UNITRIN INC
Form 10-Q
August 04, 2008
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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For Quarterly Period Ended June 30, 2008

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 0-18298

Unitrin, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**95-4255452**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
One East Wacker Drive, Chicago, Illinois	**60601**
(Address of principal executive offices)	**(Zip Code)**

(312) 661-4600

(Registrant s telephone number, including area code)

Not Applicable

(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 x No ¨

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. (Check one):

Large accelerated filer x 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 x

62,767,014 shares of common stock, $0.10 par value, were outstanding as of July 31, 2008.

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UNITRIN, INC.

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UNITRIN, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in millions, except per share amounts)

(Unaudited)

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007
Revenues:				
Earned Premiums	$ 1,172.2	$ 1,132.7	$ 596.3	$ 570.2
Automobile Finance Revenues	125.5	127.9	62.1	64.9
Net Investment Income	118.1	158.8	62.2	80.2
Other Income	1.4	2.2	0.9	1.2
Net Realized Investment Gains	11.2	39.5	5.0	17.0
Total Revenues	1,428.4	1,461.1	726.5	733.5
Expenses:				
Policyholders Benefits and Incurred Losses and Loss Adjustment Expenses	858.9	784.4	448.2	397.2
Insurance Expenses	355.1	345.8	182.8	174.2
Automobile Finance Expenses	123.5	85.8	69.6	43.7
Interest Expense on Certificates of Deposit	30.7	27.8	15.0	14.2
Interest and Other Expenses	31.7	36.1	15.0	20.0
Total Expenses	1,399.9	1,279.9	730.6	649.3
Income (Loss) before Income Taxes and Equity in Net Income (Loss) of Investee	28.5	181.2	(4.1)	84.2
Income Tax Benefit (Expense)	(0.1)	(54.9)	7.5	(24.9)
Income before Equity in Net Income (Loss) of Investee	28.4	126.3	3.4	59.3
Equity in Net Income (Loss) of Investee	3.3	(0.2)	1.1	(0.6)
Income from Continuing Operations	31.7	126.1	4.5	58.7
Discontinued Operations:				
Income (Loss) from Discontinued Operations (Including Gain of $8.1 on Disposal in 2008 - See Notes 1 and 3)	(12.8)	9.5	(3.9)	3.7
Income Tax Benefit (Expense)	0.7	(1.0)	(3.5)	(0.2)
Income (Loss) from Discontinued Operations	(12.1)	8.5	(7.4)	3.5
Net Income (Loss)	$ 19.6	$ 134.6	$ (2.9)	$ 62.2
Income Per Share from Continuing Operations	$ 0.50	$ 1.90	$ 0.07	$ 0.89
Income (Loss) Per Share from Discontinued Operations	(0.19)	0.13	(0.12)	0.05
Net Income (Loss) Per Share	$ 0.31	$ 2.03	$ (0.05)	$ 0.94

Income Per Share from Continuing Operations Assuming Dilution	$	0.50	$	1.88	$	0.07	$	0.89
Income (Loss) Per Share from Discontinued Operations Assuming Dilution		(0.19)		0.13		(0.12)		0.05
Net Income (Loss) Per Share Assuming Dilution	$	0.31	$	2.01	$	(0.05)	$	0.94
Dividends Paid Per Share	$	0.940	$	0.910	$	0.470	$	0.455

The Notes to the Condensed Consolidated Financial Statements are an integral part of these financial statements.

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UNITRIN, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in millions, except per share amounts)

	June 30, 2008 (Unaudited)	December 31, 2007
Assets:		
Investments:		
Fixed Maturities at Fair Value (Amortized Cost: 2008 - $3,950.5; 2007 - $3,608.9)	$ 3,949.6	$ 3,686.7
Northrop Grumman Corporation Preferred Stock at Fair Value (Cost: 2007 - $177.5)		258.5
Northrop Grumman Corporation Common Stock at Fair Value (Cost: 2008 - $403.0; 2007 - $245.5)	570.2	447.5
Other Equity Securities at Fair Value (Cost: 2008 - $485.6; 2007 - $436.5)	589.0	597.6
Investee (Intermec) at Cost Plus Cumulative Undistributed Earnings (Fair Value: 2008 - $266.8; 2007 - $257.1)	101.1	90.7
Short-term Investments at Cost which Approximates Fair Value	564.7	658.7
Other	743.5	706.7
Total Investments	6,518.1	6,446.4
Cash	62.1	103.1
Automobile Loan Receivables at Cost (Fair Value: 2008 - $1,213.6; 2007 - $1,230.3)	1,193.1	1,213.5
Other Receivables	682.3	634.8
Deferred Policy Acquisition Costs	498.4	437.4
Goodwill	344.0	314.7
Current and Deferred Income Taxes	28.5	17.2
Other Assets	107.3	109.9
Assets of Discontinued Operations		128.0
Total Assets	$ 9,433.8	$ 9,405.0
Liabilities and Shareholders Equity:		
Insurance Reserves:		
Life and Health	$ 2,960.0	$ 2,533.0
Property and Casualty	1,315.2	1,322.9
Total Insurance Reserves	4,275.2	3,855.9
Certificates of Deposits at Cost (Fair Value: 2008 - $1,221.2; 2007 - $1,269.7)	1,202.4	1,274.3
Unearned Premiums	743.0	722.2
Liabilities for Income Taxes	113.4	262.5
Notes Payable at Amortized Cost (Fair Value: 2008 $597.3; 2007 $550.3)	633.4	560.1
Accrued Expenses and Other Liabilities	421.4	380.9
Liabilities of Discontinued Operations		51.3
Total Liabilities	7,388.8	7,107.2
Shareholders Equity:		
Common Stock, $0.10 par value, 100 million Shares Authorized; 62,767,014 Shares Issued and Outstanding at June 30, 2008 and 64,254,818 Shares Issued and Outstanding at December 31, 2007	6.3	6.4
Paid-in Capital	768.3	781.3
Retained Earnings	1,107.1	1,185.3

