

WESCO FINANCIAL CORP

Form 10-K

March 01, 2007

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SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
**Form 10-K**

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2006 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  
(State or Other Jurisdiction of  
Incorporation or organization)

95-2109453  
(I.R.S. Employer Identification No.)

301 East Colorado Boulevard, Suite 300,  
Pasadena, California  
(Address of Principal Executive Offices)

91101-1901  
(Zip Code)

(626) 585-6700

(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to section 12(b) of the Act:

Title of Each Class

Name of Each Exchange on Which Registered

Capital Stock, \$1 par value

American Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

(Title of Class)

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

The aggregate market value of voting and non-voting stock of the registrant held by non-affiliates of the registrant as of June 30, 2006 was: \$510,234,000.

The number of shares outstanding of the registrant's Capital Stock as of March 2, 2007 was: 7,119,807.

DOCUMENTS INCORPORATED BY REFERENCE

| Title of Document  | Parts of Form 10-K                    |
|--|---------------------------------------|
| Proxy Statement for 2007<br>Annual Meeting of Shareholders | Part III. Items 10, 11, 12, 13 and 14 |

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**PART I**

**ITEM 1. Business**

**GENERAL**

Wesco Financial Corporation ( Wesco ) was incorporated in Delaware on March 19, 1959. Wesco engages in three principal businesses through its direct or indirect wholly owned subsidiaries:

the insurance business, through Wesco-Financial Insurance Company ( Wes-FIC ), which was incorporated in 1985 and engages in the property and casualty insurance business, and The Kansas Bankers Surety Company ( KBS ), which was incorporated in 1909, purchased by Wes-FIC in 1996 and provides specialized insurance coverages for banks;

the furniture rental business, through CORT Business Services Corporation ( CORT ), which traces its national presence to the combination of five regional furniture rental companies in 1972 and was purchased by Wesco in 2000; and

the steel service center business, through Precision Steel Warehouse, Inc. ( Precision Steel ), which was begun in 1940 and acquired by Wesco in 1979.

Wesco s operations also include, through another wholly owned subsidiary, MS Property Company ( MS Property ), management of owned commercial real estate in downtown Pasadena, California. MS Property began its operations in late 1993, upon transfer to it of real properties previously owned by Wesco and by a former savings and loan subsidiary of Wesco.

Since 1973, Wesco has been 80.1%-owned by Blue Chip Stamps ( Blue Chip ), a wholly owned subsidiary of Berkshire Hathaway Inc. ( Berkshire ). Thus, Wesco and its subsidiaries are controlled by Blue Chip and Berkshire. All of these companies may also be deemed to be controlled by Warren E. Buffett, who is Berkshire s Chairman and Chief Executive Officer and economic owner of 29.5% of its stock. Wesco s Chairman, President and Chief Executive Officer, Charles T. Munger, is also Vice Chairman of Berkshire, and consults with Mr. Buffett with respect to Wesco s investment decisions, major capital allocations, and the selection of the chief executives to head each of its operating businesses, subject to ultimate approval of Wesco s Board of Directors.

Wesco s activities fall into three business segments insurance, furniture rental and industrial. The insurance segment consists of the operations of Wes-FIC and KBS. The furniture rental segment consists of the operations of CORT. The industrial segment comprises Precision Steel s steel service center and other operations. Wesco is also engaged in several activities not identified with the three business segments, including investment activity unrelated to the insurance segment, MS Property s real estate activities, and parent company activities.

**INSURANCE SEGMENT**

Wes-FIC was incorporated in 1985 to engage in the property and casualty insurance and reinsurance business. Its insurance operations are managed by National Indemnity Company ( NICO ), which is headquartered in Omaha, Nebraska. To simplify discussion, the term Berkshire Insurance Group refers to NICO, General Reinsurance Corporation, and certain other wholly owned insurance subsidiaries of Berkshire, although Berkshire also includes in its insurance group the insurance subsidiaries that are 80.1%-owned through Berkshire s ownership of Wesco.

Wes-FIC s high statutory net worth (about \$2.3 billion at December 31, 2006) has enabled Berkshire to offer Wes-FIC the opportunity to participate, from time to time, in contracts in which Wes-FIC effectively has reinsured certain property and casualty risks of unaffiliated property and casualty insurers. These arrangements have included excess-of-loss contracts such as super-catastrophe reinsurance contracts which subject the reinsurer to especially large amounts of losses from mega-catastrophes such as hurricanes or earthquakes. Super-catastrophe policies, which indemnify the ceding companies for all or part of covered losses in excess of large, specified retentions, have

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been subject to aggregate limits. Wes-FIC has also been party to quota-share reinsurance, under which it shares in premiums and losses proportionately with the ceding company.

