UNITRIN INC
Form 10-K405
February 01, 2002

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

[X] Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. For the fiscal year ended December 31, 2001.

[_] Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. For the transition period from N/A to N/A.

Commission file number 001-18298

UNITRIN, INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	95-4255452 (I.R.S. Employer Identification Number)
One East Wacker Drive Chicago, Illinois (Address of Principal Executive Offices)	60601 (Zip Code)

(312) 661-4600
(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
Common Stock, $0.10 par value	New York Stock Exchange
Preferred Share Purchase Rights pursuant to Rights Agreement	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

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 [X] 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. [X]

Based on the closing market price of Registrant's common stock on December 31, 2001 the aggregate market value of such stock held by non-affiliates of Registrant is approximately $2.4 billion. Solely for purposes of this calculation, all executive officers and directors of Registrant are considered affiliates.

Registrant had 67,547,104 shares of common stock outstanding as of December 31, 2001.

Documents Incorporated by Reference

Document	Part of the Form 10-K into which incorporated
Portions of Proxy Statement for 2002 Annual Meeting	Part III

PART I

ITEM 1. Business

Unitrin, Inc. ("Unitrin") was incorporated in Delaware in 1990. Unitrin's subsidiaries serve the basic financial needs of individuals, families and small businesses by providing property and casualty insurance, life and health insurance, and consumer finance services.

(a) General development of business

. Events regarding Unitrin's Former Investees

Prior to the transactions described below occurring in 2001, Unitrin's investment portfolio included equity investments in Litton Industries, Inc. ("Litton") and Curtiss-Wright Corporation ("Curtiss-Wright"). In this connection, Unitrin owned approximately 28% of Litton's outstanding common stock and approximately 44% of Curtiss-Wright's outstanding common stock. Because Unitrin's equity ownership interest in each of Litton and Curtiss-Wright exceeded 20%, Unitrin accounted for these investments under the equity method of accounting.

For further discussion of Unitrin's investment in these former investees and the equity method of accounting, please refer to (i) Notes 2 and 5 to Unitrin's Consolidated Financial Statements, which financial statements are further described in Item 14(a)1, hereto and filed as Exhibit 13.1, hereto and incorporated by reference into Item 8 hereof (the "Financial Statements"), and (ii) "Management's Discussion and Analysis of Results of Operations and Financial Condition," which is filed as Exhibit 13.2 hereto and incorporated by reference into Item 7 hereof (the "MD&A").

During 2001, the following developments occurred with respect to Unitrin's investments in Litton and Curtiss-Wright:

(i) Acquisition of Litton by Northrop

In April 2001, Northrop Grumman Corporation ("Northrop") completed its acquisition of Litton (the "Northrop-Litton Transaction"). Prior to the

Northrop-Litton Transaction, Unitrin and its subsidiaries owned approximately 12.7 million shares or 28% of Litton's outstanding common stock. In connection with the Northrop-Litton Transaction, Unitrin and its subsidiaries tendered all of their shares of Litton common stock to Northrop. In exchange for their holdings of Litton common stock, Unitrin and its subsidiaries received approximately 1.8 million shares of Northrop Series B convertible preferred stock and approximately 7.7 million shares of Northrop common stock in a tax-free exchange. In addition to receiving Northrop preferred and common stock, Unitrin and its subsidiaries received approximately $171.8 million in cash, net of transaction costs. In the second quarter of 2001, Unitrin recognized a pre-tax accounting gain of $562.1 million and an after-tax accounting gain of $362.4 million, or $5.37 per Unitrin common share, resulting from the Northrop-Litton Transaction.

Prior to Northrop's acquisition of Litton, Unitrin accounted for its investment in Litton under the equity method of accounting. As a result of the Northrop-Litton Transaction, Unitrin's ownership percentage in the combined company fell below 20% and, accordingly, Unitrin does not apply the equity method of accounting to its investments in Northrop.

