WESCO FINANCIAL CORP
Form 10-Q
May 06, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

þ **Quarterly report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**
For the quarterly period ended March 31, 2011

or

o **Transition report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**
For the transition period from __________ to

Commission file number 1-4720

WESCO FINANCIAL CORPORATION
(Exact name of Registrant as Specified in its Charter)

DELAWARE	95-2109453
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

301 East Colorado Boulevard, Suite 300, Pasadena, California 91101-1901
(Address of principal executives offices) (Zip Code)
626/585-6700
(Registrant s telephone number, including area code)
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes o No o

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

Large Accelerated Filer o	Accelerated Filer þ	Non-Accelerated Filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

Yes o No þ

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS
DURING THE PRECEDING FIVE YEARS

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15 (d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes o No o

APPLICABLE ONLY TO CORPORATE ISSUERS

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. 7,119,807 as of May 6, 2011

PART I. FINANCIAL INFORMATION

Reference is made to Item 7A, Quantitative and Qualitative Disclosures About Market Risk, appearing on pages 33 34 of the Form 10-K Annual Report for the year ended December 31, 2010, filed by Wesco Financial Corporation (Wesco), for information on equity price risk, interest rate risk and foreign exchange risk at Wesco. There have been no material changes through March 31, 2011.

Item 4. Controls and Procedures.

An evaluation was performed under the supervision and with the participation of the management of Wesco, including Charles T. Munger (Chief Executive Officer) and Jeffrey L. Jacobson (Chief Financial Officer), of the effectiveness of the design and operation of Wesco s disclosure controls and procedures as of March 31, 2011. Based on that evaluation, Messrs. Munger and Jacobson concluded that the Company s disclosure controls and procedures are effective in ensuring that information required to be disclosed by the Company in reports it files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported as specified in the rules and forms of the Securities and Exchange Commission, and are effective to ensure that information required to be disclosed by Wesco in the reports it files or submits under the Securities Exchange Act of 1934, as amended, is accumulated and communicated to Wesco s management, including Mr. Munger and Mr. Jacobson, as appropriate to allow timely decisions regarding required disclosure. There have been no changes in Wesco s internal control over financial reporting during the quarter ended March 31, 2011 that have materially affected or are reasonably likely to materially affect the internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

Two lawsuits were filed on February 8, 2011 by plaintiffs claiming to be Wesco shareholders challenging the transactions contemplated by the merger agreement between Berkshire and Wesco. Both of the lawsuits name Wesco, Wesco s directors, Berkshire and Montana Acquisitions, LLC as defendants. One of them also names Blue Chip and Wesco s Chief Financial Officer as defendants. One of the actions was filed in Delaware Chancery Court and the other in Los Angeles Superior Court. Both purport to be class actions on behalf of Wesco shareholders.

The Delaware action is styled *Joel Krieger v. Wesco Financial Corporation, et al.* The Los Angeles action is styled *James Kinsey v. Wesco Financial Corporation, et al.* The lawsuits allege, among other things, that Wesco s directors have breached their fiduciary duties based on allegations that (i) the consideration being offered is unfair and inadequate, (ii) statements in Wesco s annual reports comparing its prospects for growth with those of Berkshire have been unduly unfavorable to Wesco, and (iii) the Wesco directors approval of the proposed merger was tainted by conflicts of interest between Berkshire and the non-Berkshire shareholders of Wesco in breach of the Board s fiduciary duties. The lawsuits also allege that Berkshire and its affiliates violated fiduciary duties owed by a majority shareholder and/or aided and abetted the alleged breaches by Wesco s directors. The plaintiffs seek various remedies, including enjoining the transaction from being consummated in accordance with the agreed-upon terms. The Kinsey action has been stayed pending the resolution of the similar claims asserted in the Krieger action. In the Krieger action, the plaintiff has moved for a preliminary injunction to prevent a shareholder vote on the transaction. The defendants have opposed that motion. A hearing on the motion is scheduled to take place on May 10, 2011. The defendants intend to defend against these and any additional actions asserting similar claims that may be brought in the future.

Wesco and its subsidiaries are not otherwise involved in any legal proceedings the ultimate outcomes of which are expected to be significant to Wesco.

Item 1A. Risk Factors.

Reference is made to pages 9 through 11 of Wesco s Annual Report on Form 10-K for the year ended December 31, 2010, for a summary of risk factors identified with the ownership of Wesco common stock. The following risk factor should also be considered by investors or possible investors in Wesco.