Wesco's board of directors has authorized automatic acceptance of retrocessions of super-catastrophe reinsurance offered by the Berkshire Insurance Group provided the following guidelines and limitations are complied with: (1) in order not to delay the acceptance process, the retrocession is to be accepted without delay in writing in Nebraska by agents of Wes-FIC who are salaried employees of the Berkshire Insurance Group; (2) any ceding commission received by the Berkshire Insurance Group cannot exceed 3% of premiums, which is believed to be less than the Berkshire Insurance Group could get in the marketplace; (3) Wes-FIC is to assume 20% or less of the total risk; (4) the Berkshire Insurance Group must retain at least 80% of the identical risk; and (5) the aggregate premiums from this type of business in any twelve-month period cannot exceed 10% of Wes-FIC's net worth. Occasionally, the Berkshire Insurance Group will also have an upper-level reinsurance interest with interests different from Wes-FIC's, particularly in the event of one or more large losses. Although Wes-FIC has no active super-catastrophe reinsurance contracts in force, Wes-FIC may have opportunities to participate in such business from time to time in the future.

Following are some of the more significant reinsurance arrangements in which Wes-FIC has participated in recent years:

A quota-share agreement entered into in 1985 whereby Wes-FIC effectively reinsured through the Berkshire Insurance Group, as intermediary-without-profit 2% of essentially all insurance business of a major property and casualty insurer written during a four-year coverage period that expired in 1989. Wes-FIC remains liable for its share of remaining unpaid losses and loss adjustment expenses.

A multi-year, quota-share arrangement, entered into in 2000 through NICO, as intermediary without profit, for participation in a pool of certain property and casualty risks written by a large, unaffiliated insurer. For 2003 and through the contract's commutation (termination) in the latter part of 2004, Wes-FIC participated to the extent of 6% in the pool. The terms of this arrangement were identical to those accepted by a member of the Berkshire Insurance Group, except as to the amount of the participation. As a result of the commutation of the contract, Wes-FIC is no longer liable for any claims or losses, or for adjustments to losses previously recorded, under the contract.

Participation, since 2001, in several risk pools managed by a subsidiary of General Reinsurance Corporation, a Berkshire Insurance Group member, covering principally hull, liability and workers' compensation exposures, relating to the aviation industry. In the more recent years, Wes-FIC's participation has been as follows: for 2003 and 2004, to the extent of 10% in the hull and liability pools; for 2005, 10% of the hull and liability pools and 5% of the workers' compensation pool; and, for 2006, 12.5% of the hull and liability pools and 5% of the workers' compensation pool. For 2007, the participation in the hull and liability pools has increased to 16.67%. Another General Reinsurance Corporation subsidiary provides a portion of the upper-level reinsurance protection to these aviation risk pools, and therefore to Wes-FIC, on terms that could cause some conflict of interest under certain conditions, such as in settling a large loss. Wes-FIC's exposure to detrimental effects, however, is mitigated because a senior manager of NICO who represents the membership interests of Wes-FIC, and unrelated pool members representing an additional 75% of the hull and liability pools and 90% of the workers' compensation pool who have the same exposures to this potential conflict of interest, has access to information regarding significant losses and thus is able to address conflict issues that might arise.

Wes-FIC is also licensed to write direct, or primary insurance business (as distinguished from reinsurance) in Nebraska, Utah and Iowa, and may write such insurance in the non-admitted excess and surplus lines market in several other states, but the volume written to date has been minimal.

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In 1996, Wes-FIC purchased 100% of KBS. KBS, which writes primary insurance, provides specialized insurance coverage to more than 20% of the banks in the United States, mostly small and medium-sized banks in the Midwest. It is licensed to write business in 37 states. Its product line for financial institutions includes policies for crime insurance, check kiting fraud indemnification, Internet banking catastrophe theft insurance, directors and officers liability, bank employment practices, and bank insurance agents professional errors and omissions indemnity, as well as deposit guaranty bonds which insure deposits in excess of federal deposit insurance limits. KBS purchases reinsurance for indemnification against large losses. For several years, through 2005, 50% of a layer of loss exposure was ceded to an unaffiliated reinsurer and the other 50% to the Berkshire Insurance Group, on identical terms. A second layer was reinsured 70% with the same non-affiliate and 30% was retained by KBS. Effective in 2006, the unaffiliated reinsurer declined to renew its contract with KBS. As a result, the Berkshire Insurance Group now reinsures the entire first layer of exposure itself. Another layer is 35%-retained by KBS and the other 65% is reinsured by the Berkshire Insurance Group at market prices. In 2006, premiums of \$3.3 million were ceded to the Berkshire Insurance Group and incurred reinsured losses of \$800,000 were allocated to it. In recent years, KBS has retained a greater proportion of the risks it has underwritten. By retaining a larger amount of risk than in the past, Wesco seeks satisfactory operating results over the long term in return for greater short-term volatility.