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(ii) Tax-Free Distribution of Unitrin's Investment in Curtiss-Wright

In November 2001, Unitrin distributed in a tax-free spin-off to its shareholders all Class B common stock of Curtiss-Wright owned by Unitrin. Prior to the spin-off, Unitrin owned approximately 4.4 million shares of Curtiss-Wright's common stock, representing approximately 44% of Curtiss-Wright's total issued and outstanding shares of common stock. In connection with the spin-off, all of the 4.4 million Curtiss-Wright shares held by Unitrin were exchanged for 4.4 million shares of a new Class B common stock of Curtiss-Wright that is entitled to elect at least 80% of the Board of Directors of Curtiss-Wright but is otherwise substantially identical to Curtiss-Wright's existing common stock. The Curtiss-Wright Class B common stock was distributed pro ratably to Unitrin shareholders of record as of November 12, 2001. Based on the market value of Curtiss-Wright common stock immediately prior to November 7, 2001 (the date that Unitrin common stock began trading ex-distribution), the Class B shares distributed to Unitrin shareholders were valued at approximately $196.1 million.

For further information regarding the transactions described above involving Unitrin's former investments in Litton and Curtiss-Wright, please refer to Note 5 of the Financial Statements and the MD&A sections captioned "Corporate Investments," "Investees" and "Investment Results."

. Unitrin Stock Repurchases

During 2001, Unitrin repurchased and retired approximately 723,000 shares of its common stock in open market transactions at an aggregate cost of approximately $26.6 million. Since its inception in 1990, Unitrin has repurchased, on a post-split basis, approximately 54.3 million shares of its common stock, or nearly half of Unitrin's shares originally outstanding, for an aggregate cost of approximately $1.4 billion. At December 31, 2001, approximately 3.9 million shares of Unitrin common stock remained under Unitrin's outstanding repurchase authorizations.

Stock repurchases may be made from time to time at prevailing prices in the open market or in privately negotiated transactions, subject to market conditions and other factors. Repurchases are financed through Unitrin's general corporate funds. Unitrin may also borrow funds under an existing bank credit facility to fund common stock repurchases.

(b) Business segment financial data

Financial information about Unitrin's business segments for the years ended December 31, 2001, 2000, and 1999 is contained in the following portions of this 2001 Annual Report on Form 10-K of Unitrin, Inc. and is incorporated herein by reference: (i) Note 17 to the Financial Statements, and (ii) the MD&A.

(c) Description of business

Unitrin is engaged, through its subsidiaries, in the property and casualty insurance, life and health insurance and consumer finance businesses. Unitrin conducts its operations through five operating segments: Multi Lines Insurance, Specialty Lines Insurance, Unitrin Direct, Life and Health Insurance, and Consumer Finance.

Unitrin's subsidiaries employ nearly 7,700 full-time associates of which approximately 1,200 are employed in the Multi Lines Insurance segment, 690 in the Specialty Lines Insurance segment, 225 in the Unitrin Direct segment, 4,740 in the Life and Health Insurance segment, and 655 in the Consumer Finance segment.

. Property and Casualty Insurance Business

Unitrin's property and casualty insurance business operations are conducted through the following segments: Multi Lines Insurance, Specialty Lines Insurance and Unitrin Direct. The Unitrin companies operating in these segments provide automobile, homeowners, commercial multi-peril, motorcycle, boat and watercraft, fire, casualty, workers compensation, and other types of property and casualty insurance to individuals and businesses. Automobile insurance accounted for 41%, 34%, and 31% of Unitrin's consolidated insurance premiums for the years ended December 31, 2001, 2000, and 1999, respectively.

Property insurance indemnifies an insured with an interest in physical property for loss of such property or the loss of its income-producing abilities. Casualty insurance primarily covers liability for damage to property of, or injury to, a person or entity other than the insured.

Multi Lines Insurance Segment

The Unitrin Multi Lines Insurance segment principally is comprised of 11 insurance companies operating mainly in the southern, midwestern, western and northwestern regions of the United States. With operations located in 31 states, the Multi Lines Insurance segment has over 424,000 policies in force. The states which provided the largest amount of premium for the Multi Lines Insurance segment in 2001 were Texas (38%), Oregon (9%), Wisconsin (6%), Illinois (5%), Louisiana (5%) and Washington (5%).

Insurance products provided by the Multi Lines Insurance segment primarily consist of preferred and standard risk automobile, homeowners, fire, commercial liability and workers compensation insurance. Multi Lines Insurance products are marketed exclusively by over 1,500 independent insurance agents in over 2,100 locations. These personal and commercial products are designed and priced for those individuals and businesses that have demonstrated favorable risk characteristics and loss history. Typical customers include "main street" businesses and middle income families. Products are marketed primarily in suburban and rural communities.

