UNITRIN INC
Form 10-Q
October 29, 2007
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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 September 30, 2007

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	**(I.R.S. Employer**
incorporation or organization)	**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

64,764,178 shares of common stock, $0.10 par value, were outstanding as of October 26, 2007.

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UNITRIN, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Dollars in millions, except per share amounts)

(Unaudited)

	Nine Months Ended Sept. 30, 2007	Nine Months Ended Sept. 30, 2006	Three Months Ended Sept. 30, 2007	Three Months Ended Sept. 30, 2006
Revenues:				
Earned Premiums	$ 1,712.6	$ 1,719.3	$ 579.9	$ 575.1
Consumer Finance Revenues	197.8	184.3	67.9	64.3
Net Investment Income	231.4	208.0	74.6	71.4
Other Income	2.7	13.4	0.5	11.7
Net Realized Investment Gains	52.0	23.7	12.5	3.1
Total Revenues	2,196.5	2,148.7	735.4	725.6
Expenses:				
Policyholders Benefits and Incurred Losses and Loss Adjustment Expenses	1,168.0	1,125.6	383.6	361.0
Insurance Expenses	525.4	538.7	179.6	182.0
Consumer Finance Expenses	190.3	146.2	76.7	53.7
Interest and Other Expenses	52.2	47.2	16.1	15.5
Total Expenses	1,935.9	1,857.7	656.0	612.2
Income from Continuing Operations before Income Taxes and Equity in Net Income of Investee	260.6	291.0	79.4	113.4
Income Tax Expense	77.6	91.2	22.7	35.0
Income from Continuing Operations before Equity in Net Income of Investee	183.0	199.8	56.7	78.4
Equity in Net Income of Investee	0.7	8.6	0.9	1.4
Income from Continuing Operations	183.7	208.4	57.6	79.8
Discontinued Operations:				
Income from Discontinued Operations Before Income Taxes	18.2	14.4	8.7	7.7
Income Tax Expense	3.0	1.3	2.0	1.4
Income from Discontinued Operations	15.2	13.1	6.7	6.3
Net Income	$ 198.9	$ 221.5	$ 64.3	$ 86.1
Income Per Share from Continuing Operations	$ 2.79	$ 3.06	$ 0.89	$ 1.18
Income Per Share from Discontinued Operations	0.23	0.19	0.10	0.09
Net Income Per Share	$ 3.02	$ 3.25	$ 0.99	$ 1.27
Income Per Share from Continuing Operations Assuming Dilution	$ 2.77	$ 3.04	$ 0.88	$ 1.18

Income Per Share from Discontinued Operations Assuming Dilution	0.23	0.19	0.10	0.09
Net Income Per Share Assuming Dilution	$ 3.00	$ 3.23	$ 0.98	$ 1.27

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)

	September 30, 2007 (Unaudited)	December 31, 2006
Assets:		
Investments:		
Fixed Maturities at Fair Value (Amortized Cost: 2007 - $3,761.4; 2006 - $3,780.3)	$ 3,788.1	$ 3,832.9
Northrop Grumman Corporation Preferred Stock at Fair Value (Cost: 2007 - $177.5; 2006 - $177.5)	257.7	236.0
Northrop Grumman Corporation Common Stock at Fair Value (Cost: 2007 - $271.3; 2006 - $318.8)	490.5	500.3
Other Equity Securities at Fair Value (Cost: 2007 - $415.1; 2006 - $407.8)	602.7	569.3
Investee (Intermec) at Cost Plus Cumulative Undistributed Earnings (Fair Value: 2007 - $330.6; 2006 - $307.2)	88.9	92.7
Short-term Investments at Cost which Approximates Fair Value	639.1	465.2
Other	687.0	594.6
Total Investments	6,554.0	6,291.0
Cash	49.0	157.9
Consumer Finance Receivables at Cost, Net (Fair Value: 2007 - $1,299.9; 2006 - $1,231.4)	1,296.2	1,227.0
Other Receivables	673.9	730.4
Deferred Policy Acquisition Costs	451.0	444.7
Goodwill	314.7	344.7
Other Assets	113.7	125.7
Assets of Discontinued Operations	129.5	
Total Assets	$ 9,582.0	$ 9,321.4
Liabilities and Shareholders Equity:		
Insurance Reserves:		
Life and Health	$ 2,529.7	$ 2,486.1
Property and Casualty	1,354.5	1,432.6
Total Insurance Reserves	3,884.2	3,918.7
Certificates of Deposits at Cost (Fair Value: 2007 - $1,280.7; 2006 - $1,154.6)	1,285.4	1,162.7
Unearned Premiums	754.3	778.9
Liabilities for Income Taxes	305.0	285.1
Notes Payable at Amortized Cost (Fair Value: 2007 - $554.2; 2006 - $501.3)	560.1	504.5
Accrued Expenses and Other Liabilities	411.9	387.5
Liabilities of Discontinued Operations	56.7	
Total Liabilities	7,257.6	7,037.4
Shareholders Equity:		
Common Stock, $0.10 par value, 100 million Shares Authorized; 64,718,851 Shares Issued and Outstanding at September 30, 2007 and 66,991,352 Shares Issued and Outstanding at December 31, 2006	6.5	6.7
Paid-in Capital	780.2	759.1
Retained Earnings	1,215.0	1,231.2
Accumulated Other Comprehensive Income	322.7	287.0