KBS markets its products in some states through exclusive, commissioned agents, and directly to insureds in other states. Inasmuch as the number of small Midwestern banks is declining as the banking industry consolidates, KBS relies for growth on an extraordinary level of service provided by its employees and agents, and on products such as deposit guaranty bonds, which were introduced in 1993 and currently account for approximately 48 percent of premiums written.

A significant marketing advantage enjoyed by the Berkshire Insurance Group, including Wesco's insurance segment, is the maintenance of exceptional capital strength. The combined statutory surplus of Wesco's insurance businesses totaled approximately \$2.3 billion at December 31, 2006. This capital strength creates opportunities for Wes-FIC to participate in reinsurance and insurance contracts not necessarily available to many of its competitors.

Management of Wesco believes that an insurer in the reinsurance business must maintain a large net worth in relation to annual premiums in order to remain solvent when called upon to pay claims when a loss occurs. In this respect, Wes-FIC and KBS are competitively well positioned, inasmuch as their net premiums written for calendar 2006 amounted to only 2% of their combined statutory surplus, compared to an industry average of 100% based on figures reported for 2005 by A.M. Best Company, a nationally recognized statistical rating organization for the insurance industry. Standard & Poor's Corporation, in recognition of Wes-FIC's strong competitive position as a member of the Berkshire Insurance Group and its unusual capital strength, has assigned its highest rating, AAA, to Wes-FIC's claims-paying ability. This rating recognizes the commitment of Wes-FIC's management to a disciplined approach to underwriting, conservative reserving, and Wes-FIC's extremely strong capital base.

Insurance companies are subject to regulation by the departments of insurance of the various states in which they write policies as well as the states in which they are domiciled and, in the case of KBS, because of its business of insuring banks, by the Department of the Treasury. Regulations relate to, among other things, capital requirements, shareholder and policyholder dividend restrictions, reporting requirements, annual audits by independent accountants, periodic regulatory examinations and limitations on the risk exposures that can be retained, as well as the size and types of investments that can be made.

Because it is operated by NICO, Wes-FIC has no employees of its own. KBS has 18 employees.

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**FURNITURE RENTAL SEGMENT**

CORT is the largest, and only national, provider of rental furniture, accessories and related services in the rent-to-rent (as opposed to rent-to-own) segment of the furniture industry. CORT rents high-quality furniture to corporate and individual customers who desire flexibility in meeting their temporary office, residential or trade show furnishing needs, and who typically do not seek to own such furniture. In addition, CORT sells previously rented furniture through company-owned clearance centers, thereby enabling it to regularly renew its inventory and update styles. CORT's network of facilities (in 34 states and the District of Columbia) comprises 87 showrooms, 78 clearance centers and 74 warehouses, as well as nine websites, including [www.cort.com](http://www.cort.com).

CORT's rent-to-rent business is differentiated from rent-to-own businesses primarily by the terms of the rental arrangements and the type of customer served. Rent-to-rent customers generally desire high-quality furniture to meet temporary needs, have established credit, and pay on a monthly basis. Typically, these customers do not seek to acquire the property on a permanent basis. In a typical rent-to-rent transaction, the customer agrees to rent furniture for a minimum of three months, subject to extension by the customer on a month-to-month basis. By contrast, rent-to-own arrangements are generally made by customers lacking established credit whose objective is the eventual ownership of the property. These transactions are typically entered into on a month-to-month basis and may require weekly rental payments.

CORT's customer base includes primarily Fortune 500 companies, small businesses, professionals, and owners and operators of apartment communities. CORT's management believes its size, national presence, brand awareness, consistently high level of customer service, product quality, breadth of selection, depth and experience of management, and efficient clearance centers have been key contributors to the company's success. CORT offers a wide variety of office and home furnishings, including commercial panel systems, televisions, housewares and accessories. CORT emphasizes its ability to furnish an apartment, home or entire suite of offices with high-quality furniture, housewares and accessories in two business days. CORT's objective is to build upon these core competencies and competitive advantages to increase revenues and market share. Key to CORT's growth strategies are:

expanding its commercial customer base;

enhancing its ability to capture an increasing number of Internet customers through its on-line catalog and other web services;

making selective acquisitions; and

continuing to develop various products and services.

In order to capitalize on the significant profit potential available from longer average rental periods and the higher average monthly rent typically available for office products, CORT's strategy is to place greater emphasis on rentals of office furniture than on residential furniture. In order to promote longer office lease terms, CORT offers lower rates on leases when lease terms exceed six months. A significant portion of CORT's residential furniture rentals are derived from corporate relocations and temporary assignments, as new and transferred employees of CORT's corporate customers enter into leases for residential furniture. Thus, CORT offers its corporate rental customers a way to reduce the costs of corporate relocation and travel while developing residential business with new and transferred employees. CORT also provides short-term rentals for trade shows and conventions. Its [www.corttradeshow.com](http://www.corttradeshow.com) website assists in providing information to and gathering leads from prospects.