Accumulated Other Comprehensive Income	163.3	324.8
Total Shareholders Equity	2,045.0	2,297.8
Total Liabilities and Shareholders Equity	$ 9,433.8	$ 9,405.0

The Notes to the Condensed Consolidated Financial Statements are an integral part of these financial statements.

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UNITRIN, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in millions)

(Unaudited)

	Six Months Ended	
	June 30, 2008	June 30, 2007
Operating Activities:		
Net Income	$ 19.6	$ 134.6
Adjustments to Reconcile Net Income to Net Cash		
Provided (Used) by Operating Activities:		
Increase in Deferred Policy Acquisition Costs	(9.2)	(10.0)
Equity in Net (Income) Loss of Investee before Taxes	(5.0)	0.3
Equity in Losses (Earnings) of Limited Liability Investment Companies and Limited Partnerships	29.3	(12.4)
Distribution of Accumulated Earnings of Limited Liability Investment Companies and Limited Partnerships	0.9	13.0
Amortization of Investment Securities and Depreciation of Investment Real Estate	5.3	3.2
Provision for Loan Losses	73.2	34.0
Depreciation of Property and Equipment	9.9	10.2
Decrease in Other Receivables	14.3	33.6
Increase (Decrease) in Insurance Reserves	15.6	(38.3)
Increase (Decrease) in Unearned Premiums	(30.2)	4.2
Increase (Decrease) in Liabilities for Income Taxes	(65.6)	2.6
Increase in Accrued Expenses and Other Liabilities	7.8	3.3
Net Realized Investment Gains	(11.2)	(39.5)
Gain on Disposition of Business	(8.1)	
Other, Net	17.2	17.5
Net Cash Provided by Operating Activities	63.8	156.3
Investing Activities:		
Sales and Maturities of Fixed Maturities	710.6	249.9
Purchases of Fixed Maturities	(657.1)	(200.5)
Sales of Northrop Grumman Corporation Common Stock	32.2	63.8
Sales of Other Equity Securities	111.3	50.9
Purchases of Other Equity Securities	(145.0)	(45.5)
Acquisition and Improvements of Investment Real Estate	(15.6)	(5.7)
Sale of Investment Real Estate	3.2	3.3
Acquisitions of Limited Liability Investment Companies and Limited Partnerships	(52.7)	(27.8)
Disposition of Business, Net of Cash Disposed	67.0	
Acquisition of Business, Net of Cash Acquired	(95.8)	(46.8)
Change in Short-term Investments	115.9	(475.6)
Change in Automobile Loan Receivables	(51.3)	(91.6)
Change in Other Investments	(1.8)	(1.0)
Other, Net	(14.6)	(6.2)
Net Cash Provided (Used) by Investing Activities	6.3	(532.8)
Financing Activities:		
Change in Certificates of Deposits	(72.0)	48.0
Cash Dividends Paid	(59.7)	(60.7)

Note Payable Proceeds	181.0	354.9
Note Payable Payments	(108.0)	
Common Stock Repurchases	(57.4)	(74.8)
Cash Exercise of Stock Options	1.6	1.5
Excess Tax Benefits from Share-based Awards	0.2	0.8
Other, Net	1.8	2.0
Net Cash Provided (Used) by Financing Activities	(112.5)	271.7
Decrease in Cash	(42.4)	(104.8)
Cash, Beginning of Year Including Cash Reported in Discontinued Operations	104.5	157.9
Cash, End of Period	$ 62.1	$ 53.1

The Notes to the Condensed Consolidated Financial Statements are an integral part of these financial statements.