Total Shareholders Equity		2,324.4		2,284.0
Total Liabilities and Shareholders Equity	$	9,582.0	$	9,321.4

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)

	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
Operating Activities:		
Net Income	$ 198.9	$ 221.5
Adjustments to Reconcile Net Income to Net Cash Provided (Used) by Operating Activities:		
Increase in Deferred Policy Acquisition Costs	(8.6)	(14.4)
Equity in Net Income of Investee before Taxes	(1.1)	(13.3)
Net Activity of Limited Partnerships and Limited Liability Companies	(1.2)	(5.0)
Amortization of Investments	4.7	5.2
Depreciation of Fixed Assets	15.4	16.7
Decrease in Other Receivables	28.6	64.3
Decrease in Insurance Reserves	(62.6)	(31.5)
Increase in Unearned Premiums	13.8	5.3
Increase in Liabilities for Income Taxes	4.4	
Increase (Decrease) in Accrued Expenses and Other Liabilities	0.9	(34.0)
Net Realized Investment Gains	(52.0)	(23.7)
Provision for Loan Losses	69.5	41.9
Other, Net	18.6	6.6
Net Cash Provided by Operating Activities	229.3	239.6
Investing Activities:		
Sales and Maturities of Fixed Maturities	360.9	387.9
Purchases of Fixed Maturities	(320.8)	(245.3)
Sales of Northrop Grumman Corporation Common Stock	82.8	17.5
Sales of Other Equity Securities	84.1	72.7
Purchases of Other Equity Securities	(75.7)	(135.6)
Change in Short-term Investments	(158.9)	(62.5)
Acquisition and Improvements of Investment Real Estate	(15.6)	(9.6)
Sales of Investment Real Estate	3.3	
Acquisition of Business, Net of Cash Acquired	(46.9)	
Disposition of Business, Net of Cash Disposed	3.9	
Change in Other Investments	(85.4)	(71.9)
Change in Consumer Finance Receivables	(138.0)	(159.5)
Other, Net	(10.2)	5.2
Net Cash Used by Investing Activities	(316.5)	(201.1)
Financing Activities:		
Change in Certificates of Deposits	122.7	113.1
Change in Universal Life and Annuity Contracts	3.0	3.5
Notes Payable Proceeds	354.9	20.0
Notes Payable Payments	(300.1)	(20.1)
Cash Dividends Paid	(90.4)	(90.3)

Common Stock Repurchases	(116.3)	(72.6)
Cash Exercise of Stock Options	3.3	4.0
Excess Tax Benefits from Share-based Awards	1.2	2.4
Net Cash Used by Financing Activities	(21.7)	(40.0)
Decrease in Cash	(108.9)	(1.5)
Cash, Beginning of Year	157.9	44.5
Cash, End of Period	$ 49.0	$ 43.0

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

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Note 1 Basis of Presentation

The unaudited 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. and its subsidiaries (Unitrin or the Company). 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 unaudited 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 unaudited 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, 2006 (the 2006 Annual Report).

Discontinued Operations

On September 5, 2007, the Company reached an agreement in principle to sell its Unitrin Business Insurance operations to AmTrust Financial Services, Inc. (AmTrust) in a cash transaction. The transaction is subject to the negotiation and execution of a definitive agreement, approvals by insurance regulators and other customary closing conditions. The transaction is expected to close in 2008. Under the provisions of Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, the 2007 results of the Unitrin Business Insurance operations are classified as discontinued operations and certain amounts for prior periods have been reclassified to conform with the current presentation (see Note 3, Discontinued Operations to the Condensed Consolidated Financial Statements).

