

WESCO FINANCIAL CORP

Form 10-Q

August 14, 2002

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, 2002 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

**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 8, 2002

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

PART II. OTHER INFORMATION

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

Item 6. Exhibits and Reports on Form 8-K

SIGNATURES

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

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

The condensed consolidated financial statements of Wesco Financial Corporation, listed in the accompanying index, are incorporated as an integral part of this report.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

See pages 10 through 16.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

See page 16.

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 8, 2002, at which meeting the shareholders reelected all of its Directors:

| Name | Favorable Votes | Votes Withheld |
|--------------------------|--------------------|-------------------|
| Charles T. Munger | 6,846,421 | 69,626 |
| Robert H. Bird | 6,839,481 | 76,566 |
| Carolyn H. Carlburg | 6,903,670 | 12,377 |
| Robert E. Denham | 6,903,064 | 12,983 |
| James N. Gamble | 6,793,221 | 122,826 |
| Elizabeth Caspers Peters | 6,889,065 | 26,982 |
| David K. Robinson | 6,896,301 | 19,746 |

There were no abstentions or broker non-votes. No other matters were voted upon at the meeting.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits None

(b) Reports on Form 8-K None

Table of Contents

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 14, 2002

By: /s/ Jeffrey L. Jacobson

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

**WESCO FINANCIAL CORPORATION
FINANCIAL STATEMENTS FILED WITH FORM 10-Q
FOR QUARTER ENDED JUNE 30, 2002**

INDEX

| | <u>Page(s)</u> |
|---|----------------|
| Condensed consolidated statement of income and retained earnings three- and six-month periods ended June 30, 2002 and June 30, 2001 | 4 |
| Condensed consolidated balance sheet June 30, 2002 and December 31, 2001 | 5 |
| Condensed consolidated statement of cash flows six-month periods ended June 30, 2002 and June 30, 2001 | 6 |
| Notes to condensed consolidated financial statements | 7-9 |

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 | | Six Months Ended | |
|---|---------------------|---------------------|---------------------|---------------------|
| | June 30, 2002 | June 30, 2001 | June 30, 2002 | June 30, 2001 |
| Revenues: | | | | |
| Sales and service revenues | \$ 111,928 | \$ 116,203 | \$ 223,893 | \$ 236,734 |
| Insurance premiums earned | 13,192 | 8,900 | 26,091 | 17,577 |
| Dividend and interest income | 18,448 | 18,174 | 36,082 | 38,029 |
| Other | 829 | 783 | 1,640 | 1,571 |
| | <u>144,397</u> | <u>144,060</u> | <u>287,706</u> | <u>293,911</u> |
| Costs and expenses: | | | | |
| Cost of products and services sold | 36,917 | 36,955 | 73,979 | 76,407 |
| Insurance losses, loss adjustment and underwriting expenses | 12,919 | 7,257 | 24,847 | 14,436 |
| Selling, general and administrative expenses | 72,778 | 73,328 | 144,315 | 142,528 |
| Interest expense | 510 | 1,447 | 1,073 | 2,713 |
| Goodwill amortization | | 1,878 | | 3,709 |
| | <u>123,124</u> | <u>120,865</u> | <u>244,214</u> | <u>239,793</u> |
| Income before income taxes | 21,273 | 23,195 | 43,492 | 54,118 |
| Provision for income taxes | (6,393) | (8,089) | (14,175) | (19,195) |
| Net income | 14,880 | 15,106 | 29,317 | 34,923 |
| Retained earnings beginning of period | 1,521,814 | 1,483,701 | 1,509,691 | 1,466,126 |
| Cash dividends declared and paid | (2,315) | (2,243) | (4,629) | (4,485) |
| Retained earnings end of period | <u>\$ 1,534,379</u> | <u>\$ 1,496,564</u> | <u>\$ 1,534,379</u> | <u>\$ 1,496,564</u> |
| Amounts per capital share based on 7,119,807 shares outstanding throughout each period: | | | | |
| Net income | \$ 2.09 | \$ 2.12 | \$ 4.12 | \$ 4.90 |
| Cash dividends | \$.325 | \$.315 | \$.650 | \$.630 |

See notes beginning on page 7.