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UNITRIN, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1 Basis of Presentation

The Condensed Consolidated Financial Statements included herein have been prepared pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (the SEC) and include the accounts of Unitrin, Inc. (Unitrin) and its subsidiaries (individually and collectively referred to herein as the Company) and are unaudited. All significant intercompany accounts and transactions have been eliminated. Certain financial information that is normally included in annual financial statements, including certain financial statement footnote disclosures, prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) is not required by the rules and regulations of the SEC and has been condensed or omitted. In the opinion of the Company s management, the Condensed Consolidated Financial Statements include all adjustments necessary for a fair presentation. The preparation of interim financial statements relies heavily on estimates. This factor and certain other factors, such as the seasonal nature of some portions of the insurance business, as well as market conditions, call for caution in drawing specific conclusions from interim results. The accompanying Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and related notes included in the Company s Annual Report on Form 10-K, filed with the SEC for the year ended December 31, 2007 (the 2007 Annual Report).

Discontinued Operations

The Company accounts for its former Unitrin Business Insurance operations as discontinued operations in accordance with Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* In accordance with SFAS No. 144, the Condensed Consolidated Statements of Operations and related disclosures for the six and three months ended June 30, 2007 have been reclassified to conform to the current presentation (see Note 3, Discontinued Operations, to the Condensed Consolidated Financial Statements).

Accounting Changes

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value under GAAP and expands disclosures about fair value measurements. SFAS No. 157 applies to other accounting pronouncements that require or permit fair value measurements, but does not require any new fair value measurements. On January 1, 2008, the Company adopted SFAS No. 157. The initial application of SFAS No. 157 did not have a material effect on the fair values reported by the Company. The additional disclosures required by SFAS No. 157 are presented in Note 14, Fair Value Measurements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115*. SFAS No. 159 permits the choice of measuring financial instruments and certain other items at fair value. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. On January 1, 2008, the Company adopted SFAS No. 159 and elected not to apply the provisions of SFAS No. 159 to its eligible financial assets and financial liabilities on the date of adoption. Accordingly, the initial application of SFAS No. 159 had no effect on the Company.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations*. SFAS No. 141(R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree and recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase. SFAS No. 141(R) also sets forth the disclosures required to be made in the financial statements to evaluate the nature and financial effects of the business combination. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Accordingly, SFAS No. 141(R) will be applied by the Company to business combinations occurring on or after January 1, 2009.

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UNITRIN, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1 Basis of Presentation (continued)

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51*. SFAS No. 160 establishes accounting and reporting standards that require: that the ownership interests in subsidiaries held by parties other than the parent be clearly identified, labeled, and presented in the consolidated statement of financial position within equity, but separate from the parent s equity; the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of operations; and changes in a parent s ownership interest while the parent retains its controlling financial interest in its subsidiary be accounted for consistently. SFAS No. 160 also requires that any retained noncontrolling equity investment in the former subsidiary be initially measured at fair value when a subsidiary is deconsolidated. SFAS No. 160 also sets forth the disclosure requirements to identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 applies to all entities that prepare consolidated financial statements, except not-for-profit organizations, but will affect only those entities that have an outstanding noncontrolling interest in one or more subsidiaries or that deconsolidate a subsidiary. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. SFAS No. 160 must be applied prospectively as of the beginning of the fiscal year in which SFAS No. 160 is initially applied, except for the presentation and disclosure requirements. The presentation and disclosure requirements are applied retrospectively for all periods presented. The Company does not have a noncontrolling interest in one or more subsidiaries. Accordingly, the Company does not anticipate that the initial application of SFAS No. 160 will have an impact on the Company.

In March 2008, the FASB issued SFAS No. 161, *Disclosure about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133*. SFAS No. 161 establishes, among other things, the disclosure requirements for derivative instruments and for hedging activities. SFAS No. 161 amends and expands the disclosure requirements of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, with the intent to provide users of financial statements with enhanced understanding of: how and why an entity uses derivative securities; how derivatives and hedges are being accounted for under SFAS No. 133; and how derivatives and hedges affect an entity s financial position, financial performance and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years beginning after November 15, 2008 with early adoption permitted. The Company estimates that the initial application of SFAS No. 161 will not be material.

In April 2008, the FASB issued FASB Staff Position (FSP) SFAS 142-3, *Determination of the Useful Life of Intangible Assets*. FSP SFAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets*. Previously, under the provisions of SFAS No. 142, an entity was precluded from using its own assumptions about renewal or extension of an arrangement where there was likely to be substantial cost or material modifications. FSP SFAS 142-3 removes the requirement of SFAS No. 142 for an entity to consider whether an intangible asset can be renewed without substantial cost or material modification to the existing terms and conditions and requires an entity to consider its own experience in renewing similar arrangements. FSP SFAS 142-3 also increases the disclosure requirements for a recognized intangible asset to enable a user of financial statements to assess the extent to which the expected future cash flows associated with the asset are affected by the entity s intent or ability to renew or extend the arrangement. FSP SFAS 142-3 is effective for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years. Early adoption is prohibited. The guidance for determining the useful life of a recognized intangible asset is applied prospectively to intangible assets acquired after the effective date. Accordingly, the Company does not anticipate that the initial application of FSP SFAS No. 142-3 will have an impact on the Company. The disclosure requirements must be applied prospectively to all intangible assets recognized as of, and subsequent to, the effective date.

