



# WESCO FINANCIAL CORPORATION

*Annual Report 2009*  
*Form 10-K Annual Report 2009*

## WESCO FINANCIAL CORPORATION LETTER TO SHAREHOLDERS

### To Our Shareholders:

Consolidated net “operating” income (i.e., before realized investment gains shown in the table below) for the calendar year 2009 decreased to \$54,073,000 (\$7.59 per share) from \$77,562,000 (\$10.89 per share) in the previous year.

Consolidated net income decreased to \$54,073,000 (\$7.59 per share) from \$82,116,000 (\$11.53 per share) in 2008. The 2008 figure included realized after-tax investment gains of \$4,554,000 (\$.64 per share). No investment gains or losses were realized in 2009.

Wesco has four major subsidiaries: (1) Wesco-Financial Insurance Company (“Wes-FIC”), headquartered in Omaha and engaged principally in the reinsurance business, (2) The Kansas Bankers Surety Company (“Kansas Bankers”), owned by Wes-FIC and specializing in insurance products tailored to Midwestern community banks, (3) CORT Business Services Corporation (“CORT”), headquartered in Fairfax, Virginia and engaged principally in the furniture rental business, and (4) Precision Steel Warehouse, Inc. (“Precision Steel”), headquartered in Chicago and engaged in the steel warehousing and specialty metal products businesses.

Consolidated net income for the two years just ended breaks down as follows (in thousands except for per-share amounts)<sup>(1)</sup>:

	Year Ended			
	December 31, 2009		December 31, 2008	
	Amount	Per Wesco Share <sup>(2)</sup>	Amount	Per Wesco Share <sup>(2)</sup>
Wesco-Financial and Kansas Bankers insurance businesses —				
Underwriting gain (loss) . . . . .	\$ 7,222	\$1.01	\$ (2,942)	\$ (.42)
Investment income . . . . .	55,781	7.83	64,274	9.03
CORT furniture rental business . . . . .	(1,359)	(.19)	15,744	2.21
Precision Steel businesses . . . . .	(648)	(.09)	842	.12
All other “normal” net operating earnings (loss) <sup>(3)</sup> . . . . .	(6,923)	(.97)	(356)	(.05)
	<u>54,073</u>	<u>7.59</u>	<u>77,562</u>	<u>10.89</u>
Realized investment gains . . . . .	—	—	4,554	.64
Wesco consolidated net income . . . . .	<u>\$54,073</u>	<u>\$7.59</u>	<u>\$82,116</u>	<u>\$11.53</u>

(1) All figures are net of income taxes.

(2) Per-share data are based on 7,119,807 shares outstanding. Wesco has no dilutive capital stock equivalents.

(3) Includes income from ownership of the Wesco headquarters office building, primarily leased to outside tenants, and interest and dividend income from cash equivalents and marketable securities owned outside the insurance subsidiaries, less interest and other corporate expenses, and, in 2009, a \$6.2 million (after taxes) writedown of real estate held for sale.

This supplementary breakdown of earnings differs somewhat from that used in audited financial statements which follow standard accounting convention. The foregoing supplementary breakdown is furnished because it is considered useful to shareholders. The total consolidated net income shown above is, of course, identical to the total in our audited financial statements.

## Insurance Businesses

Consolidated operating earnings from insurance businesses represent the combination of the results of their insurance underwriting (premiums earned, less insurance losses, loss adjustment expenses and underwriting expenses) with their investment income. Following is a summary of these figures as they pertain to all insurance operations (in 000s).

	<u>Year Ended December 31,</u>	
	<u>2009</u>	<u>2008</u>
Premiums written . . . . .	<u>\$339,191</u>	<u>\$316,472</u>
Premiums earned . . . . .	<u>\$323,221</u>	<u>\$237,964</u>
Underwriting gain (loss) . . . . .	\$ 11,111	\$ (4,527)
Dividend and interest income . . . . .	<u>67,049</u>	<u>84,920</u>
Income before income taxes . . . . .	78,160	80,393
Income taxes . . . . .	<u>15,157</u>	<u>19,061</u>
Total operating income — insurance businesses . . . . .	<u>\$ 63,003</u>	<u>\$ 61,332</u>