Table of Contents

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

| | June 30, 2002 | Dec. 31, 2001 |
|--|------------------|------------------|
| ASSETS | | |
| Cash and cash equivalents | \$ 85,396 | \$ 120,784 |
| Investments: | | |
| Securities with fixed maturities | 1,001,109 | 924,160 |
| Marketable equity securities | 741,996 | 667,262 |
| Rental furniture | 216,302 | 212,586 |
| Goodwill of acquired businesses | 264,930 | 264,465 |
| Other assets | 154,487 | 130,436 |
| | \$2,464,220 | \$2,319,693 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| Insurance losses and loss adjustment expenses | \$ 67,358 | \$ 61,879 |
| Deferred furniture rental income and security deposits | 23,344 | 23,796 |
| Notes payable | 41,975 | 33,649 |
| Income taxes payable, principally deferred | 253,362 | 225,665 |
| Other liabilities | 85,460 | 62,307 |
| | 471,499 | 407,296 |
| Shareholders' equity: | | |
| Capital stock and capital in excess of par value | 30,439 | 30,439 |
| Unrealized appreciation of investments, net of taxes | 427,903 | 372,267 |
| Retained earnings | 1,534,379 | 1,509,691 |
| Total shareholders' equity | 1,992,721 | 1,912,397 |
| | \$2,464,220 | \$2,319,693 |

See notes beginning on page 7.

Table of Contents

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

| | Six Months Ended | |
|--|------------------|------------------|
| | June 30, 2002 | June 30, 2001 |
| Cash flows from operating activities, net | \$ 87,223 | \$ 64,034 |
| Cash flows from investing activities: | | |
| Maturities of investments | 221,245 | 366,653 |
| Purchases of investments | (288,936) | (251,474) |
| Acquisition of business, net of cash and cash equivalents acquired | (30,285) | (16,514) |
| Purchases of rental furniture | (25,643) | (40,561) |
| Other, net | (2,689) | (2,218) |
| Net cash flows from investing activities | (126,308) | 55,886 |
| Cash flows from financing activities: | | |
| Net increase in notes payable | 8,326 | 20,100 |
| Payment of cash dividends | (4,629) | (4,485) |
| Net cash flows from financing activities | 3,697 | 15,615 |
| Increase (decrease) in cash and cash equivalents | (35,388) | 135,535 |
| Cash and cash equivalents beginning of period | 120,784 | 153,810 |
| Cash and cash equivalents end of period | \$ 85,396 | \$ 289,345 |
| Supplementary information: | | |
| Interest paid during period | \$ 1,065 | \$ 2,559 |
| Income taxes paid, net, during period | 16,632 | 43,461 |

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 generally accepted accounting principles.

In June 2001, the Financial Accounting Standards Board issued SFAS No. 142, Goodwill and Other Intangible Assets, changing from an accounting model that required amortization of goodwill, supplemented by impairment tests, to an accounting model based solely on impairment tests. SFAS No. 142 also provided guidance on accounting for identifiable intangible assets that may or may not require amortization. The provisions of SFAS No. 142 became effective for Wesco at the beginning of 2002; as a result, the accompanying condensed consolidated financial statements do not reflect any goodwill amortization in 2002, compared to \$1,878, before taxes, of goodwill amortization for the second quarter, and \$3,709 for the first six months, of 2001. Had Wesco adopted the provisions of SFAS No. 142 and ceased goodwill amortization as of the beginning of 2001, its after-tax income in 2001 would have been \$16,813 (\$2.36 per share) for the second quarter, and \$38,307 (\$5.38 per share) for the first six months, representing increases in after-tax earnings of \$1,707 (\$.24 per share) for the second quarter, and \$3,384 (\$.48 per share) for the first six months.

Reference is made to the notes to Wesco's consolidated financial statements appearing on pages 36 through 44 of its 2001 Form 10-K Annual Report for other information deemed generally applicable to the condensed consolidated financial statements.