Following four years of disappointing results, CORT began to see improved profitability in 2004. This trend continued through 2006, with increased lease pricing and improved gross margins outpacing a decline in the number of outstanding leases in each of the past two years. The furniture rental business is dependent on economic cycles. We are hopeful that the recent softening of the housing sector is not a precursor of a weakening of the furniture rental business. Because CORT has

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made several selective acquisitions since it was purchased by Wesco, it is believed that CORT is now well positioned to benefit from domestic job growth and any corresponding economic expansion.

CORT provides a nation-wide apartment locator service through its websites (www.cortline.com, www.relocationcentral.com and www.apartmentsearch.com) customer call centers and walk-in locations. The apartment locator service, which was begun in 2001 as CORT's Relocation Central Corporation subsidiary and marketed to individuals, has not operated profitably since inception. In order to trim operating costs, its operations were reorganized and, by yearend 2004, absorbed into CORT's. CORT's apartment locator service, which was originally intended mainly to lead to increased furniture rentals, now relies more on internet traffic and less on walk-in locations. In consideration of its national presence and expertise in filling a need of the business community, late in 2006 CORT began marketing its relocation service, designed specifically for renters, to Fortune 2000 companies as a comprehensive, seamless solution to their employee-relocation needs. In addition to providing rental furniture, CORT provides assistance with all aspects of employee rental-related relocations, from guiding city tours, to arranging for movers, locating temporary or long-term housing, assisting with settling in and other ancillary services. Through its network of foreign contacts, CORT also provides such services internationally. Although the relocation business is competitive, it is believed that CORT is well positioned to expand these services due not only to its national presence and liquidity, but also because the business reputation of Berkshire Hathaway, its ultimate parent, gives it entrée into the offices of many prospective customers, and thus a competitive advantage.

The rent-to-rent segment of the furniture rental industry is highly competitive. There are several large regional competitors, as well as a number of smaller regional and local rent-to-rent competitors. In addition, numerous retailers offer residential and office furniture under rent-to-own arrangements. It is believed that the principal competitive factors in the furniture rental industry are product value, furniture condition, the extent of furniture selection, terms of the rental agreement, speed of delivery, exchange privileges, options to purchase, deposit requirements and customer service.

The majority of CORT's furniture sales revenue is from its clearance center sales. The remaining furniture sales revenue is derived principally from lease conversions and sales of new furniture. The sale of previously leased furniture allows CORT to control inventory quantities and to maintain inventory quality at showroom level. On the average, furniture is typically sold through the clearance centers three years after its initial purchase. With respect to sales of furniture through its clearance centers, CORT competes with numerous new and used furniture retailers, some of which are larger than CORT. Wesco management believes that price and value are CORT's principal competitive advantages in this activity.

CORT has approximately 2,400 full-time employees, including 61 union members. Management considers labor relations to be good.

**INDUSTRIAL SEGMENT**

Precision Steel and one of its subsidiaries operate steel service centers in the Chicago and Charlotte metropolitan areas. The service centers buy stainless steel, low carbon sheet and strip steel, coated metals, spring steel, brass, phosphor bronze, aluminum and other metals, cut these metals to order, and sell them to a wide variety of customers.

The service center business is highly competitive. Precision Steel's annual sales volume of approximately 23 thousand tons of flat rolled products compares with the domestic steel service industry's annual volume of approximately 13 million tons of comparable products. Precision Steel competes not only with other service centers but also with mills that supply metal to the service centers. Sales competition exists in the areas of price, quality, availability and speed of delivery. Because it is willing to sell in relatively small quantities, Precision Steel has been able to compete in geographic areas distant from its service center facilities. Competitive pressure has been intensified by



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imports, a shift to production abroad and an increasing tendency of domestic manufacturers to use less costly materials in making parts.

Precision Brand Products, Inc. ( Precision Brand ), a wholly owned subsidiary of Precision Steel that is also located in the Chicago area, manufactures shim stock and other toolroom specialty items, and distributes a line of hose clamps and threaded rod. These products are sold under the Precision Brand and DuPage names nationwide, generally through industrial distributors. This business is highly competitive, and Precision Brand's sales represent a very small share of the market.

Steel service raw materials are obtained principally from major domestic steel mills, and their availability had generally been good until approximately three years ago, when the market drifted into near chaos caused by shortages. Consolidation and downsizing at the mill level, coupled with unanticipated demand for steel due to a higher level of manufacturing activity, resulted in extended mill lead times and limitations placed on order quantities by the producing mills. Although conditions have recently become less difficult, Precision Steel's service centers maintain extensive inventories in order to meet customer demand for prompt deliveries; typically, processed metals are delivered to the customer within one or two weeks. Precision Brand normally maintains inventories adequate to allow for off-the-shelf service to customers within 24 hours.