In May 2008, the FASB issued SFAS No. 163, *Accounting for Financial Guarantee Insurance Contracts, an interpretation of FASB Statement No. 60*. SFAS No. 163 clarifies how SFAS No. 60, *Accounting and Reporting by Insurance Enterprises*, applies to financial guarantee insurance contracts (GIC s), including the recognition and measurement of premium revenue and claim liabilities and requires expanded disclosures about GIC s. SFAS No. 163 does not apply to a GIC that is accounted for as a derivative instrument within the scope of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. Except for certain disclosure requirements regarding insurance enterprise risk-management activities, SFAS No. 163 is effective for financial statements issued for fiscal years beginning after December 15, 2008 and all interim periods within those fiscal years. Early adoption is generally not permitted. The Company estimates that the initial application of SFAS No. 163 will not be material.

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UNITRIN, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1 Basis of Presentation (continued)

In June 2008, the FASB issued FSP Emerging Issues Task Force (EITF) 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*. FSP EITF 03-6-1 concluded that all outstanding share-based payment awards that contain a right to receive nonforfeitable dividends participate in the undistributed earnings with common shareholders, and therefore, the issuing entity is required to apply the two-class method of computing basic and diluted earnings per share, pursuant to SFAS No. 128, *Earnings per Share*. FSP EITF 03-6-1 is effective for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years. Early adoption is prohibited. Upon adoption, all prior-period earnings per share data presented must be adjusted retrospectively to conform to FSP EITF 03-6-1. The Company estimates that its Basic Net Income per Share from Continuing Operations will decrease by no more than $0.01 per common share on an annual basis on the initial and retrospective application of FSP EITF 03-6-1.

Note 2 Acquisition of Business

On April 1, 2008, the Company completed its acquisition of 100% of Primesco, Inc. (Primesco), including its wholly owned subsidiaries, Mutual Savings Life Insurance Company (Mutual Savings Life) and Mutual Savings Fire Insurance Company (Mutual Savings Fire) in a cash merger transaction for a total purchase price of $95.8 million, including transaction costs of $0.2 million. The results of the acquired companies are included in the Company s financial statements from the date of acquisition and are reported in the Company s Life and Health Insurance segment.

The Company has not yet completed the process of estimating the fair value of assets acquired and liabilities assumed. Accordingly, the Company s estimates and allocation may change as the Company completes the process. Due to the complex nature of the valuation calculations, the estimates of fair value that are most likely to change are the estimates of the fair value of the Value of Insurance Inforce, Insurance Reserves and costs associated with exiting certain activities of Primesco. Changes in the Company s preliminary estimates of fair values of assets and liabilities acquired, if any, would also likely impact the Company s allocation of the purchase price to Goodwill and Liabilities for Income Taxes. The Company expects to finalize the allocation of the purchase price to the fair value of the assets acquired and the liabilities assumed in the fourth quarter of 2008. Based on the Company s preliminary allocation of the purchase price, assets acquired and liabilities assumed were:

(Dollars in Millions)	
Investments	$ 399.1
Other Receivables	12.6
Value of Insurance Inforce (Reported in Deferred Policy Acquisition Costs)	52.4
Goodwill	29.3
Other Assets	3.7
Insurance Reserves	(401.9)
Unearned Premiums	(0.2)
Liabilities for Income Taxes	7.5
Accrued Expenses and Other Liabilities	(6.7)
Total Purchase Price	$ 95.8

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UNITRIN, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 3 Discontinued Operations

On June 3, 2008, the Company completed its previously disclosed sale of its Unitrin Business Insurance operations to AmTrust Financial Services, Inc. (AmTrust) for total consideration of $101.8 million. Total consideration consisted of cash, other receivables of $10.9 million, with an outstanding balance of $8.7 million at June 30, 2008, and a note receivable from AmTrust valued at $25.1 million The note receivable is payable in four equal annual installments of $7.5 million and is non-interest bearing. Net proceeds were $94.5 million, including $7.3 million of early contract termination fees and other transaction related costs, of which $6.0 million remained unpaid at June 30, 2008. AmTrust acquired the renewal rights to the Unitrin Business Insurance book of business, certain legal entities, selected other assets, and the workforce that the Company employed to underwrite and process its Unitrin Business Insurance products. The results for discontinued operations for the six and three months ended June 30, 2008 and 2007 are summarized below:

	Six Months Ended		Three Months Ended	
(Dollars in Millions)	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Total Earned Premiums	$ 70.8	$ 83.5	$ 27.6	$ 42.7
Net Investment Income	5.6	12.6	1.9	5.8
Total Revenues	$ 76.4	$ 96.1	$ 29.5	$ 48.5
Income (Loss) from Discontinued Operations before Income Taxes:				
Results of Operations	$ (20.9)	$ 9.5	$ (12.0)	$ 3.7
Gain on Disposition	8.1		8.1	
Income (Loss) from Discontinued Operations before Income Taxes	$ (12.8)	$ 9.5	$ (3.9)	$ 3.7