Note 2

Following is a summary of securities with fixed maturities:

| | June 30, 2002 | | December 31, 2001 | |
|--|-------------------|--------------------------------------|-------------------|--------------------------------------|
| | Amortized Cost | Quoted Market (Carrying) Value | Amortized Cost | Quoted Market (Carrying) Value |
| Mortgage-backed securities | \$667,574 | \$ 686,636 | \$886,186 | \$899,066 |
| Other, principally U.S. government obligations | 310,624 | 314,473 | 26,119 | 25,094 |
| | <u>\$978,198</u> | <u>\$1,001,109</u> | <u>\$912,305</u> | <u>\$924,160</u> |

Table of Contents

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

| | June 30, 2002 | | December 31, 2001 | |
|-----------------------|-------------------|--------------------------------|-------------------|--------------------------------|
| | Amortized Cost | Quoted Market (Carrying) Value | Amortized Cost | Quoted Market (Carrying) Value |
| The Coca-Cola Company | \$ 40,761 | \$403,514 | \$ 40,761 | \$339,744 |
| The Gillette Company | 40,000 | 216,768 | 40,000 | 213,760 |
| Other | 27,020 | 121,714 | 27,020 | 113,758 |
| | <u>\$ 107,781</u> | <u>\$ 741,996</u> | <u>\$ 107,781</u> | <u>\$ 667,262</u> |

Note 3

The following table sets forth Wesco's consolidated comprehensive income (loss) for the three- and six-month periods ended June 30, 2002 and 2001:

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|-------------------|------------------|--------------------|
| | June 30, 2002 | June 30, 2001 | June 30, 2002 | June 30, 2001 |
| Net income | \$ 14,880 | \$ 15,106 | \$ 29,317 | \$ 34,923 |
| Increase (decrease) in unrealized appreciation of investments, net of income tax effect of (\$12,453), \$8,996, (\$30,154) and \$70,203 | 23,091 | (16,855) | 55,636 | (130,252) |
| Comprehensive income (loss) | <u>\$ 37,971</u> | <u>\$ (1,749)</u> | <u>\$ 84,953</u> | <u>\$ (95,329)</u> |

Table of Contents

Note 4

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

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|------------------|------------------|------------------|
| | June 30, 2002 | June 30, 2001 | June 30, 2002 | June 30, 2001 |
| Insurance segment: | | | | |
| Revenues | \$ 31,465 | \$ 26,768 | \$ 61,860 | \$ 55,048 |
| Net income | 12,643 | 13,270 | 25,201 | 27,549 |
| Assets at end of period | 1,852,665 | 1,649,643 | 1,852,665 | 1,649,643 |
| Furniture rental segment: | | | | |
| Revenues | \$ 99,509 | \$ 103,960 | \$ 199,701 | \$ 209,918 |
| Net income | 1,988 | 3,494 | 3,742 | 10,269 |
| Assets at end of period | 301,566 | 331,146 | 301,566 | 331,146 |
| Industrial segment: | | | | |
| Revenues | \$ 12,432 | \$ 12,232 | \$ 24,212 | \$ 26,810 |
| Net income (loss) | 128 | (8) | 124 | 275 |
| Assets at end of period | 19,219 | 21,326 | 19,219 | 21,326 |
| Goodwill of acquired businesses: | | | | |
| Amortization, net of income taxes | \$ | \$ (1,707) | \$ | \$ (3,384) |
| Assets at end of period | 264,930 | 267,265 | 264,930 | 267,265 |
| Other items unrelated to business segments: | | | | |
| Revenues | \$ 991 | \$ 1,100 | \$ 1,933 | \$ 2,135 |
| Net income | 121 | 57 | 250 | 214 |
| Assets at end of period | 25,840 | 24,295 | 25,840 | 24,295 |
| Consolidated totals: | | | | |
| Revenues | \$ 144,397 | \$ 144,060 | \$ 287,706 | \$ 293,911 |
| Net income | 14,880 | 15,106 | 29,317 | 34,923 |
| Assets at end of period | 2,464,220 | 2,293,675 | 2,464,220 | 2,293,675 |

Table of Contents

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

Reference is made to management's discussion and analysis of Wesco's consolidated financial condition and results of operations appearing on pages 18 through 27 of its 2002 Form 10-K Annual Report 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. In reviewing the following paragraphs, attention is also directed to the accompanying condensed consolidated financial statements.

FINANCIAL CONDITION

Wesco's shareholders' equity at June 30, 2002 was approximately \$1.99 billion (\$280 per share), compared to \$1.91 billion (\$269 per share) at December 31, 2001. The increase was due mainly to an increase in appreciation in market value of investments, which is credited, net of taxes, directly to shareholders' equity, without being reflected in earnings. 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, which constituted 21% of shareholders' equity at June 30, 2002.

At June 30, 2002, Wesco's consolidated cash and cash equivalents totaled \$85.5 million, down from \$120.8 million at December 31, 2001. The \$35.3 million decrease was more than offset by an increase in investments in securities with fixed maturities.