Following is a breakdown of premiums written (in 000s):

Wes-FIC reinsurance —		
Swiss Re contract . . . . .	\$294,142	\$265,248
Aviation pools . . . . .	35,085	33,374
Kansas Bankers primary insurance . . . . .	<u>9,964</u>	<u>17,850</u>
Premiums written . . . . .	<u>\$339,191</u>	<u>\$316,472</u>

Following is a breakdown of premiums earned (in 000s):

Wes-FIC reinsurance —		
Swiss Re contract . . . . .	\$276,681	\$183,166
Aviation pools . . . . .	34,463	34,418
Kansas Bankers primary insurance . . . . .	<u>12,077</u>	<u>20,380</u>
Premiums earned . . . . .	<u>\$323,221</u>	<u>\$237,964</u>

Following is a breakdown of after-tax results (in 000s):

Underwriting gain (loss) —		
Wes-FIC reinsurance . . . . .	\$ 10,379	\$ (1,405)
Kansas Bankers primary insurance . . . . .	<u>(3,157)</u>	<u>(1,537)</u>
Underwriting gain (loss) . . . . .	<u>7,222</u>	<u>(2,942)</u>
Net investment income . . . . .	<u>55,781</u>	<u>64,274</u>
Total operating income — insurance businesses . . . . .	<u>\$ 63,003</u>	<u>\$ 61,332</u>

As shown above, operating income includes significant net investment income, representing dividends and interest earned from marketable securities. However, operating income excludes after-tax investment gains of \$4.6 million realized in 2008. The discussion below will concentrate on insurance underwriting, not on the results from investments.

Wes-FIC engages in the reinsurance business. At the beginning of 2008, it entered into a retrocession agreement with National Indemnity Company (“NICO”), an insurance subsidiary of Berkshire Hathaway, Wesco’s 80%-owning parent. Under the contract, Wes-FIC has assumed 10% of NICO’s 20% quota-share reinsurance of Swiss Reinsurance Company and its

principal property-casualty affiliates (“Swiss Re”). Under this agreement, which was enthusiastically approved by Wesco’s Board of Directors, Wes-FIC assumed 2% of essentially all Swiss Re property-casualty risks incepting over the five-year period which began on January 1, 2008, on the same terms as NICO’s agreement with Swiss Re. Wes-FIC’s share of written and earned premiums under the contract were \$294.1 million and \$276.7 million for 2009 and \$265.2 million and \$183.2 million for 2008, representing very significant increases in Wes-FIC’s reinsurance activities. It is important to keep in mind that premiums assumed under the contract in each of the next three years could vary significantly depending on market conditions and opportunities.

For several years, through yearend 2007, Wes-FIC’s principal reinsurance activity consisted only of its participation in several pools managed by a subsidiary of General Reinsurance Corporation (“Gen Re”), another insurance subsidiary of Berkshire Hathaway. The arrangement became effective in 2001 and has covered domestic hull, liability and workers’ compensation exposures relating to the aviation industry. For the past three years, Wes-FIC has reinsured 16.67% of the hull and liability pools and 5% of the workers’ compensation pool. Since mid-2009 Wes-FIC has also been reinsuring 25% of an international hull and liability pool. Another subsidiary of Gen Re provides a portion of the upper-level reinsurance protection to these aviation risk pools on terms that could result in the Berkshire subsidiary having a different interest from that of Wes-FIC under certain conditions, e.g., in settling a large loss. Premium volume under these pools has approximated \$35 million annually.

It is the nature of even the finest property-casualty insurance businesses that in keeping their accounts they must estimate and deduct all future costs and losses from premiums already earned. Uncertainties inherent in this undertaking make financial statements more mere “best honest guesses” than is typically the case with accounts of non-insurance-writing corporations. And the reinsurance portion of the property-casualty insurance business, because it contains one or more extra links in the loss-reporting chain, usually creates more accounting uncertainty than the non-reinsurance portion. Wesco shareholders should remain aware of the inherent imperfections of Wes-FIC’s financial reporting, based as it is on forecasts of outcomes over many future years.