The industrial segment businesses are subject to economic cycles and other factors. These businesses are not dependent on a few large customers. The backlog of steel service orders decreased to \$4.1 million at December 31, 2006 from \$6.0 million at December 31, 2005. The 2005 figure included an extraordinarily high \$0.9 million order for industrial supplies shipped early in 2006 to a customer of Precision Brand.

There are 202 full-time employees engaged in the industrial segment businesses, 40% of whom are members of unions. Management considers labor relations to be good.

### **ACTIVITIES NOT IDENTIFIED WITH A BUSINESS SEGMENT**

Certain of Wesco's activities are not identified with any business segment. These include investment activity unrelated to the insurance segment, management of owned commercial real property, a portion of which it is redeveloping, and parent company activities.

Six full-time employees are engaged in the activities of Wesco and MS Property.

### **AVAILABLE INFORMATION**

Wesco's Forms 10-K, 10-Q and 8-K, and amendments thereto, may be accessed soon after they are electronically filed with the Securities and Exchange Commission ( SEC ), through Wesco's website, [www.wescofinancial.com](http://www.wescofinancial.com), or the SEC's website, [www.sec.gov](http://www.sec.gov).

### **Item 1A. Risk Factors**

In addition to the factors affecting specific business operations identified in connection with the description of these operations and their financial results elsewhere in this report, the most significant factors affecting Wesco's operations are listed below. These factors could cause Wesco's actual results to differ materially from the forward-looking and other statements contained in this report and in the other periodic reports and other filings Wesco makes with the SEC, as well as in news releases, annual reports and other communications that Wesco makes from time to time.

#### **An investment in Wesco is not an investment in Berkshire Hathaway.**

From time to time there is an erroneous report by an analyst or reporter that an investor wishing to purchase Berkshire Hathaway common stock can simply purchase shares of Wesco stock at a lower price. Berkshire Hathaway is the parent of Wesco. Wesco's operations differ significantly from those of Berkshire Hathaway, and its shares may trade at a significantly different price relative to its intrinsic

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value than do those of Berkshire Hathaway. In addition to the risk factors affecting Wesco's operations, Berkshire Hathaway has risk factors of its own. Investors wishing to invest in shares of Berkshire Hathaway cannot do so by purchasing Wesco shares. They should carefully read Berkshire Hathaway's published financial statements and filings with the SEC.

**Wesco is dependent for its investment and all other capital allocation decisions on a few key people.**

Investment decisions and all other capital allocation decisions are made for Wesco's businesses by Charles T. Munger, Chairman of the Board of Directors, President and CEO of Wesco, and Vice Chairman of the Board of Directors of Berkshire Hathaway, age 83, in consultation with Warren E. Buffett, Chairman of the Board of Directors and CEO of Berkshire Hathaway, age 76. If for any reason the services of those key personnel, particularly Mr. Buffett, were to become unavailable to Wesco, there could be a materially adverse effect on the Company. However, Berkshire's Board of Directors has identified three current Berkshire subsidiary managers who are capable of being CEO of Berkshire, Wesco's parent company. Berkshire's Board has agreed on a replacement for Mr. Buffett should a replacement be needed currently. Its Board continually monitors this matter and could alter its current view in the future. Management of Wesco believes that the Berkshire Board's succession plan mitigates this risk.

**Unless Wesco can reinvest a large amount currently invested in cash equivalents at attractive returns, future returns on shareholders' equity will probably be less than those of the past.**

Wesco's consolidated balance sheet reflects total assets of \$3.0 billion as of yearend 2006. Of that amount, more than \$1 billion has been invested in cash equivalents and fixed-maturity investments since early in 2003. Unless those funds can be attractively reinvested in acquisitions, equity securities or other long-term instruments of the type that have been principally responsible for the long-term growth of Wesco's shareholders' equity, future returns on shareholders' equity will probably be less than those of the past. Due to the current size of Wesco and its parent, Berkshire Hathaway, Wesco's opportunities for growing shareholders' equity are unlikely to be as attractive as in the past.

**Wesco's Wes-FIC subsidiary is dependent upon the Berkshire Insurance Group for its management and personnel, and for opportunities to participate with the Group in reinsurance contracts representing essentially the entirety of its reinsurance business, as well as a significant portion of its insurance business to date.**

Since the incorporation of Wes-FIC in 1985, its insurance and reinsurance business, other than that conducted by its Kansas Bankers Surety subsidiary, has been limited principally to participation with members of the Berkshire Insurance Group in contracts for the reinsurance of risks of unaffiliated property and casualty insurance companies. Wes-FIC's operations are managed by National Indemnity Company, a member of the Berkshire Insurance Group; it has no employees of its own. In the event the Berkshire Insurance Group were to cease operating Wes-FIC's business or to significantly curtail Wes-FIC's participation with it in reinsurance contracts, Wes-FIC would be required to look elsewhere for personnel who would conduct and manage its operations, and/or seek to continue its insurance business in a different manner, possibly by acquisition. Inasmuch as Wesco and its subsidiaries, including Wes-FIC, are also subsidiaries of Berkshire Hathaway through Berkshire Hathaway's 80.1%-ownership of Wesco, Wesco does not foresee a time when Berkshire Hathaway would not continue operating its insurance business.