Accounting Changes

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. (FIN) 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized under SFAS No. 109, *Accounting for Income Taxes.* FIN 48 prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and also provides guidance on various related matters such as derecognition, interest and penalties, and disclosure. On January 1, 2007, the Company adopted FIN 48. The initial application of FIN 48 to the Company s tax positions had no effect on the Company s Shareholders Equity. The Company accounts for its investment in its investee, Intermec, Inc. (Intermec), under the equity method of accounting on a three-month-delay basis. Accordingly, the Company recognized its pro rata share of the effect of Intermec s adoption of FIN 48 in the Company s financial statements in the second quarter of 2007. Based on Intermec s disclosure in its Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2007, the impact of Intermec s initial application of FIN 48 resulted in the Company recognizing a reduction in the Company s Shareholders Equity of $0.9 million, which was net of a tax benefit of $0.5 million.

In September 2006, the 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. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company estimates that the initial application of SFAS No. 157 will not be material.

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Note 1 Basis of Presentation (continued)

In September 2006, the FASB issued SFAS No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans*. SFAS No. 158 amends SFAS No. 87, *Employers Accounting for Pensions*, SFAS No. 88, *Employers Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and Termination Benefits*, SFAS No. 106, *Employers Accounting for Postretirement Benefits Other Than Pensions*, and SFAS No. 132(R), *Employers Disclosure about Pensions and Other Postretirement Benefits*. SFAS No. 158 requires the recognition of the funded status of a defined benefit postretirement plan (other than a multi-employer plan) as an asset or liability in the statement of financial position and the recognition of changes in the funded status through comprehensive income in the year in which such changes occur. The Company adopted the recognition provisions of SFAS No. 158 and initially applied them to the funded status of its defined benefit postretirement plans and provided the required disclosures as of December 31, 2006. The Company s investee, Intermec, recognized the financial impact of SFAS No. 158 in its financial statements at December 31, 2006. The Company accounts for its investment in Intermec under the equity method of accounting on a three-month-delay basis. Accordingly, the Company recognized a decrease of $2.3 million, which was net of a tax benefit of $1.3 million, to its Shareholders Equity in the first quarter of 2007 for its pro rata share of the impact of Intermec s adoption of SFAS No. 158.

The incremental effect of the Company recognizing its pro rata share of the impact of Intermec s initial application of SFAS No. 158 on individual lines of the Condensed Consolidated Balance Sheet at September 30, 2007 was:

(Dollars in Millions)	Before Application of SFAS No. 158 by Investee	Incremental Effect of Applying SFAS No. 158 by Investee	After Application of SFAS No. 158 by Investee
Investment in Investee (Intermec)	$ 92.5	$ (3.6)	$ 88.9
Total Investments	6,557.6	(3.6)	6,554.0
Total Assets	9,585.6	(3.6)	9,582.0
Liabilities for Income Taxes	306.3	(1.3)	305.0
Total Liabilities	7,258.9	(1.3)	7,257.6
Accumulated Other Comprehensive Income	325.0	(2.3)	322.7
Total Shareholders Equity	2,326.7	(2.3)	2,324.4
Total Liabilities and Shareholders Equity	9,585.6	(3.6)	9,582.0

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. The Company has not yet determined the manner or the impact of adoption of SFAS No. 159 on the Company.

Note 2 Acquisition of Business

On June 29, 2007, Trinity Universal Insurance Company (Trinity), a subsidiary of the Company, completed its acquisition of 100% of Merastar Industries, Ltd., including its wholly owned subsidiary, Merastar Insurance Company (Merastar) in a cash transaction for a total purchase price of $47.9 million, including transaction costs of $0.7 million. Beginning with the Company s third quarter of 2007, the results of the acquisition have been included in the Company s financial statements from the date of acquisition and are reported in the Company s Unitrin Direct segment.