The effective income tax rate differs from the federal statutory income tax rate due primarily to goodwill that is not deductible for tax purposes, tax-exempt investment income and dividends received deductions. It is the Company s management reporting practice to allocate indirect overhead expenses to all of its insurance operations. In accordance with SFAS No. 144, the Company is not permitted to allocate indirect overhead expenses to discontinued operations. Accordingly, the Company s results for discontinued operations presented above and in the Condensed Consolidated Statements of Operations exclude indirect overhead expenses of $2.3 million and $1.0 million for the six and three months ended June 30, 2008, respectively, compared to $2.6 million and $1.3 million for the six and three months ended June 30, 2007, respectively.

The Company retained Property and Casualty Insurance Reserves for unpaid insured losses that occurred prior to June 1, 2008, the effective date of the sale. In accordance with SFAS No. 144, the Company is not permitted to report these liabilities as Liabilities of Discontinued Operations. Accordingly, Property and Casualty Insurance Reserves as reported in the Company s Condensed Consolidated Balance Sheets at June 30, 2008 and December 31, 2007 include $342.1 million and $342.2 million, respectively, for unpaid insured losses incurred by Unitrin Business Insurance retained by the Company. However, pursuant to the provisions of SFAS No. 144, if there are any changes in the Company s estimate of such retained liabilities after the sale, the impact of these changes will be reported as a separate component of the results of discontinued operations.

UNITRIN, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 4 Automobile Loan Receivables

Automobile Loan Receivables consists primarily of sub-prime loans, which are secured by automobiles, to residents of California and other western and Midwestern states. Automobile Loan Receivables is stated net of unearned discount, loan fees and reserve for loan losses.

The components of Automobile Loan Receivables at June 30, 2008 and December 31, 2007 were:

(Dollars in Millions)	June 30, 2008	Dec. 31, 2007
Sales Contracts and Loans Receivable	$ 1,367.0	$ 1,390.8
Unearned Discounts and Deferred Fees	(21.7)	(28.9)
Net Automobile Loan Receivables Outstanding	1,345.3	1,361.9
Reserve for Loan Losses	(152.2)	(148.4)
Automobile Loan Receivables	$ 1,193.1	$ 1,213.5

The status of loan balances included in Net Automobile Loan Receivables Outstanding at June 30, 2008 and December 31, 2007 is presented below:

(Dollars in Millions)	Amount	As a Percentage of Net Automobile Loan Receivables Outstanding	Amount	As a Percentage of Net Automobile Loan Receivables Outstanding
	June 30, 2008		December 31, 2007	
Current Loan Balances	$ 893.1	66.4%	$ 833.1	61.2%
Delinquent Loan Balance:				
Less than 30 Days Delinquent	310.8	23.1%	356.7	26.2%
30 Days to 59 Days Delinquent	95.1	7.1%	111.1	8.1%
60 Days to 89 Days Delinquent	33.4	2.4%	45.8	3.4%
Delinquent 90 Days and Greater	12.9	1.0%	15.2	1.1%
Net Automobile Loan Receivables Outstanding	1,345.3	100.0%	1,361.9	100.0%
Reserve for Loan Losses	(152.2)		(148.4)	
Automobile Loan Receivables	$ 1,193.1		$ 1,213.5	

Activity in the Reserve for Loan Losses for the six and three months ended June 30, 2008 and 2007 was:

(Dollars in Millions)	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007
Reserve for Loan Losses - Beginning of Period	$ 148.4	$ 68.8	$ 136.6	$ 69.2
Provision for Loan Losses	73.2	34.0	46.0	17.5
Net Charge-off:				
Automobile Loan Receivables Charged-off	(90.8)	(57.4)	(40.5)	(28.0)
Automobile Loan Receivables Recovered	21.4	25.6	10.1	12.3
Net Charge-off	(69.4)	(31.8)	(30.4)	(15.7)
Reserve for Loan Losses - End of Period	$ 152.2	$ 71.0	$ 152.2	$ 71.0

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UNITRIN, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 5 Property and Casualty Insurance Reserves

Property and Casualty Insurance Reserve activity for the six months ended June 30, 2008 and 2007 was:

	Six Months Ended	
(Dollars in Millions)	June 30, 2008	June 30, 2007
Property and Casualty Insurance Reserves -		
Gross of Reinsurance at Beginning of Year	$ 1,322.9	$ 1,432.6
Less Reinsurance Recoverables at Beginning of Year	84.8	137.9
Property and Casualty Insurance Reserves -		
Net of Reinsurance at Beginning of Year	1,238.1	1,294.7
Acquired, Net of Reinsurance	0.2	25.0
Incurred Losses and LAE Related to:		
Current Year:		
Continuing Operations	714.7	641.0
Discontinued Operations	62.7	58.0
Total Incurred Losses and LAE related to Current Year	777.4	699.0
Prior Years:		
Continuing Operations	(36.9)	(33.6)
Discontinued Operations	(1.0)	(14.4)
Total Incurred Losses and LAE related to Prior Years	(37.9)	(48.0)
Total Incurred Losses and LAE	739.5	651.0
Paid Losses and LAE Related to:		
Current Year:		
Continuing Operations	384.8	333.9
Discontinued Operations	19.8	14.4
Total Paid Losses and LAE related to Current Year	404.6	348.3
Prior Years:		
Continuing Operations	291.9	285.7
Discontinued Operations	41.3	47.1
Total Paid Losses and LAE related to Prior Years	333.2	332.8
Total Paid Losses and LAE	737.8	681.1

Property and Casualty Insurance Reserves -		
Net of Reinsurance at End of Period	1,240.0	1,289.6
Plus Reinsurance Recoverable at End of Period	75.2	98.8
Property and Casualty Insurance Reserves -		
Gross of Reinsurance at End of Period	$ 1,315.2	$ 1,388.4

Property and Casualty Insurance Reserves are estimated based on historical experience patterns and current economic trends. Actual loss experience and loss trends are likely to differ from these historical experience patterns and economic conditions. Loss experience and loss trends emerge over several years from the dates of loss inception. The Company monitors such emerging loss trends. Upon concluding, based on the data available, that an emerging loss trend will continue, the Company adjusts its property and casualty insurance reserves to recognize such trend. Changes in such estimates are included in the Condensed Consolidated Statements of Operations in the period of change.

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Note 5 Property and Casualty Insurance Reserves (continued)

For the six months ended June 30, 2008, the Company reduced its property and casualty insurance reserves by $37.9 million, to recognize favorable development of losses and loss adjustment expenses (LAE) from prior accident years. For the six months ended June 30, 2008, personal lines insurance losses and LAE reserves developed favorably by $33.9 million and commercial lines insurance losses and LAE reserves developed favorably by $4.0 million. The personal lines insurance losses and LAE reserves developed favorably due primarily to the emergence of more favorable loss trends than expected for the 2006 and 2005 accident years, partially due to the improvements in the Company s claims handling procedures. For the six months ended June 30, 2007, the Company reduced its property and casualty insurance reserves by $48.0 million to recognize favorable development of losses and LAE from prior accident years. For the six months ended June 30, 2007, personal lines insurance losses and LAE developed favorably by $28.1 million and commercial lines insurance losses and LAE developed favorably by $19.9 million. The reserve reductions were primarily due to the emergence of more favorable loss trends than expected for the 2005 and 2004 accident years, partially due to the improvements in the Company s claims handling procedures.

The Company cannot predict whether losses and LAE will or will not develop favorably or unfavorably from the amounts reported in the Company s condensed consolidated financial statements. However, the Company believes that such development will not have a material effect on the Company s consolidated financial position, but could have a material effect on the Company s consolidated financial results for a given period.

Note 6 Notes Payable

Total debt outstanding at June 30, 2008 and December 31, 2007 was:

(Dollars in Millions)	**June 30, 2008**	**Dec. 31, 2007**
Senior Notes at Amortized Cost:		
6.00% Senior Notes due May 15, 2017	$ 355.2	$ 355.0
4.875% Senior Notes due November 1, 2010	199.2	199.1
Notes Payable under Revolving Credit Agreement	73.0	
Mortgage Note Payable at Amortized Cost	6.0	6.0
Total Debt Outstanding	$ 633.4	$ 560.1

The Company had $73.0 million of outstanding advances under its $325 million, unsecured, revolving credit agreement at June 30, 2008. The Company had no outstanding advances under this agreement at December 31, 2007. Undrawn letters of credit issued pursuant to this agreement were $13.1 million at both June 30, 2008 and December 31, 2007. Accordingly, the amounts available for future borrowing were $238.9 million and $311.9 million at June 30, 2008 and December 31, 2007, respectively.

Interest Expense, including facility fees and accretion of discount, for the six and three months ended June 30, 2008 and 2007 was:

	Six Months Ended	**Three Months Ended**

(Dollars in Millions)	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Notes Payable under Revolving Credit Agreement	$ 0.9	$ 0.2	$ 0.8	$ 0.1
6.00% Senior Notes due May 15, 2017	11.0	3.0	5.5	3.0
4.875% Senior Notes due November 1, 2010	5.0	5.0	2.5	2.5
5.75% Senior Notes due July 1, 2007		9.0		4.5
Mortgage Note Payable	0.2	0.2	0.1	0.1
Interest Expense before Capitalization of Interest	17.1	17.4	8.9	10.2
Capitalization of Interest	(0.5)		(0.3)	
Total Interest Expense	$ 16.6	$ 17.4	$ 8.6	$ 10.2