**Wesco's tolerance for risk in its insurance businesses may result in a high degree of volatility in periodic reported earnings.**

Wes-FIC participates with members of the Berkshire Insurance Group in certain reinsurance contracts in which significant risk is periodically assumed. The Berkshire Insurance Group has

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indicated that it continues to be willing to assume more risk than any other insurer has knowingly taken on. Although Wes-FIC's reinsurance currently in force does not subject it to super-catastrophe risks, it has procedures in place for the immediate acceptance of participations in catastrophic excess of loss reinsurance, which could subject it to large amounts of losses from mega-catastrophes such as hurricanes or earthquakes, if offered to it by the Berkshire Insurance Group, so long as the Berkshire Insurance Group participates in such reinsurance activities to a greater degree. The tolerance for significant losses may in certain future periods result in significant losses. This policy may result in a high degree of volatility in Wesco's periodic reported earnings.

**The degree of estimation error inherent in the process of estimating property and casualty insurance loss reserves may result in a high degree of volatility in periodic reported earnings.**

In the insurance business, premiums are charged today for promises to pay covered losses in the future. The principal cost associated with premium revenue is claims. However, it will literally take decades before all losses that have occurred as of the balance sheet date will be reported and settled. Although Wesco believes that loss reserve balances are adequate to cover losses, Wesco will not truly know whether the premiums charged for the coverages provided are sufficient until well after the balance sheet date. Wesco's objective is to generate underwriting profits over the long term. Estimating insurance claim costs is inherently imprecise. Wesco's reserve estimates are subject to revision, so adjustments to reserve estimates can have a material effect on periodic reported earnings.

**Wesco's insurance subsidiaries' investments are unusually concentrated.**

Compared to other insurers, Wesco's insurance subsidiaries may keep an unusually high percentage of their assets in common stocks and diversify their portfolios far less than is conventional. A significant decline in the stock market or in the price of major investees could produce a large decrease in Wesco's shareholders' equity, and could precipitate recognition of such losses in the statement of earnings. Decreases in values of equity investments could have a materially adverse effect on Wesco's book value per share, and could affect the price at which Wesco shares are traded.

**Each of Wesco's operating businesses faces intense competitive pressures.**

Each of Wesco's operating businesses faces intense competitive pressures within its respective market. While Wesco's businesses are managed with the objective of achieving sustainable growth over the long term through developing and strengthening competitive advantages, many factors, including market changes and technology, could erode or impede those competitive advantages.

The property and casualty insurance industry is highly competitive. Many insurers price their business more to provide immediate cash flow than profitability. Competition occurs not only with respect to price, but also to service, the ability to adapt to meet needs of customers as changes occur, reputation, and often, the need to satisfy customers' expectations that insurers have sufficient capital strength to ensure that they will be viable when called upon to pay large losses in the future. Because of the disciplined underwriting standards of the Berkshire Insurance Group, Wes-FIC does not enter into insurance or reinsurance activities that do not provide the expectation of acceptable underwriting profitability. Thus, the volume of written premiums will continue to vary significantly from period to period.

CORT competes not only with regional and local furniture rental businesses, but also with furniture businesses offering lease purchase or rent-to-own programs, as well as with national, regional and local furniture retailers. Competitive factors include price, furniture style and condition, lease terms, speed of delivery and overall customer service.

Precision Steel's annual sales volume is a small fraction of the domestic steel service industry's. Precision Steel competes not only with other service centers, but also with mills that supply metal to the service centers. Sales competition exists in the areas of price, quality, availability, speed of delivery, and customer service. Competitive pressure has been intensified by imports, a shift to

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production abroad and an increasing tendency of domestic manufacturers to use less costly materials in making products. Precision Steel's subsidiary's toolroom specialty business also faces strong competition, mainly based on price.

**In addition to the foregoing risk factors inherent in Wesco's operations, Wesco's shareholders face a market liquidity risk because the daily trading volume of Wesco's shares on the American Stock Exchange is relatively low.**

In addition to the risks facing Wesco in its business operations, investors wishing to purchase or sell shares of its capital stock face market price risks because the daily AMEX trading volume of Wesco's shares is relatively low. An order for the purchase or sale of a large number of Wesco shares could significantly affect the price at which the order is executed.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

CORT leases 16,212 square feet of office space in a multistory office building in Fairfax, Virginia, which it uses as its headquarters under a lease which will expire in 2012.