Merastar provides automobile and homeowners insurance and is licensed in 48 states. The Company s preliminary estimate of the fair value of the net assets acquired exceeds the purchase price. Such excess has been allocated to reduce the estimated fair value of non-financial assets acquired in accordance with SFAS No. 141, *Business Combinations.*

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Note 2 Acquisition of Business (continued)

The Company has not yet completed the process of estimating the fair value of the assets acquired and the 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 Insurance Reserves and the Value of Insurance In Force. Changes in the Company s estimates of fair value, if any, would be included in the period in which such changes occur. 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 2007. Based on the Company s preliminary allocation of the purchase price, assets acquired and liabilities assumed were:

(Dollars in Millions)	
Investments	$ 58.7
Cash	1.0
Other Receivables	11.5
Value of Insurance In Force	13.0
Value of Licenses Acquired	5.8
Other Assets	0.6
Insurance Reserves	(25.0)
Unearned Premiums	(12.5)
Liabilities for Income Taxes	(0.1)
Accrued Expenses and Other Liabilities	(5.1)
Total Purchase Price	$ 47.9

Note 3 Discontinued Operations

The Company accounts for its Unitrin Business Insurance operations as discontinued operations in accordance with SFAS No. 144 (See Note 1, Basis of Presentation, to the Condensed Consolidated Financial Statements). In accordance with SFAS No. 144, the Company has reclassified the results of Unitrin Business Insurance for prior periods to conform to the current presentation. Results for discontinued operations for the nine and three months ended September 30, 2007 and 2006 are presented below:

(Dollars in Millions)	Nine Months Ended Sept. 30, 2007	Nine Months Ended Sept. 30, 2006	Three Months Ended Sept. 30, 2007	Three Months Ended Sept. 30, 2006
Total Earned Premiums	$ 127.4	$ 140.5	$ 43.9	$ 46.9
Net Investment Income	18.8	21.1	6.2	6.4
Other Income		1.3		
Total Revenues	146.2	162.9	50.1	53.3
Incurred Losses and Loss Adjustment Expenses	63.2	82.4	19.6	24.4
Insurance Expenses	64.8	66.1	21.8	21.2
Income from Discontinued Operations before Income Taxes	18.2	14.4	8.7	7.7
Income Tax Expense	3.0	1.3	2.0	1.4
Income from Discontinued Operations	$ 15.2	$ 13.1	$ 6.7	$ 6.3

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, however, 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 Income exclude indirect overhead expenses of $3.8 million and $1.2 million for the nine and three months ended September 30, 2007, respectively, and $4.5 million and $1.4 million for the nine and three months ended September 30, 2006, respectively. The effective income tax rate for discontinued operations differs from the federal statutory income tax rate due primarily to tax-exempt investment income and dividends received deductions. Tax-exempt investment income and dividends received deductions were $9.8 million and $3.2 million for the nine and three months ended September 30, 2007, respectively, and $10.9 million and $3.6 million for the nine and three months ended September 30, 2006, respectively.

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Note 3 Discontinued Operations (continued)

The components of Assets of Discontinued Operations and Liabilities of Discontinued Operations at September 30, 2007 were:

(Dollars in Millions)	
Assets:	
Investments:	
Fixed Maturities at Fair Value (Amortized Cost - $28.4)	$ 29.5
Short-term Investments at Cost which Approximates Fair Value	8.9
Total Investments	38.4
Other Receivables	38.0
Deferred Policy Acquisition Costs	15.4
Goodwill	30.0
Other Assets	7.7
Total Assets of Discontinued Operations	129.5
Liabilities:	
Unearned Premiums	50.8
Liabilities for Income Taxes	5.9
Total Liabilities of Discontinued Operations	56.7
Net Assets of Discontinued Operations	$ 72.8

The Company will retain Property and Casualty Insurance Reserves for unpaid insured losses that have occurred and will occur prior to 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 Sheet at September 30, 2007 include $367.0 million for unpaid insured losses incurred by Unitrin Business Insurance. 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.

Note 4 Catastrophe Reinsurance

The Company maintains three separate catastrophe reinsurance programs for its property and casualty insurance businesses. Coverage for each reinsurance program is provided in three layers.