On February 7, 2011, Wesco and Berkshire announced that they had entered into a definitive merger agreement, whereby Berkshire will acquire the remaining 19.9% of the shares of Wesco s capital stock that it does not presently own in exchange for cash or shares of Berkshire Class B common stock, at the election of each Wesco shareholder. The transaction requires the affirmative vote of holders of a majority of Wesco s outstanding shares in favor of the adoption of the merger agreement, which will be sought at a special meeting of the shareholders of Wesco, and is subject to customary closing conditions. The transaction is also subject to a non-waivable condition that a majority of the outstanding shares not owned by Berkshire (and excluding certain specified shareholders) vote in favor of the adoption of the merger agreement. There can be no assurance that any transaction will be completed. The trading price of Wesco s capital stock on the NYSE Amex increased upon the public announcement of Berkshire s original offer to acquire the remaining Wesco shares, and it increased again upon public announcement of the execution of the merger agreement. In the event a transaction does not occur, there could be an adverse effect on the

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trading price of Wesco s capital stock.

A Form 8-K filed by Wesco with the Securities and Exchange Commission (the SEC) on February 7, 2011, and Schedules 13 E-3 and 13-E-3/A filed on March 7, 2011 and April 15, 2011, respectively, contain additional information about the proposed transaction, including a copy of the merger agreement. Those documents are available at no charge at Wesco s website, www.wescofinancial.com, or the SEC s website, www.sec.gov.

Item 6. Exhibits

31 (a) Certification Pursuant to Rule 13a-14 under the Securities Exchange Act of 1934, as amended (Chief Executive Officer)

31 (b) Certification Pursuant to Rule 13a-14 under the Securities Exchange Act of 1934, as amended (Chief Financial Officer)

32 (a) Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chief Executive Officer)

32 (b) Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chief Financial Officer)

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

	March 31, 2011	Dec. 31, 2010
ASSETS		
Cash and cash equivalents	$ 492,599	$ 472,569
Investments		
Securities with fixed maturities	236,338	235,193
Equity securities	2,247,792	2,272,253
Receivable from affiliates	220,820	170,852
Rental furniture	186,112	177,680
Goodwill of acquired businesses	277,578	277,514
Other assets	217,605	185,883
	$ 3,878,844	$ 3,791,944
LIABILITIES AND SHAREHOLDERS EQUITY		
Insurance losses and loss adjustment expenses		
Affiliated business	$ 467,347	$ 371,805
Unaffiliated business	34,338	36,579
Unearned insurance premiums		
Affiliated business	151,615	112,019
Unaffiliated business	8,075	9,545
Deferred furniture rental income and security deposits	8,039	8,269
Notes payable	64,900	51,200
Income taxes payable, principally deferred	337,814	363,310
Other liabilities	79,053	73,500
	1,151,181	1,026,227
Shareholders equity:		
Capital stock and additional paid-in capital	33,324	33,324
Accumulated other comprehensive income	455,785	437,365
Retained earnings	2,238,554	2,295,028
Total shareholders equity	2,727,663	2,765,717
	$ 3,878,844	$ 3,791,944

See notes beginning on page 8.

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WESCO FINANCIAL CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF
INCOME AND RETAINED EARNINGS
(Dollar amounts in thousands except for amounts per share)
(Unaudited)

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Revenues:		
Furniture rentals	$ 77,690	$ 71,865
Sales and service revenues	28,108	27,623
Insurance premiums earned		
Affiliated business	85,240	66,113
Unaffiliated business	5,371	5,741
Dividend and interest income	24,522	19,681
Realized net investment gains (losses)	1,800	(259)
Other-than-temporary impairment losses on investments	(52,705)	
Other	1,022	1,034
	171,048	191,798
Costs and expenses:		
Cost of products and services sold	31,640	31,993
Insurance losses and loss adjustment expenses		
Affiliated business	122,511	51,570
Unaffiliated business	3,013	5,733
Insurance underwriting expenses		
Affiliated business	29,048	20,944
Unaffiliated business	2,576	1,673
Selling, general and administrative expenses	71,102	66,039
Interest expense	109	87
	259,999	178,039
Income (loss) before income taxes	(88,951)	13,759
Income taxes	(35,467)	1,432
Net income (loss)	(53,484)	12,327
Retained earnings beginning of period	2,295,028	2,234,493
Cash dividends declared and paid	(2,990)	(2,919)
Retained earnings end of period	$ 2,238,554	$ 2,243,901

Amounts per capital share based on 7,119,807 shares outstanding throughout each period:				
Net income (loss)	$	(7.51)	$	1.73
Cash dividends	$	.42	$	.41

See notes beginning on page 8.