Trinity Universal Insurance Company ("Trinity") and certain of Unitrin's subsidiaries (Milwaukee Casualty Insurance Co., Milwaukee Safeguard Insurance Company, Security National Insurance Company, Trinity Universal Insurance Company of Kansas, Inc., Valley Insurance Company and Valley Property & Casualty Insurance Company) and affiliates (Milwaukee Mutual Insurance Company and Trinity Lloyd's Insurance Company) principally provide the Unitrin Multi Lines Insurance segment's preferred and standard products. These products accounted for approximately 62% of the aggregate insurance premium revenue of Unitrin's property and casualty insurance business in 2001.

Specialty Lines Insurance Segment

Unitrin's Specialty Lines Insurance segment principally is comprised of 4 insurance companies operating in the southern, western, midwestern and northwestern regions of the United States. With operations located in 28 states, the Specialty Lines Insurance segment has over 300,000 policies in force. The states which provided the largest amount of premium in 2001 were California (28%), Texas (26%), and Washington (6%).

The Specialty Lines Insurance segment's products are provided primarily by Financial Indemnity Company, Alpha Property & Casualty Insurance Company, Charter Indemnity Company and Charter County Mutual Insurance Company, and include nonstandard personal and commercial automobile, motorcycle, and specialty watercraft insurance. Nonstandard automobile insurance is provided for individuals and businesses that have had difficulty obtaining standard or preferred risk insurance, usually because of their driving records. Nonstandard automobile insurance products are marketed through approximately 8,000 independent agents in 11,500 locations. Specialty Lines Insurance products

accounted for approximately 37% of the aggregate insurance premium revenue of Unitrin's property and casualty insurance business in 2001.

Unitrin Direct Segment

On January 3, 2000, Unitrin established Unitrin Direct, a direct marketing automobile insurance unit, to market personal automobile insurance through direct mail, radio and television advertising and the Internet. This business unit primarily utilizes Unitrin's wholly owned subsidiary, Unitrin Direct Insurance Company, but has other subsidiaries of Unitrin available for utilization as needed in states in which Unitrin Direct Insurance Company is not currently licensed. Unitrin Direct's efforts in 2000 generally were devoted to the development of business plans and establishment of operational infrastructure. Unitrin Direct began actively marketing personal automobile insurance in the State of Pennsylvania in January 2001. Unitrin Direct then entered Florida in May 2001, Michigan in September 2001, and California in November of 2001. Several additional states are planned for introduction in 2002, subject to applicable state insurance regulatory approvals.

Unitrin Direct offers a wide range of standard, preferred and nonstandard private passenger auto insurance products, and competes with companies that sell insurance directly to the consumer, as well as with companies that sell through agents. Irrespective of the sales methods used by a company, personal auto insurance is a highly competitive business, particularly in the areas of price and customer service. Unitrin Direct's overall business strategy places great emphasis on competitive pricing and quality customer service.

While key business metrics for Unitrin Direct are still developing, and while initial results may not be indicative of future results, its first full year of active operating results primarily are meeting or exceeding Unitrin's expectations. Key business metrics include mix of business, conversion ratios (number of quotes that become sold policies), acquisition cost per sale, average premiums, claim frequencies and loss ratios. Building a direct marketing insurance operation, such as Unitrin Direct, requires a significant investment resulting in up-front costs and expenses associated with marketing products and acquiring new policies. Although over time Unitrin Direct expects to experience lower renewal costs than traditional insurance providers, Unitrin expects that Unitrin Direct will produce operating losses for at least the next few years.

Property and Casualty Loss and Loss Adjustment Expense Reserves

Property and casualty insurance companies establish reserves to cover their estimated ultimate liability for losses and loss adjustment expenses with respect to claims under their insurance policies. The reserves of the Unitrin property and casualty insurance companies reflect management's estimate of these amounts based on its judgment regarding a variety of factors, including the facts and circumstances of the claims, past claims experience, current claim trends, and relevant legal, economic and social conditions.