The annual program covering the Company s Unitrin Direct, Unitrin Specialty and Unitrin Business Insurance operations provides, effective January 1, 2007, reinsurance coverage of 100% of reinsured catastrophe losses of $36 million above retention of $4 million. In 2006, the annual program covering these segments also provided reinsurance coverage of 100% of reinsured catastrophe losses of $36 million above retention of $4 million. The aggregate annual premium, excluding reinstatement premium, for the 2007 annual program covering these segments is $2.6 million, compared to an annual cost of $1.9 million, excluding reinstatement premium, for the 2006 annual program. The 2007 and 2006 annual programs covering these segments do not include Merastar. The annual program covering Merastar was effective on March 31, 2007 and provides reinsurance coverage of 97.5% of reinsured catastrophe losses of $7.25 million above retention of $0.75 million. The aggregate annual premium, excluding reinstatement premium, for the Merastar annual program is $0.4 million.

The annual program covering the property insurance operations of the Company s Life and Health Insurance segment was changed to provide, effective January 1, 2007, reinsurance coverage of 100% of reinsured catastrophe losses of $120 million above retention of $10 million. In 2006, the annual program covering this segment provided reinsurance coverage of 100% of reinsured catastrophe losses of $90 million above retention of $10 million. The aggregate annual premium, excluding reinstatement premium, for the 2007 annual program covering this segment is $9.3 million, compared to an annual cost of $6.1 million, excluding reinstatement premium, for the 2006 annual program.

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Note 4 Catastrophe Reinsurance (continued)

The Company has established, effective April 1, 2007, a new annual program covering the Company s Kemper segment on terms that are different from the prior annual program. Under the new annual program, the first layer provides reinsurance coverage of approximately 62% of reinsured catastrophe losses of $30 million above retention of $40 million. The second layer under the new annual program provides reinsurance coverage of approximately 90% of reinsured catastrophe losses of $80 million above retention of $70 million. The third layer under the new annual program provides reinsurance coverage of approximately 90% of reinsured catastrophe losses of $100 million above retention of $150 million. Under the prior annual program, which was effective July 1, 2006 and was terminated effective with the new annual program, the first layer provided reinsurance coverage of approximately 65% of reinsured catastrophe losses of $30 million above retention of $40 million. The second layer under the prior annual program provided reinsurance coverage of approximately 88% of reinsured catastrophe losses of $80 million above retention of $70 million. The third layer under the prior annual program provided reinsurance coverage of approximately 80% of reinsured catastrophe losses of $100 million above retention of $150 million. The aggregate annual premium, excluding reinstatement premium, for Kemper s new annual program is $20.1 million, compared to an annual cost of $19.5 million, excluding reinstatement premium, for the prior program.

In addition, in the event that the Company s incurred catastrophe losses and loss adjustment expenses (LAE) covered by any of its three catastrophe reinsurance programs exceed the retention for that particular program, each of the programs requires one reinstatement of such coverage. In such an instance, the Company is required to pay a reinstatement premium to the reinsurers to reinstate the full amount of reinsurance available under such program. The reinstatement premium is a percentage of the original premium based on the ratio of the losses exceeding the Company s retention to the reinsurers coverage limit. In addition to these programs, the Company purchases reinsurance from the Florida Hurricane Catastrophe Fund for hurricane losses in the state of Florida at retentions lower than those described above.

Note 5 Notes Payable

On May 11, 2007, the Company issued $360 million of its 6.00% senior notes due May 15, 2017 (the 6.00% Senior Notes). The 6.00% Senior Notes are unsecured and may be redeemed in whole at any time or in part from time to time at the Company s option at specified redemption prices. The Company issued the 6.00% Senior Notes for proceeds of $354.9 million, net of transaction costs, for an effective yield of 6.19%. The Company used a portion of the proceeds from the sale of the 6.00% Senior Notes to repay the $300 million aggregate principal amount of its 5.75% senior notes which matured in the third quarter of 2007.

Total Debt Outstanding at September 30, 2007 and December 31, 2006 was:

(Dollars in Millions)	Sept. 30, 2007	Dec. 31, 2006
Senior Notes at Amortized Cost:		
5.75% Senior Notes due July 1, 2007	$	$ 299.6
4.875% Senior Notes due November 1, 2010	199.0	198.8
6.00% Senior Notes due May 15, 2017	355.1	
Mortgage Note Payable at Amortized Cost	6.0	6.1
Total Debt Outstanding	$ 560.1	$ 504.5

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Note 5 Notes Payable (continued)

The Company had no outstanding advances under its $325 million, unsecured, revolving credit agreement at September 30, 2007 or December 31, 2006. Undrawn letters of credit issued pursuant to the unsecured, revolving credit agreement were $13.1 million at both September 30, 2007 and December 31, 2006. Accordingly, the amounts available for future borrowing were $311.9 million at both September 30, 2007 and December 31, 2006.