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Note 6 Notes Payable (continued)

Interest Paid, including facility fees, for the six and three months ended June 30, 2008 and 2007 was:

(Dollars in Millions)	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007
Notes Payable under Revolving Credit Agreement	$ 0.7	$ 0.1	$ 0.6	$ 0.1
6.00% Senior Notes due May 15, 2017	10.8		10.8	
4.875% Senior Notes due November 1, 2010	4.9	4.9	4.9	4.9
5.75% Senior Notes due July 1, 2007		8.6		
Mortgage Note Payable	0.2	0.2	0.1	0.1
Total Interest Paid	$ 16.6	$ 13.8	$ 16.4	$ 5.1

Note 7 Income from Investments

Net Investment Income for the six and three months ended June 30, 2008 and 2007 was:

(Dollars in Millions)	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007
Investment Income:				
Interest and Dividends on Fixed Maturities	$ 117.3	$ 106.5	$ 65.9	$ 52.9
Dividends on Northrop Preferred Stock		9.3		3.1
Dividends on Northrop Common Stock	6.6	5.0	3.4	2.5
Dividends on Other Equity Securities	10.4	11.0	6.4	8.1
Short-term Investments	8.3	18.6	2.8	11.0
Loans to Policyholders	7.1	6.7	3.6	3.3
Real Estate	15.5	15.0	8.0	7.5
Limited Partnerships and Limited Liability Companies	(28.9)	12.4	(19.8)	4.0
Total Investment Income	136.3	184.5	70.3	92.4
Investment Expenses:				
Real Estate	11.8	12.2	5.8	5.9
Other investment Expenses	0.8	0.9	0.4	0.5
Total Investment Expenses	12.6	13.1	6.2	6.4
Net Investment Income Including Discontinued Operations	123.7	171.4	64.1	86.0

Net Investment Income Reported in Discontinued Operations	(5.6)	(12.6)	(1.9)	(5.8)
Net Investment Income	$ 118.1	$ 158.8	$ 62.2	$ 80.2

Dividend income from the Company s investment in Northrop Grumman Corporation (Northrop) preferred stock decreased for the six and three months ended June 30, 2008, compared to the same periods in 2007, due to the timing of the ex-dividend date in 2007, which resulted in two dividend payments in the first quarter of 2007, and the conversion of the Company s preferred stock holdings into Northrop common stock in 2008. Short-term investment income decreased for the six and three months ended June 30, 2008, compared to the same periods in 2007, due primarily to lower yields on short-term investments. Investment income from limited liability investment companies and limited partnerships decreased for the six and three months ended June 30, 2008, compared to the same periods in 2007, due primarily to the Company s pro rata share of unrealized losses from investments recognized in operations by certain of the limited liability investment companies and limited partnerships.

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Note 7 Income from Investments (continued)

The components of Net Realized Investment Gains for the six and three months ended June 30, 2008 and 2007 were:

(Dollars in Millions)	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007
Fixed Maturities:				
Gains on Dispositions	$ 4.5	$ 1.2	$ 4.0	$ 0.7
Losses on Dispositions	(1.2)	(3.7)	(1.1)	(3.7)
Losses from Write-downs	(1.7)	(0.7)	(1.1)	(0.2)
Northrop Common Stock:				
Gains on Dispositions	12.1	26.6	1.8	7.7
Other Equity Securities:				
Gains on Dispositions	27.3	14.8	21.5	10.9
Losses on Dispositions	(5.6)	(0.5)	(4.3)	(0.4)
Losses from Write-downs	(25.1)	(0.3)	(17.2)	
Real Estate:				
Gains on Dispositions	1.5	1.9	1.5	1.9
Other Investments:				
Gains on Dispositions	0.3	0.3	0.3	0.2
Losses on Dispositions	(0.9)	(0.1)	(0.4)	(0.1)
Net Realized Investment Gains	$ 11.2	$ 39.5	$ 5.0	$ 17.0

Note 8 Pension Benefits and Postretirement Benefits Other Than Pensions

The components of Pension Expense for the six and three months ended June 30, 2008 and 2007 were:

(Dollars in Millions)	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007
Service Cost Benefits Earned	$ 6.2	$ 6.7	$ 2.7	$ 3.2
Interest Cost on Projected Benefit Obligation	10.4	10.0	5.1	5.0
Expected Return on Plan Assets	(12.6)	(12.3)	(6.4)	(6.2)
Net Amortization and Deferral		0.3	(0.2)	0.3
Total Pension Expense	$ 4.0	$ 4.7	$ 1.2	$ 2.3

Total Pension Expense presented above includes service cost benefits earned and reported in discontinued operations of $0.7 million and $0.4 million for the six and three months ended June 30, 2008, respectively, compared to $0.6 million and $0.2 million for the same periods in 2007.