Wes-FIC’s underwriting results have typically fluctuated from year to year, but have been satisfactory. When stated as a percentage, the sum of insurance losses, loss adjustment expenses and underwriting expenses, divided by premiums, gives the combined ratio. Wes-FIC’s combined ratios from reinsurance activities were 94.9% for 2009, 101.0% for 2008 and 93.9% for 2007, much better than average for insurers. We try to create some underwriting gain as results are averaged out over many years. We expect this to become increasingly difficult.

Float is the term for money we hold temporarily. Its major components are unpaid losses and unearned premiums, less premiums and reinsurance receivable, and deferred policy acquisition costs. As long as our insurance underwriting results are break-even or better, float costs us nothing. The new Swiss Re venture with NICO has significantly increased Wes-FIC’s float, from \$76 million at the end of 2007, to \$264 million at yearend 2009, thus providing additional opportunities for investment. We hope to see our float continue to increase, but we make no predictions.

Kansas Bankers was purchased by Wes-FIC in 1996 for approximately \$80 million in cash. Its tangible net worth now exceeds its acquisition price, and it has been a very satisfactory acquisition, reflecting the sound management of President Don Towle and his team.

Kansas Bankers was chartered in 1909 to underwrite deposit insurance for Kansas banks. Its offices are in Topeka, Kansas. Over the years its service has continued to adapt to the changing needs of the banking industry. Today its customer base, consisting mostly of small- and medium-sized community banks, is spread throughout 29 mainly Midwestern states. Kansas Bankers offers policies for crime insurance, check kiting fraud indemnification, Internet banking catastrophe theft insurance, Internet banking privacy liability insurance, directors and officers liability, bank employment practices, and bank insurance agents professional errors and omissions indemnity.

Last year we reported that events in the banking industry, including a number of bank failures, caused us to become less confident in the long-term profitability of Kansas Bankers' long-established line of deposit guarantee bonds. These bonds insure specific customer bank deposits above Federal insurance limits. After sustaining a loss of \$4.7 million, after taxes, from a bank failure in the latter half of 2008, Kansas Bankers discontinued writing deposit guarantee bonds, and in September 2008 it began to exit this line of insurance as rapidly as feasible. The aggregate face amount of outstanding deposit guarantee bonds has been reduced, from \$9.7 billion, insuring 1,671 institutions at September 30, 2008, to \$33 million, insuring 10 institutions, currently. We believe that none of the banks whose deposits are currently insured are facing significant risk of failure.

This decrease in exposure to loss, of course, has caused a sharp decline in Kansas Bankers' insurance volume, inasmuch as premiums from guarantee bonds not only approximated half of Kansas Bankers' written premiums for 2008, but also represented the entirety of the business it had conducted in almost half of the states in which it was licensed to write insurance in 2008. The insurance business is highly competitive, with lengthy periods during which competitors offer coverages at prices we do not consider adequate. Kansas Bankers is now licensed to sell insurance in 29 states, down from 39 states one year earlier, with plans soon to withdraw from 4 more. We expect that Kansas Bankers will ultimately expand its premium volume, at prices deemed satisfactory.

When Wesco purchased Kansas Bankers, it had been ceding almost half of its premium volume to reinsurers. In 2009 it reinsured only about 1%. And, because it has also restructured the layers of losses reinsured, it is now better protected from the downside risk of large losses. Effective in 2006, insurance subsidiaries of Berkshire Hathaway became KBS's sole reinsurers. Previously, an unaffiliated reinsurer was also involved. The increased volume of business retained comes, of course, with increased irregularity in the income stream. Kansas Bankers' combined ratios were 140.2% for 2009, 111.6% for 2008 and 55.1% for 2007. Kansas Bankers' business activities require a base of operations supported by significant fixed operating costs which do not lend themselves to downsizing in proportion to the recent decline in premium volume. We continue to expect volatile but favorable long-term results from the now much smaller business remaining in Kansas Bankers.

### **CORT Business Services Corporation ("CORT")**

In February 2000, Wesco purchased CORT Business Services Corporation ("CORT") for \$386 million in cash.

CORT is a very long-established company that is the country's leader in rentals of high-quality furniture that lessees have no intention of buying. In the trade, people call CORT's activity "rent-to-rent" to distinguish it from "lease-to-purchase" businesses that are, in essence, installment sellers of furniture.