Wesco's consolidated borrowings totaled \$42.0 million at June 30, 2002 versus \$33.6 million at December 31, 2001. The increased borrowings related mainly to an acquisition by CORT early in 2002, which it financed using its revolving line of credit.

Wesco's management continues to believe that the Wesco group has adequate liquidity and financial resources to cover existing liquidity requirements and 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. Goodwill amortization was discontinued in connection with the adoption of new accounting standards required by Statement of Financial Standards No. 142, Goodwill and Other Intangible Assets, effective in 2002. (Amounts are in thousands, *all after income tax effect.*)

Table of Contents

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|-------------------|-------------------|-------------------|
| | June 30, 2002 | June 30, 2001 | June 30, 2002 | June 30, 2001 |
| Insurance segment | \$ 12,643 | \$ 13,270 | \$ 25,201 | \$ 27,549 |
| Furniture rental segment | 1,988 | 3,494 | 3,742 | 10,269 |
| Industrial segment | 128 | (8) | 124 | 275 |
| Unrelated to business segment operations | | | | |
| Goodwill amortization | | (1,707) | | (3,384) |
| Other nonsegment items | 121 | 57 | 250 | 214 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Consolidated net income | \$ 14,880 | \$ 15,106 | \$ 29,317 | \$ 34,923 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

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, 2002 | June 30, 2001 | June 30, 2002 | June 30, 2001 |
| Premiums written | \$ 19,746 | \$ 9,260 | \$ 33,238 | \$ 19,892 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Premiums earned | \$ 13,192 | \$ 8,900 | \$ 26,091 | \$ 17,577 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Underwriting gain | \$ 273 | \$ 1,643 | \$ 1,244 | \$ 3,141 |
| Dividend and interest income | 18,273 | 17,868 | 35,769 | 37,471 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Income before income taxes | 18,546 | 19,511 | 37,013 | 40,612 |
| Income tax provision | (5,903) | (6,241) | (11,812) | (13,063) |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Segment net income | \$ 12,643 | \$ 13,270 | \$ 25,201 | \$ 27,549 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

Premiums written for the second quarters of 2002 and 2001 included \$14.7 million and \$4.9 million written by Wes-FIC. Premiums written for the six-month periods ended June 30, 2002 and 2001 included \$22.7 million and \$10.6 million written by Wes-FIC. The remainder for each period was attributable to KBS.

Earned premiums for the second quarters of 2002 and 2001 included \$8.5 million and \$4.5 million attributable to Wes-FIC. Earned premiums for the first six months of 2002 and 2001 included \$16.9 million and \$9.0 million attributable to Wes-FIC. The balance for each period was attributable to KBS.

At June 30, 2002, Wes-FIC's in-force reinsurance business consisted principally of a three-year contract incepting in 2000 with a large, unaffiliated insurer and a contract incepting in 2001 under which Wes-FIC assumes aviation-related risks. Wes-FIC's participation in the aviation-risk pool increased from approximately 3.0% for risks incepting in 2001 to 15.5% for the 2002 year. Written and earned premiums increased accordingly.

Table of Contents

The net underwriting gains reported for the three- and six-month periods ended June 30, 2002 and 2001 were attributable to the profitable underwriting results of KBS. Wes-FIC's reinsurance activities produced underwriting losses of \$2.0 million and \$0.7 million for the second quarters of 2002 and 2001, and \$2.7 million and \$1.3 million for the respective six-month periods. The aforementioned reinsurance arrangements accounted for most of these losses, reflecting increases of unpaid loss estimates. Wes-FIC's estimate of losses in connection with the September 11 terrorist activity remains unchanged at \$10 million.

Dividend and interest income fluctuate from period to period as a result of amount and mix of investments, as well as changes in yield on investments. Fluctuations in dividend and interest income for the second quarters and first halves of 2002 and 2001 were not significant.