CORT carries out its rental, sales and warehouse operations in metropolitan areas in 32 states and the District of Columbia through 167 facilities, of which 18 were owned and the balance leased as of December 31, 2006. The leased facilities' lease terms expire at dates ranging from 2007 to 2017. CORT has generally been able to extend expiration dates of its leases or obtain suitable alternative facilities on satisfactory terms. As leases expire, CORT has been eliminating redundant locations and decreasing the size of its showrooms, which as of yearend 2006 ranged in size from 2,500 to 10,388 square feet of floor space. Where locations are desirable, its management has been attempting to combine rental, clearance and warehouse operations rather than retain separate showrooms, because business and residential customers have been increasingly using the Internet. CORT regularly reviews the presentation and appearance of its furniture showrooms and clearance centers and periodically improves or refurbishes them to enhance their attractiveness to customers.

MS Property owns a business block in Pasadena, California situated between the city hall and a large shopping mall. The block's improvements include a nine-story office building that was constructed in 1964 and has approximately 125,000 square feet of net rentable area, and a multistory garage with space for 420 vehicles. Of the 125,000 square feet of space in the office building, approximately 5,000 square feet are used by MS Property or leased to Blue Chip or Wesco at market rental rates. The remaining space is almost fully leased to outside parties, including Citibank (the ground floor tenant), law firms and others, under agreements expiring at dates extending to 2017. Adjacent to the building and garage is a parcel on which MS Property is nearing completion of a multi-story, 28-unit, luxury condominium building. MS Property is seeking city approval of its plans to build another multi-story luxury condominium building on a vacant parcel of land it owns in the next block.

MS Property also owns several buildings that are leased to various small businesses in a small shopping center in Southern California.

Wes-FIC's place of business is the Omaha, Nebraska headquarters office of NICO.

KBS leases 5,100 square feet of office space in a multistory office building in Topeka, Kansas under a lease that expires June 30, 2012.

Precision Steel and its subsidiaries own three buildings housing their plant and office facilities, with usable area approximately as follows: 138,000 square feet in Franklin Park, Illinois; 63,000 square feet in Charlotte, North Carolina; and 59,000 square feet in Downers Grove, Illinois.

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**Table of Contents****Item 3. Legal Proceedings**

Wesco and its subsidiaries are not involved in any legal proceedings that are expected to result in detrimental financial impact material to its shareholders' equity. However, see Note 10 to the accompanying consolidated financial statements for an explanation of an environmental matter involving Precision Steel and one of its subsidiaries that could materially impact consolidated net income in any given fiscal period.

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

None.

**PART II****Item 5. Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Repurchases of Equity Securities**

Throughout 2006, Wesco's capital stock was listed on the American Stock Exchange and on the NYSE Arca Exchange (previously, the Pacific Exchange). Effective as of yearend 2006, in order to reduce duplicative administrative burdens and costs, Wesco withdrew its shares from listing on the NYSE Arca Exchange.

The following table sets forth quarterly ranges of composite prices for American Stock Exchange trading of Wesco shares for 2006 and 2005, based on data reported by the American Stock Exchange, as well as cash dividends paid by Wesco on each outstanding share:

| Quarter Ended | 2006        |        |                | 2005        |        |                |
|---------------|-------------|--------|----------------|-------------|--------|----------------|
|               | Sales Price |        | Dividends Paid | Sales Price |        | Dividends Paid |
|               | High        | Low    |                | High        | Low    |                |
| March 31      | \$ 411      | \$ 377 | \$ 0.365       | \$ 405      | \$ 369 | \$ 0.355       |
| June 30       | 408         | 361    | 0.365          | 388         | 341    | 0.355          |
| September 30  | 437         | 367    | 0.365          | 360         | 330    | 0.355          |
| December 31   | 505         | 429    | 0.365          | 395         | 339    | 0.355          |
|               |             |        | \$ 1.460       |             |        | \$ 1.420       |

There were approximately 440 shareholders of record of Wesco's capital stock as of the close of business on February 14, 2007. It is estimated that approximately 6,000 additional Wesco shareholders held shares of Wesco's capital stock in street name at that date.

Wesco did not purchase any of its own equity securities during 2006.