The objective of the Unitrin property and casualty companies is to set reserves that are adequate; that is, the amounts originally recorded as reserves should at least equal the ultimate net cost to investigate and settle claims. However, the process of establishing adequate reserves is inherently uncertain, and the ultimate net cost of a claim may vary materially from the amounts reserved. The reserving process is particularly imprecise for claims involving asbestos, environmental, toxic mold and other emerging long-tailed exposures now confronting property and casualty insurers. The Unitrin property and casualty insurance companies regularly monitor and evaluate loss and loss adjustment expense reserve development to verify reserve adequacy. Any adjustment to reserves is reflected in net income for the accounting period in which the adjustment is made. For additional information regarding reserves, please refer to the MD&A and Notes 2, 7 and 19 to the Financial Statements.

Storms/Catastrophe Losses

Severe weather and catastrophic events, such as hurricanes, tornadoes, earthquakes and wind, snow, ice and hail storms, are inherent risks of the property insurance business. Such occurrences result in insurance losses that are and will continue to be a material factor in the results of operations and financial position of Unitrin's property and casualty insurance companies. Further, because the level of these insurance losses experienced in any year cannot be predicted, these losses contribute to the year-to-year fluctuations in the results of operations and financial position of these companies. As a consequence, management has implemented certain strategies intended to reduce exposure to storm and catastrophe losses, including, as described below, geographic diversification of property insurance risk and catastrophe reinsurance arrangements. Although management believes that such strategies have reduced or will reduce the exposure of the property and casualty insurance operations to storm and catastrophe losses over time, the extent of such reduction is uncertain.

With respect to storm losses, the frequency and occurrence of severe weather are difficult to predict in any year. However, geographic location can have an impact on a property insurer's exposure to losses from storms. Moreover, these storms add an element of seasonality to property insurance claims, since windstorms and tornadoes tend to occur in the spring of the year, while hurricanes generally occur in the summer and fall. Historically, Unitrin's property and casualty insurance companies have written a sizable portion of business in Texas, the plains states, and certain coastal areas that are prone to storms. Management has endeavored to reduce its vulnerability to storm losses through a combination of geographic expansion outside of these areas and reduced concentration of property business in storm-prone areas.

As a part of the overall reinsurance program covering Unitrin's property and casualty insurance companies, management acquires excess of loss reinsurance coverage designed specifically to protect against losses arising from catastrophic events such as storms. The catastrophe reinsurance program is typically purchased annually and is structured according to a series of coverage layers based on geographic region. For example, the 2001 catastrophe reinsurance program provided for $6 million in reinsurance protection for losses in excess of $4 million occurring in Washington, Oregon, California, Idaho, Nevada, Montana, Wyoming, Utah, Colorado and Arizona. With respect to New Mexico, North Dakota, South Dakota, Nebraska, Kansas, Oklahoma, Minnesota, Iowa, Missouri, Arkansas, Mississippi, Georgia, Tennessee, Kentucky, Ohio, Indiana, Illinois and Wisconsin, the program provided for $5 million in reinsurance protection for losses in excess of $5 million. The program provided $45 million in reinsurance coverage for losses in excess of $10 million in all states in which the Unitrin property and casualty insurance companies operated, including the Gulf states of Texas, Louisiana and Alabama. In addition, the 2001 program provided a further layer of protection in the amount of 75% of $55 million for losses in excess of $55 million in all states in which Unitrin property and casualty insurance companies operated. This layer also was shared with the Life and Health Insurance segment's property insurance companies, but at a different attachment point and coverage level. Based on external modeling studies, the estimated probable maximum loss of the Unitrin property and casualty insurance companies for storms occurring in all states with a statistical frequency of occurrence of once per 100 years is approximately $34 million. For further discussion of the reinsurance program, see discussion below and Note 18 to the Financial Statements.

Reinsurance

In addition to the catastrophe reinsurance program described above, Unitrin's property and casualty insurance companies utilize reinsurance arrangements to limit their maximum loss, provide greater diversification of risk and minimize exposures on larger risks. Under such arrangements, these companies are indemnified by reinsurers for losses incurred under insurance policies issued by the

companies. As indemnity reinsurance does not discharge an insurer from its direct obligations to policyholders on risks insured, Unitrin's property and casualty insurance companies remain contingently liable. However, so long as the reinsurers meet their obligations, these companies' net liability is limited