Furniture Rental Segment

The furniture rental segment consists of CORT Business Services Corporation (CORT) and its Relocation Central Corporation subsidiary (Relocation Central). Following is a summary of segment operating results for the three- and six-month periods ended June 30, 2002 and June 30, 2001. (Amounts are in thousands.)

| | Three Months Ended | | Six Months Ended | |
|----------------------------|--------------------|-------------------|-------------------|-------------------|
| | June 30, 2002 | June 30, 2001 | June 30, 2002 | June 30, 2001 |
| Revenues: | | | | |
| Furniture rentals | \$ 81,293 | \$ 86,902 | \$ 163,232 | \$ 175,797 |
| Furniture sales | 18,216 | 17,058 | 36,469 | 34,121 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Total revenues | \$ 99,509 | \$ 103,960 | \$ 199,701 | \$ 209,918 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Income before income taxes | \$ 2,360 | \$ 5,497 | \$ 5,954 | \$ 16,473 |
| Income tax provision | (372) | (2,003) | (2,212) | (6,204) |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Segment net income | \$ 1,988 | \$ 3,494 | \$ 3,742 | \$ 10,269 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

Furniture rental segment revenues for the second quarter and first six months of 2002 decreased \$4.5 million and \$10.2 million, or 4.3% and 4.9%, from the corresponding 2001 figures. Rental revenues for the second quarter and first six months declined \$5.6 million and \$12.6 million, or 6.5% and 7.1%. Excluding rental revenues from locations acquired since June 30, 2001, trade show revenues in 2002 and 2001, and revenues generated by Relocation Central from the start-up of its apartment locator operation (\$1.4 million and \$2.7 million for the three- and six-month periods ended June 30, 2002, versus none for the first six months of 2001), rental revenues for the first six months of 2002 decreased approximately 20% from those reported for the comparable 2001 period. The number of furniture leases outstanding continued the downward trend begun in late 2000, reflecting continued weakness of the economy. Furniture sales revenues increased approximately 7% for both the current quarter and first six months; excluding sales revenues resulting from acquisitions, furniture sales decreased by approximately 4.6% and 4.1%, also reflecting weakness in the economy.

Income before income taxes and net income of the furniture rental segment are dependent not only on revenues, but also on operating expenses and cost of rentals and sales. Income before income taxes decreased in relation to revenues from 2001 to 2002 (from 5.3% to 2.4% of revenues for the second quarters, and from 7.8% to 3.0% for the first halves) due partially to increases in cost of rentals and sales (from 25.9% to 26.9%

Table of Contents

of revenues for the second quarters and from 26.0% to 27.1% for the first halves). More importantly, selling, general and administrative expenses increased: The 2002 figures included expenses related to the January 2002 and other acquisitions as well as to increased expenses of Relocation Central, which began operations in January 2001; these more than offset significant expense reductions realized by CORT on its older operations.

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, 2002 | June 30, 2001 | June 30, 2002 | June 30, 2001 |
| Revenues, principally sales and services | \$ 12,432 | \$ 12,232 | \$ 24,212 | \$ 26,810 |
| Income before income taxes | \$ 215 | \$ 20 | \$ 208 | \$ 488 |
| Income tax provision | (87) | (28) | (84) | (213) |
| Segment net income (loss) | \$ 128 | \$ (8) | \$ 124 | \$ 275 |

Revenues of Precision Steel's businesses for the second quarter and first six months of 2002 increased \$0.2 million, or 1.6%, and decreased \$2.6 million, or 9.7%, from the corresponding 2001 figures. Pounds of steel products sold increased 10.4% for the second quarter, but decreased 4.1% for the six-month period. Precision Steel is continuing to suffer extraordinary, and increasing, competitive pressures combined with ongoing weakness in the manufacturing segment of the economy. The small relative increase in revenues compared to that of pounds sold during the current quarter is attributed principally to deflation in sales prices. Steel mills and other suppliers have lowered many prices, allowing Precision, in turn, to lower many of its selling prices while not significantly affecting its gross profit margins.

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. The latter, as a percentage of revenues, amounted to 81.6% each, for the second quarters of 2002 and 2001, and 82.4% and 81.3% for the corresponding six-month periods. The cost percentage typically fluctuates slightly from period to period as a result of changes in product mix and price competition at all levels.

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, 2002 | June 30, 2001 | June 30, 2002 | June 30, 2001 |
| Goodwill amortization, before income tax effect | \$ | \$(1,878) | \$ | \$(3,709) |
| Income tax benefit | | 171 | | 325 |
| | <u>\$</u> | <u>\$(1,707)</u> | <u>\$</u> | <u>\$(3,384)</u> |
| Other nonsegment items, net, before income tax effect | \$152 | \$ 43 | \$317 | \$ 254 |
| Income tax provision | (31) | 14 | (67) | (40) |
| | <u>\$121</u> | <u>\$ 57</u> | <u>\$250</u> | <u>\$ 214</u> |

As explained in Note 1 to the accompanying condensed consolidated financial statements, Wesco discontinued amortization of goodwill effective as of the beginning of 2002, as required by the Financial Accounting Standards Board. Goodwill amortization for 2001 related principally to CORT.