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

	Three Months Ended March 31, 2011	March 31, 2010
Cash flows from operating activities	$ 22,965	$ 18,948
Cash flows from investing activities:		
Maturities and redemptions of securities with fixed maturities	802	5,769
Proceeds from sales of equity securities		11,394
Purchases of rental furniture	(26,262)	(13,793)
Sales of rental furniture	13,353	14,204
Change in condominium construction in process		6,889
Other, net	(1,539)	(1,677)
Net cash flows from investing activities	(13,646)	22,786
Cash flows from financing activities:		
Net increase in notes payable, principally line of credit	13,700	2,000
Payment of cash dividends	(2,990)	(2,919)
Net cash flows from financing activities	10,710	(919)
Effect of foreign currency exchange rate changes	1	(24)
Increase in cash and cash equivalents	20,030	40,791
Cash and cash equivalents beginning of period	472,569	273,671
Cash and cash equivalents end of period	$ 492,599	$ 314,462
Supplementary information:		
Interest paid during period	$ 139	$ 74
Income taxes paid, net, during period	132	2,565

See notes beginning on page 8.

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WESCO FINANCIAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollar amounts in thousands except for amounts per share)
(Unaudited)

Note 1. General

The unaudited condensed consolidated financial statements of which these notes are an integral part include the accounts of Wesco Financial Corporation (Wesco) and its subsidiaries. In preparing these financial statements, management has evaluated events and transactions that have occurred subsequent to March 31, 2011. In management s opinion, such statements reflect all adjustments (all of them of a normal recurring nature) necessary to a fair statement of interim results in accordance with accounting principles generally accepted in the United States of America.

Reference is made to the notes to Wesco s consolidated financial statements appearing on pages 54 through 69 of its 2010 Form 10-K Annual Report for other information deemed generally applicable to the condensed consolidated financial statements. In particular, Wesco s significant accounting policies and practices are set forth in Note 1 on pages 54 through 59. There have been no changes in such policies and practices since yearend.

Consolidated U.S. federal income tax return liabilities have been substantially settled with the Internal Revenue Service (the IRS) through 2001. The IRS has completed its examination of the consolidated U.S. federal income tax returns for the years 2002 through 2006. The results of the examinations are currently in the IRS appeals process. The IRS has begun its examination of returns for the 2007 through 2009 tax years. Wesco management believes that the ultimate outcome of the Federal income tax audits will not materially affect Wesco s consolidated financial statements.

Wesco s management does not believe that any accounting pronouncements issued by the Financial Accounting Standards Board or other applicable authorities that are required to be adopted after March 31, 2011 are likely to have a material effect on reported shareholders equity.

Note 2. Investments

Following is a summary of investments in securities with fixed maturities:

	March 31, 2011			
	Amortized Cost	Unrealized Gains	Fair Value	Carrying Value
Mortgage-backed securities	$ 16,226	$ 1,922	$ 18,148	$ 18,148
Corporate bonds	208,600	5,200	213,800	208,600
Other	9,422	168	9,590	9,590
	$ 234,248	$ 7,290	$ 241,538	$ 236,338

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	December 31, 2010			
	Amortized Cost	Unrealized Gains	Fair Value	Carrying Value
Mortgage-backed securities	$ 17,031	$ 1,941	$ 18,972	$ 18,972
Corporate Bonds	206,800	5,400	212,200	206,800
Other	9,407	14	9,421	9,421
	$ 233,238	$ 7,355	$ 240,593	$ 235,193

At March 31, 2011 and December 31, 2010, the carrying values of securities with fixed maturities contained no unrealized losses.

Following is a summary of investments in equity securities:

	March 31, 2011		December 31, 2010	
	Cost	Fair Value	Cost	Fair Value
The Procter & Gamble Company	$ 372,480	$ 384,384	$ 372,480	$ 401,419
The Coca-Cola Company	40,761	478,019	40,761	473,912
Wells Fargo & Company	342,290	400,916	382,779	391,813
Kraft Foods Incorporated	313,600	313,600	325,816	315,100
US Bancorp	245,919	264,300	245,919	269,700
Other	232,007	406,573	232,007	420,309
	$ 1,547,057	$ 2,247,792	$ 1,599,762	$ 2,272,253

Fair values of equity securities included gross unrealized losses of $2,973 at March 31, 2011 and $58,668 at December 31, 2010.

