.)

**Table of Contents***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.)

|  | <b>Three Months Ended</b> |                           | <b>Nine Months Ended</b>  |                           |
|--|---------------------------|---------------------------|---------------------------|---------------------------|
|  | <b>Sept. 30,<br/>2004</b> | <b>Sept. 30,<br/>2003</b> | <b>Sept. 30,<br/>2004</b> | <b>Sept. 30,<br/>2003</b> |
| Revenues, principally sales and services | \$ 15,607                 | \$ 11,523                 | \$ 46,203                 | \$ 34,951                 |
| Income (loss) before income taxes        | \$ 60                     | \$ (1,139)                | \$ 2,072                  | \$ (1,311)                |
| Income tax provision (benefit)           | 27                        | (419)                     | 827                       | (551)                     |
| Segment net income (loss)                | \$ 33                     | \$ (720)                  | \$ 1,245                  | \$ (760)                  |

At the start of 2004, a shortage of raw materials from domestic mills produced near chaos in the steel service industry. The impact on Wesco's industrial segment revenues has been favorable thus far in 2004: Segment revenues for the third quarter increased \$4.1 million, or 35.4%, from those of the third quarter of 2003 and \$11.3 million, or 32.2%, for the first nine months from those reported for the comparable period of 2003. Pounds of steel products sold increased 11.4% for the third quarter and 22.5% for the first nine months of 2004 from the comparable prior year figures. The increases in industrial segment revenues are reflective of higher demand due to a rise in manufacturing activity and higher unit prices. At present, domestic steel mills are operating at capacity and imported steel is not readily available. These and other factors have enabled steel mills to raise prices, place limits on order quantities and extend delivery times. Precision Steel has reacted to these pressures by passing the price increases, plus normal mark-ups, on to customers, and favoring long-term customer relationships. Despite the favorable upturn in segment operating results, management continues to be concerned about the availability of steel and the future of the domestic manufacturing sector of the economy.

Income 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. Cost of products sold for the third quarter and first nine months of 2004, which amounted to 85.3% and 81.7% of revenues, included adverse adjustments of \$1.0 million and \$1.8 million (\$0.6 million and \$1.1 million, after income tax benefit) necessitated by Precision Steel's use of the last in, first out (LIFO) inventory accounting method; under this method, the most recent costs are reflected in cost of goods sold. LIFO adjustments were insignificant in the corresponding 2003 periods, when the cost of products sold amounted to 84.2% and 84.0% for the third quarter and first nine months. Excluding LIFO adjustments, cost of products sold, as a percentage of revenues, declined to 78.9% and 77.8% for the third quarter and first nine months of 2004, from 84.1% and 83.8% for the corresponding prior year periods due mainly to increased sales prices.

Reference is made to page 25 of Wesco's 2003 Form 10-K annual report for information as to an environmental matter affecting Precision Steel and its Precision Brands Products (PBP) subsidiary. In the quarter ended September 30, 2003, PBP recorded a provision of approximately \$1.0 million (\$0.6 million, after income tax benefit),

representing a preliminary estimate of its share of costs of remediation agreed to with governmental entities and other parties to date and related expenses. In the third quarter of 2004, PBP increased that estimate by \$0.1 million (\$0.1 million, after income tax benefit). Management anticipates that additional provisions with respect to such remediation and other legal matters may be required in the future, but does not anticipate that the ultimate impact of such provisions 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***Realized Investment Gains*

Set forth below is a summary of realized investment gains. (Amounts are in thousands.)

|   | Three Months Ended   |                   | Nine Months Ended    |                   |
|---|----------------------|-------------------|----------------------|-------------------|
|   | Sept.<br>30,<br>2004 | Sept. 30,<br>2003 | Sept.<br>30,<br>2004 | Sept. 30,<br>2003 |
| Realized investment gains, before income tax effect | \$                   | \$ 447            | \$                   | \$53,466          |
| Income taxes  | —                    | 156               | —                    | 18,713            |
| Realized investment gains                           | \$                   | \$ 291            | \$                   | \$34,753          |

Wesco's consolidated earnings for the first nine months of 2003 contained realized investment gains, after taxes, of \$34.8 million, including \$0.3 million realized in the third quarter. No gains or losses were realized in the first nine months of 2004. 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.

\* \* \* \* \*

Wesco's effective consolidated income tax rate typically fluctuates somewhat from period to period based mainly on the relation of dividend income, which is substantially exempt from income taxes, to other pre-tax earnings or losses, including realized investment gains, which are fully taxable. The respective income tax provisions, expressed as percentages of income before income taxes, amounted to 28.5% and 23.0% for the quarters ended September 30, 2004 and September 30, 2003, and 29.4% and 32.8% for the respective nine-month periods.

**CONTRACTUAL OBLIGATIONS**

Reference is made to page 27 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, 2003 for a table summarizing the contractual obligations of Wesco and its subsidiaries associated with ongoing business activities, which will result in cash payments in periods after yearend 2003. At September 30, 2004, there have been no material changes in contractual obligations of Wesco or its subsidiaries from those reported as of December 31, 2003, other than an increase in borrowings under a revolving line of credit used in the furniture rental business.

**CRITICAL ACCOUNTING POLICIES AND PRACTICES**

Reference is made to pages 27 and 28 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, 2003 for the accounting policies and practices considered by Wesco 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 40 through 42 thereof (updated by Note 1 to the

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accompanying condensed consolidated financial statements) 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 significant changes since December 31, 2003.

**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 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 5, 2004

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