The components of Postretirement Benefits Other than Pension Expense for the six and three months ended June 30, 2008 and 2007 were:

(Dollars in Millions)	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007
Service Cost on Benefits Earned	$ 0.1	$ 0.1	$ 0.1	$ 0.1
Interest Cost on Projected Benefit Obligation	1.0	1.0	0.5	0.4
Net Amortization and Deferral	(1.1)	(1.2)	(0.6)	(0.8)
Total Postretirement Benefits Other than Pensions Expense	$	$ (0.1)	$	$ (0.3)

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Note 9 Long-term Equity Compensation Plans

The Company has four stock option plans, all of which have been approved by Unitrin s shareholders. Stock options to purchase Unitrin s common stock are granted at prices equal to the fair market value of Unitrin s common stock on the date of grant to both employees and directors. Employee options generally vest over a period of three and one-half years and expire ten years from the date of grant. Beginning in 2003, options granted to employees were coupled with tandem stock appreciation rights (SAR), settled in Unitrin stock. Options granted to directors are exercisable one year from the date of grant and expire ten years from the date of grant. At June 30, 2008, options to purchase 5,331,840 shares of Unitrin s common stock were outstanding and options to purchase 1,332,027 shares of Unitrin s common stock were available for future grants under the Company s four stock option plans.

To encourage stock ownership, the Company s four stock option plans include provisions, subject to certain limitations beginning in 2006 as described below, to automatically grant restorative, or reload stock options (Restorative Options), to replace shares of previously owned Unitrin common stock that an exercising option holder surrenders, either actually or constructively, to satisfy the exercise price and/or tax withholding obligations relating to the exercise. Restorative Options are subject to the same terms and conditions as the original options, including the expiration date, except that the exercise price is equal to the fair market value of Unitrin common stock on the date of grant and cannot be exercised until six months after the date of grant. The grant of a Restorative Option does not result in an increase in the total number of shares and options held by an employee, but changes the mix of the two.

For original awards granted beginning in 2006 and Restorative Options granted thereunder, Restorative Options will be granted only if, on the date of exercise of the option giving rise to the Restorative Option, the market price of Unitrin common stock exceeds such option s exercise price by 15%. Further, no Restorative Options will be granted if the option giving rise to the Restorative Option is set to expire within twelve months.

In addition, the Company has a restricted stock plan, which has been approved by Unitrin s shareholders. Under this plan, restricted stock and restricted stock units may be granted to all eligible employees. Recipients of restricted stock are entitled to full dividend and voting rights and all awards are subject to forfeiture until certain restrictions have lapsed. As of June 30, 2008, 345,400 shares of restricted stock having a weighted-average grant-date fair value of $44.30 per share have been awarded, of which 33,788 shares were forfeited and 17,640 were tendered to satisfy tax withholding obligations. As of June 30, 2008, there were 706,028 common shares available for future grants.

The Company uses the Black-Scholes option pricing model to estimate the fair value of each option on the date of grant. The expected terms of options are developed by considering the Company s historical share option exercise experience, demographic profiles, historical share retention practices of employees and assumptions about their propensity for early exercise in the future. Further, the Company aggregates individual awards into relatively homogenous groups that exhibit similar exercise behavior to obtain a more refined estimate of the expected term of options. Expected volatility is estimated using weekly historical volatility. The Company believes that historical volatility is currently the best estimate of expected volatility. The dividend yield is the annualized yield on Unitrin common stock on the date of grant for all original grants made after 2005. For Restorative Options, the annualized yield on Unitrin common stock for the month prior to the grant of the Restorative Option is used for all restorative grants made after 2005. For all grants made in years prior to 2006, the dividend yield on Unitrin common stock was a five-year moving average. No assumption for any future dividend rate change is included in the current expected dividend yield assumption. The risk free interest rate is the yield on the grant date of U.S. Treasury zero coupon issues with a maturity comparable to the expected term of the option.

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Note 9 Long-term Equity Compensation Plans (continued)

The assumptions used in the Black-Scholes pricing model for options granted during the six months ended June 30, 2008 and 2007 were as follows:

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Range of Valuation Assumptions		
Expected Volatility	22.36% - 24.52%	17.57% - 22.55%
Risk Free Interest Rate	2.18% - 3.39%	4.45% - 4.81%
Expected Dividend Yield	3.86% - 5.49%	3.51% - 3.96%
Weighted-Average Expected Life		
Employee Grants	2.5 - 7.5 years	2 - 7 years
Director Grants	4 - 6.5 years	4 - 6 years

Option and SAR activity for the six months ended June 30, 2008 is presented below:

	Shares Subject to Options	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Life (in Years)	Aggregate Intrinsic Value ($ in Millions)
Outstanding at Beginning of the Year	5,275,958	$ 46.95		
Granted	497,941	37.31		
Exercised	(69,746)	32.76		
Forfeited or Expired	(372,313)	48.74		
Outstanding at June 30, 2008	5,331,840	$ 46.11	5.20	$ 0.2
Vested and Expected to Vest	5,242,064	$ 46.19	5.64	$ 1.0