However, just as Enterprise, as a rent-to-rent auto lessor in short-term arrangements, must be skilled in selling used cars, CORT must be and is skilled in selling used furniture.

CORT's revenues totaled \$380 million for calendar 2009, versus \$410 million for calendar 2008. Of these amounts, furniture rental revenues were \$312 million and \$340 million, furniture sales revenues were \$61 million and \$62 million, and rental relocation revenues were \$7 million and \$8 million. CORT operated at an after-tax loss of \$1.4 million for 2009 versus after-tax profits of \$15.7 million for 2008 and \$20.3 million for 2007. Headwinds from the "Great Recession" that began in 2008 have caused the shift from moderate profit to the small loss that occurred last year.

CORT has made several "tuck-in" acquisitions since its purchase by Wesco; most recently, the residential furniture rental division of Aaron Rents, Inc., purchased late in 2008. Earlier in 2008, CORT expanded its operations internationally, through the purchase of Roomservice Group, a small regional provider of rental furniture and relocation services in the United Kingdom, now doing business as CORT Business Services UK Ltd. Factoring out the effects of those acquisitions, CORT's core revenues fell by almost 20% in 2009, reflecting the hammering caused by the severe economic recession. So far, CORT's business has been melting away faster than CORT can fix it.

Shortly after its acquisition by Wesco, CORT started up a nation-wide apartment locator service, originally intended mainly to supplement CORT's furniture rental business by providing apartment locator and ancillary services to relocating individuals. Paul Arnold, long CORT's able CEO, and his management team, have devoted much effort in recent years, expanding CORT's rental relocation services, and redirecting them toward the needs of businesses and government agencies who require a skilled and able partner to provide comprehensive and seamless relocation services for the temporary relocation of employees worldwide. These efforts had not yet gained traction when recession hit. CORT is now focusing its efforts more on cost containment than on expansion of services.

Under Wesco's ownership, CORT has continuously undertaken to improve its competitive position. With several websites, principally, [www.cort.com](http://www.cort.com) and [www.apartment-search.com](http://www.apartment-search.com), professionals in more than 80 domestic metropolitan markets, affiliates servicing more than 50 countries, almost twenty-one thousand apartment communities referring their tenants to CORT, many ancillary services, and its entrée to the business community as a Berkshire Hathaway company, CORT is better positioned than previously to benefit from an economic turnaround if it occurs in due course. Near term, we expect more of the difficult business conditions of the recent past, but we do not expect another operating loss at CORT in 2010. Instead, we expect disappointing profits.

More details with respect to CORT are contained throughout this annual report, to which your careful attention is directed.

### **Precision Steel Warehouse, Inc. ("Precision Steel")**

The businesses of Wesco's Precision Steel subsidiary, headquartered in the outskirts of Chicago at Franklin Park, Illinois, were pounded by the "Great Recession," exacerbating a long-term reduction in demand resulting from movement of manufacturing outside the United States. Revenues were \$38.4 million for 2009 versus \$60.9 million for 2008. Sales volume for 2009, in terms of pounds sold, declined by one-third and represented less than half the annual volume that Precision Steel had sold thirty years earlier, when it was acquired by Wesco.

Precision Steel operated at an after-tax loss of \$0.6 million in 2009 versus an after-tax profit of \$0.8 million in 2008. These figures reflect after-tax LIFO inventory accounting adjustments increasing after-tax income by \$1.5 million for 2009 and decreasing after-tax income by \$0.7 million for 2008. Had it not been for the LIFO accounting adjustments, Precision Steel would have reported an after-tax operating loss of \$2.1 million for 2009 versus after-tax operating income of \$1.5 million for 2008. Moreover, the \$2.1 million pre-LIFO-effect loss last year would have been about \$0.5 million greater without after-tax profits from a couple of Precision Steel's small businesses that are different from conventional steel warehousing.

We do not consider Precision Steel's recent operating results to be a satisfactory investment outcome, particularly when one compares its recent performance with its after-tax operating earnings which averaged \$2.3 million for the years 1998 through 2000. And, because of the ongoing recession, more difficulty for Precision Steel will surely lie ahead.