Other equity securities at March 31, 2011 includes an investment of $205,000, at cost, in shares of 10% cumulative perpetual preferred stock of The Goldman Sachs Group, Inc. (GS) and warrants to acquire up to approximately 1.78 million shares of GS common stock, at any time until they expire on October 1, 2013, at a price of $115 per share. On April 18, 2011, GS redeemed Wesco s investment in its cumulative preferred stock, for $225,500. Wesco s consolidated second quarter 2011 earnings will include a pre-tax realized investment gain of $51,250 ($33,313, after taxes) in connection with the redemption, representing the excess of the after-tax redemption proceeds over Wesco s cost. Wesco carries its investments on its consolidated balance sheet at fair value, with unrealized gains and losses included in shareholders equity. As of March 31, 2011, the fair value of the GS preferred stock was $225,500, and shareholders equity included unrealized after-tax gains of $33,313 relating to the investment. As a result, the investment gain that will be included in Wesco s second quarter earnings from the redemption of the GS preferred stock will be entirely offset by the reversal of the unrealized gain recorded as of March 31, 2011, and there will therefore be no effect on Wesco s total consolidated shareholders equity.

During the first quarter of 2011, Wesco recorded other-than-temporary impairment (OTTI) losses of $52,705, before taxes, with respect to certain purchase lots of its investments in Wells Fargo and Kraft Foods common stocks, whose fair values had been below cost for an extended period of time. OTTI losses result in a reduction of the cost basis of the investments and not their fair values. Accordingly, such losses that are included in after-tax earnings are offset by corresponding credits to other comprehensive income, without effect on Wesco s total consolidated shareholders equity.

Dollar amounts in thousands, except for amounts per share

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Note 3. Comprehensive income

The following table sets forth Wesco s consolidated comprehensive income for the three-month periods ended March 31, 2011 and 2010:

	Three Months Ended March 31, 2011	March 31, 2010
Net income (loss)	$ (53,484)	$ 12,327
Foreign currency translation adjustment, net of tax *	321	(586)
Change in unrealized appreciation of investments, net of income tax effect of $9,746 and $41,294	18,099	76,242
Comprehensive income (loss)	$ (35,064)	$ 87,983

* Represents gains and losses from translating the financial statements of the furniture rental segment s foreign-based operations, acquired in January of 2009, from the local currency to U.S. dollars.

Note 4. Fair value measurements

Following is a summary of Wesco s financial assets and liabilities measured and carried at fair value on a recurring basis by the type of inputs applicable to fair value measurement.

	Total Fair Value	Fair Value Measurements Using (Level 1)	(Level 2)	(Level 3)
March 31, 2011				
Investments in fixed-maturity securities	$ 27,738	$	$ 27,738	$
Investments in equity securities	2,247,792	1,937,600	225,500	84,692
December 31, 2010				
Investments in fixed-maturity securities	$ 28,393	$	$ 28,393	$
Investments in equity securities	2,272,253	1,944,271		327,982

As of March 31, 2011, Wesco transferred its investment in GS preferred stock to the category Level 2 measurements given the pending redemption of that investment which occurred on April 18, 2011.

Following is a summary of Wesco s assets and liabilities measured at fair value, with the use of significant unobservable inputs (Level 3):

	Investments in Equity Securities
Balance as of December 31, 2010	$ 327,982
Transfer to level 2 investments	(225,500)
Unrealized losses on level 3 investments, included in other comprehensive income	(17,790)
Balance as of March 31, 2011	$ 84,692
Balance as of December 31, 2009	$ 338,749
Unrealized losses on level 3 investments, included in other comprehensive income	(1,925)

Balance as of March 31, 2010	$	336,824

Dollar amounts in thousands, except for amounts per share

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Note 5. Goodwill

The Company performed its annual impairment tests in the fourth quarter of 2010 and concluded that there was no impairment for any of its reporting units because the fair values exceeded the carrying values. In connection with the preparation of its consolidated financial statements for the first quarter of 2011, the Company reviewed the conclusions reached in connection with its impairment testing as of yearend 2010 and noted that no events had occurred, nor had circumstances changed significantly subsequent to yearend, that would more likely than not reduce the fair values of its reporting units below their carrying amounts.