**Table of Contents****Item 6. Selected Financial Data**

Set forth below and on the following page are selected consolidated financial data for Wesco and its subsidiaries. For additional financial information, attention is directed to Wesco's audited 2006 consolidated financial statements appearing elsewhere in this report. (Amounts are in thousands except for amounts per share.)

|  | <b>December 31,</b> |                     |                     |                     |                     |
|--|---------------------|---------------------|---------------------|---------------------|---------------------|
|  | <b>2006</b>         | <b>2005</b>         | <b>2004</b>         | <b>2003</b>         | <b>2002</b>         |
| <b>Assets:</b>   |                     |                     |                     |                     |                     |
| Cash and cash equivalents                              | \$ 1,257,351        | \$ 1,194,113        | \$ 1,161,163        | \$ 1,052,462        | \$ 349,812          |
| <b>Investments</b>                                     |                     |                     |                     |                     |                     |
| Securities with fixed maturities                       | 81,861              | 74,441              | 94,299              | 167,390             | 827,537             |
| Marketable equity securities                           | 1,040,550           | 884,673             | 759,658             | 754,634             | 626,768             |
| Accounts receivable                                    | 60,386              | 53,987              | 46,007              | 60,168              | 67,425              |
| Rental furniture                                       | 182,846             | 187,572             | 171,983             | 163,699             | 187,480             |
| Goodwill of acquired businesses                        | 266,607             | 266,607             | 266,607             | 266,607             | 266,203             |
| Other assets   | 80,704              | 67,118              | 71,818              | 73,435              | 81,750              |
| <b>Total assets</b>                                    | <b>\$ 2,970,305</b> | <b>\$ 2,728,511</b> | <b>\$ 2,571,535</b> | <b>\$ 2,538,395</b> | <b>\$ 2,406,975</b> |
| <b>Liabilities:</b>                                    |                     |                     |                     |                     |                     |
| Insurance losses and loss adjustment expenses          | \$ 29,761           | \$ 19,697           | \$ 14,910           | \$ 67,416           | \$ 50,299           |
| Affiliated business                                    |                     |                     |                     |                     |                     |
| Unaffiliated business                                  | 48,549              | 42,283              | 41,252              | 35,110              | 22,766              |
| <b>Unearned insurance premiums</b>                     |                     |                     |                     |                     |                     |
| Affiliated business                                    | 14,062              | 12,301              | 14,118              | 8,646               | 23,115              |
| Unaffiliated business                                  | 15,298              | 16,092              | 11,223              | 20,347              | 25,566              |
| Deferred furniture rental income and security deposits | 20,440              | 22,204              | 20,358              | 19,835              | 21,562              |
| Accounts payable and accrued expenses                  | 48,258              | 52,587              | 51,501              | 48,931              | 45,122              |
| Notes payable  | 38,200              | 42,300              | 29,225              | 12,679              | 32,481              |
| Income taxes payable, principally deferred             | 355,399             | 290,615             | 272,005             | 247,241             | 227,902             |
| <b>Total liabilities</b>                               | <b>\$ 569,967</b>   | <b>\$ 498,079</b>   | <b>\$ 454,592</b>   | <b>\$ 460,205</b>   | <b>\$ 448,813</b>   |
| <b>Shareholders' equity:</b>                           |                     |                     |                     |                     |                     |
| Capital stock and additional paid-in capital           | \$ 33,324           | \$ 33,324           | \$ 33,324           | \$ 33,324           | \$ 30,439           |
| Unrealized appreciation of investments, net of taxes   | 344,978             | 256,710             | 427,690             | 426,542             | 374,571             |
| Retained earnings                                      | 2,022,036           | 1,940,398           | 1,655,929           | 1,618,324           | 1,553,152           |
| <b>Total shareholders' equity</b>                      | <b>\$ 2,400,338</b> | <b>\$ 2,230,432</b> | <b>\$ 2,116,943</b> | <b>\$ 2,078,190</b> | <b>\$ 1,958,162</b> |
| <b>Per capital share</b>                               | <b>\$ 337.14</b>    | <b>\$ 313.27</b>    | <b>\$ 297.33</b>    | <b>\$ 291.89</b>    | <b>\$ 275.03</b>    |



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|                               | <b>Year Ended December 31,</b> |             |             |             |             |
|-------------------------------|--------------------------------|-------------|-------------|-------------|-------------|
|                               | <b>2006</b>                    | <b>2005</b> | <b>2004</b> | <b>2003</b> | <b>2002</b> |
| <b>Revenues:</b>              |                                |             |             |             |             |
| Furniture rentals             | \$ 324,300                     | \$ 303,485  | \$ 275,378  | \$ 275,949  | \$ 309,341  |
| Sales and service revenues    | 139,058                        | 141,749     | 139,130     | 130,301     | 127,758     |
| Insurance premiums earned     |                                |             |             |             |             |
| Affiliated business           | 32,643                         | 32,450      | 19,371      | 47,818      | 23,768      |
| Unaffiliated business         | 21,506                         | 17,032      | 35,218      | 58,833      | 40,859      |
| Dividend and interest income  | 84,504                         | 56,792      | 36,844      | 44,763      | 70,652      |
| Realized net investment gains |                                | 333,241     |             | 53,466      |             |
| Other                         | 3,716                          | 3,541       | 3,372       | 3,187       | 3,299       |
|                               | 605,727                        | 888,290     | 509,313     | 614,317     | 575,677     |