Apart from the recessionary-caused weakness, the general and ongoing decline in Precision Steel's physical volume is a serious reverse, not likely to disappear in some "bounce back" effect once the economy recovers.

Terry Piper, who became Precision Steel's President and Chief Executive Officer in 1999, has done an outstanding job in leading Precision Steel through very difficult years. But he has no magic wand with which to compensate for competitive losses among his best customers or from the weak economic conditions. He is redoubling his efforts to pare costs, which must be his response to conditions faced.

### **Tag Ends from Savings and Loan Days**

All that now remains outside Wes-FIC but within Wesco as a consequence of Wesco's former involvement with Mutual Savings, Wesco's long-held savings and loan subsidiary, is a small real estate subsidiary, MS Property Company, that holds tag ends of appreciated real estate assets consisting mainly of the nine-story commercial office building in downtown Pasadena, where Wesco is headquartered. Adjacent to that building is a multi-story luxury condominium building which MS Property Company has recently built and is in process of marketing. For more information, if you want a very-high-end condominium, simply phone Chris Greco (626-585-6700). MS Property Company's results of operations, immaterial versus Wesco's present size, are included in the breakdown of earnings on page 1 within "other operating earnings."

### **Other Operating Earnings (Loss)**

Other operating earnings (loss), net of interest paid and general corporate expenses, amounted to (\$6.9 million) in 2009 and (\$0.4 million) in 2008. The 2009 figure includes a \$6.2 million after-tax writedown of the book carrying value of a condominium building that was completed in the worst condominium market in decades. Other components of the other operating loss in 2009 were (1) rents (\$4.1 million gross) principally from Wesco's Pasadena office property (leased almost entirely to outsiders, including Citibank as the ground floor tenant), and (2) interest and dividends from cash equivalents and marketable securities held outside the insurance subsidiaries, less (3) general corporate expenses plus expenses involving tag-end real estate and real estate held for sale.

## Consolidated Balance Sheet and Related Discussion

Wesco has unusual balance sheet strength, concentrated in security holdings of its insurance subsidiaries. These holdings, in turn, are concentrated in a few securities. Details can be found in Note 2 to the accompanying financial statements.

Wesco carries its investments at fair value. As a result, unrealized appreciation or depreciation, after income tax effect, is included as a component of shareholders' equity and net worth per share.

Affected substantially by changes in market value of securities owned, Wesco's yearend net worth per share has varied only slightly during recent tumultuous years. Figures are as follows:

2006	\$337
2007	356
2008	334
2009	358

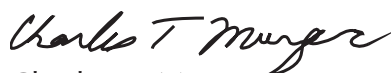
These results are not impressive. Moreover, if net worth per share had been computed at its low point in the recent stock market panic, stability implied by the foregoing figures would have been considerably lessened.

We repeat our standard warning. Business and human quality in place at Wesco continues to be not nearly as good, all factors considered, as that in place at Berkshire Hathaway. Wesco is not an equally-good-but-smaller version of Berkshire Hathaway, better because its small size makes growth easier. Instead, each dollar of book value at Wesco continues plainly to provide much less intrinsic value than a similar dollar of book value at Berkshire Hathaway. Moreover, the quality disparity in book value's intrinsic merits has, in recent years, continued to widen in favor of Berkshire Hathaway.

The Board of Directors recently increased Wesco's regular dividend from 39½ cents per share to 41 cents per share, payable March 4, 2010, to shareholders of record as of the close of business on February 4, 2010. Shareholders can thank Director Elizabeth Peters for the recommendation that Wesco *increase* its next and future dividends to ensure that shareholders are paid in even pennies.

This annual report contains Form 10-K, a report filed with the Securities and Exchange Commission, and includes detailed information about Wesco and its subsidiaries, as well as audited financial statements bearing extensive footnotes. As usual, your careful attention is sought with respect to these items.

Shareholders can access much Wesco information, including printed annual reports, earnings releases, SEC filings, and the websites of Wesco's subsidiaries and parent, Berkshire Hathaway, from Wesco's website: [www.wescofinancial.com](http://www.wescofinancial.com).



Charles T. Munger  
Chairman of the Board  
and President

Dated: February 26, 2010