Certain of the Company s reporting units have been negatively impacted by the recent economic recession from which their businesses have not yet fully recovered, but the extent of the impact over the long term cannot be reasonably predicted. There can be no assurance that the Company s estimates and assumptions regarding future operating results made for purposes of the goodwill impairment testing will prove to be accurate predictions of the future. If the weak economic conditions have an adverse impact on the long-term economic value of the reporting units, the Company may be required to record goodwill impairment losses in future periods. Currently, it is not possible to determine if any such future impairment losses would result or if such losses would be material.

Note 6. Recent Events

On February 7, 2011, Wesco and Berkshire announced that they had entered into a definitive merger agreement, whereby Berkshire will acquire the remaining 19.9% of the shares of Wesco s common stock that it does not presently own in exchange for cash or shares of Berkshire Class B common stock, at the election of each Wesco shareholder. The transaction requires the affirmative vote of holders of a majority of Wesco s outstanding shares in favor of the adoption of the merger agreement, which will be sought at a special meeting of the shareholders of Wesco, and is subject to customary closing conditions. The transaction is also subject to a non-waivable condition that a majority of the outstanding shares not owned by Berkshire (and excluding certain specified shareholders) vote in favor of the adoption of the merger agreement. There can be no assurance that any transaction will actually be completed.

Note 7. Litigation and Environmental Matters

Two lawsuits were filed on February 8, 2011 by plaintiffs claiming to be Wesco shareholders challenging the transactions contemplated by the merger agreement between Berkshire and Wesco. Both of the lawsuits name Wesco, Wesco s directors, Berkshire and Montana Acquisitions, LLC as defendants. One of them also names Blue Chip Stamps (a wholly owned subsidiary of Berkshire) and Wesco s Chief Financial Officer as defendants. One of the actions was filed in Delaware Chancery Court and the other in Los Angeles Superior Court. Both purport to be class actions on behalf of Wesco shareholders.

The Delaware action is styled *Joel Krieger v. Wesco Financial Corporation, et al.* The Los Angeles action is styled *James Kinsey v. Wesco Financial Corporation, et al.* The lawsuits allege, among other things, that Wesco s directors have breached their fiduciary duties based on allegations that (i) the consideration being offered is unfair and inadequate, (ii) statements in Wesco s annual reports comparing its prospects for growth with those of Berkshire have been unduly unfavorable to Wesco, and (iii) the Wesco directors approval of the proposed merger was tainted by conflicts of interest between Berkshire and the non-Berkshire shareholders of Wesco in breach of the Board s fiduciary duties. The lawsuits also allege that

Dollar amounts in thousands, except for amounts per share

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Berkshire and its affiliates violated fiduciary duties owed by a majority shareholder and/or aided and abetted the alleged breaches by Wesco s directors. The plaintiffs seek various remedies, including enjoining the transaction from being consummated in accordance with the agreed-upon terms. The Kinsey action has been stayed pending the resolution of the similar claims asserted in the Krieger action. In the Krieger action, the plaintiff has moved for a preliminary injunction to prevent a shareholder vote on the transaction. The defendants have opposed that motion. A hearing on the motion is scheduled to take place on May 10, 2011. The defendants intend to defend against these and any additional actions asserting similar claims that may be brought in the future.

Wesco s Precision Steel subsidiary and one of its subsidiaries are parties to an environmental matter in the state of Illinois, the ultimate outcome of which is not expected to be material.

Note 8. Business segment data

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

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Insurance segment:		
Revenues	$ 115,035	$ 91,491
Net income (loss)	(22,918)	10,817
Goodwill of acquired businesses	26,991	26,991
Assets at end of period	3,257,200	2,980,822
Furniture rental segment:		
Revenues	$ 92,595	$ 87,396
Net income	2,558	1,740
Goodwill of acquired businesses	250,587	250,483
Assets at end of period	519,638	501,522
Industrial segment:		
Revenues	$ 13,203	$ 12,092
Net income	380	54
Assets at end of period	20,556	20,662
Realized net investment gain (loss):		
Before taxes (included in revenues)	$ 1,800	$ (259)
After taxes (included in net income)	1,170	(168)
Other-than-temporary impairment losses on investments:		
Before taxes (included in revenues)	$ (52,705)	$
After taxes (included in net income)	(34,259)	

Dollar amounts in thousands, except for amounts per share

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Other items unrelated to business segments:		
Revenues	$ 1,120	$ 1,078