Realized gains and losses on investments, when they occur, are classified by Wesco as nonsegment items. These realizations tend to fluctuate in amount from period to period, sometimes impacting net income significantly, and their amounts and timing have no predictive or practical analytical value. No securities gains or losses were realized during the first six months of 2002 or the entire calendar year ended December 31, 2001.

Other nonsegment items comprise mainly rental income from owned commercial real estate and dividend and interest income from investments owned outside the insurance segment, reduced by real estate and other expenses.

* * * * *

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 30.1% and 34.9% for the quarters ended June 30, 2002 and June 30, 2001, and 32.6% and 35.5% for the six-month periods then ended.

CRITICAL ACCOUNTING POLICIES

In applying certain accounting policies, Wesco is required to make estimates and judgments regarding transactions that have occurred and ultimately will be settled in the future. Amounts recognized in the financial statements from such estimates are necessarily based on assumptions about numerous factors involving varying, and possibly significant, degrees of uncertainty. Accordingly, the amounts currently recorded in the financial statements may prove, with the benefit of hindsight, to be inaccurate.

Table of Contents

Wesco accrues liabilities for unpaid property and casualty insurance and reinsurance losses based upon estimates of the ultimate amounts payable under the contracts related to losses occurring on or before the balance sheet date. As of any balance sheet date, all claims have not yet been reported and some claims may not be reported for many years. As a result, the liability for unpaid losses includes significant estimates for incurred-but-not-reported claims. Additionally, reported claims are in various stages of the settlement process. Each claim is settled individually based upon its merits and certain liability or workers' compensation claims may take years to settle, especially if legal action is involved.

Wesco uses a variety of techniques to establish the liabilities for unpaid claims recorded at the balance sheet date. While techniques may vary, all employ significant judgments and assumptions. Techniques may involve detailed statistical analysis of past claim reporting, settlement activity, claim frequency and severity data when sufficient information exists to lend statistical credibility to the analysis. The analysis may be based upon internal loss experience, the experience of clients or industry experience. Techniques may vary depending on the type of claim being estimated. More judgmental techniques are used in lines when statistical data is insufficient or unavailable. Liabilities may also reflect implicit or explicit assumptions regarding the potential effects of future economic and social inflation, judicial decisions, law changes, and recent trends in such factors.

Wesco's condensed consolidated balance sheet includes estimated liabilities for unpaid losses from property and casualty insurance and reinsurance contracts of \$67.4 million at June 30, 2002. Due to the inherent uncertainties in the process of establishing these amounts, the actual ultimate claims amounts will likely differ from the currently recorded amounts. Future effects from changes in these estimates will be recorded as a component of losses incurred in the period of the change. Such changes are not expected to materially affect Wesco's shareholders' equity.

Wesco's financial position reflects large amounts of invested assets. A substantial portion of these assets are carried at fair values based upon current market quotations and, when not available, based upon fair value pricing models.

Wesco's condensed consolidated balance sheet as of June 30, 2002 includes goodwill of acquired businesses of approximately \$265 million. These amounts have been recorded as a result of Wesco's prior business acquisitions accounted for under the purchase method. Prior to 2002, goodwill from each acquisition was amortized as a charge to earnings over periods not exceeding 40 years. Under SFAS No. 142, which was adopted by Wesco as of January 1, 2002, periodic amortization ceased.

A significant amount of judgment is required in performing goodwill impairment tests. Such tests include periodically determining or reviewing the estimated fair value of Wesco's reporting units. Under SFAS No. 142, 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, and other valuation techniques such as 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. Any excess of the carrying value of the reporting unit over the estimated fair value of underlying net assets would represent implied goodwill and be charged off as an impairment loss.

Table of Contents

MARKET RISK ANALYSIS

Reference is made to the section, "Market Risk Analysis" included in management's discussion and analysis of Wesco's consolidated financial condition and results of operations, appearing on pages 24 through 26 of its 2001 Form 10-K Annual Report. There have been no material changes through June 30, 2002.

FORWARD-LOOKING STATEMENTS

Certain written or oral representations of management stated herein 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 investees, 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.