Interest Paid, including facility fees, for the nine and three months ended September 30, 2007 and 2006 was:

	Nine Months Ended		Three Months Ended	
(Dollars in Millions)	Sept. 30, 2007	Sept. 30, 2006	Sept. 30, 2007	Sept. 30, 2006
Notes Payable under Revolving Credit Agreement	$ 0.2	$ 0.3	$ 0.1	$
5.75% Senior Notes due July 1, 2007	17.2	17.2	8.6	8.6
4.875% Senior Notes due November 1, 2010	4.9	4.9		
6.00% Senior Notes due May 15, 2017				
Mortgage Note Payable	0.3	0.3	0.1	0.1
Total Interest Paid	$ 22.6	$ 22.7	$ 8.8	$ 8.7

Interest Expense, including facility fees and accretion of discount, for the nine and three months ended September 30, 2007 and 2006 was:

	Nine Months Ended		Three Months Ended	
(Dollars in Millions)	Sept. 30, 2007	Sept. 30, 2006	Sept. 30, 2007	Sept. 30, 2006
Notes Payable under Revolving Credit Agreement	$ 0.3	$ 0.3	$ 0.1	$
5.75% Senior Notes due July 1, 2007	9.0	13.5		4.6
4.875% Senior Notes due November 1, 2010	7.5	7.5	2.5	2.5
6.00% Senior Notes due May 15, 2017	8.5		5.5	
Mortgage Note Payable	0.3	0.3	0.1	0.1
Total Interest Expense	$ 25.6	$ 21.6	$ 8.2	$ 7.2

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Note 6 Net Income Per Share

Net Income Per Share and Net Income Per Share Assuming Dilution for the nine and three months ended September 30, 2007 and 2006 were as follows:

(Dollars and Shares in Millions, Except Per Share Amounts)	Nine Months Ended Sept. 30, 2007	Nine Months Ended Sept. 30, 2006	Three Months Ended Sept. 30, 2007	Three Months Ended Sept. 30, 2006
Income from Continuing Operations	$ 183.7	$ 208.4	$ 57.6	$ 79.8
Income from Discontinued Operations	15.2	13.1	6.7	6.3
Dilutive Effect on Income from Continuing Operations from Investee s Equivalent Shares	(0.1)	(0.2)	(0.1)	
Net Income Assuming Dilution	$ 198.8	$ 221.3	$ 64.2	$ 86.1
Weighted Average Common Shares Outstanding	65.9	68.2	65.0	67.7
Dilutive Effect of Unitrin Share-based Compensation Plans	0.4	0.3	0.3	0.2
Weighted Average Common Shares and Equivalent Shares Outstanding Assuming Dilution	66.3	68.5	65.3	67.9
Income Per Share from Continuing Operations	$ 2.79	$ 3.06	$ 0.89	$ 1.18
Income Per Share from Discontinued Operations	0.23	0.19	0.10	0.09
Net Income Per Share	$ 3.02	$ 3.25	$ 0.99	$ 1.27
Income Per Share from Continuing Operations Assuming Dilution	$ 2.77	$ 3.04	$ 0.88	$ 1.18
Income Per Share from Discontinued Operations Assuming Dilution	0.23	0.19	0.10	0.09
Net Income Per Share Assuming Dilution	$ 3.00	$ 3.23	$ 0.98	$ 1.27

Options outstanding at September 30, 2007 and 2006 to purchase 3.8 million shares and 3.6 million shares, respectively, of Unitrin common stock were excluded from the computation of Net Income Per Share Assuming Dilution for the nine months ended September 30, 2007 and 2006, respectively, because the exercise prices exceeded the average market price.

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Note 7 Comprehensive Income

Other Comprehensive Income for the nine and three months ended September 30, 2007 and 2006 was:

(Dollars in Millions)	Nine Months Ended Sept. 30, 2007	Nine Months Ended Sept. 30, 2006	Three Months Ended Sept. 30, 2007	Three Months Ended Sept. 30, 2006
Other Comprehensive Income, Before Tax:				
Unrealized Holding Gains (Losses) Arising During the Period Before Reclassification Adjustment	$ 106.3	$ 69.5	$ 57.0	$ 161.8
Reclassification Adjustment for Amounts Included in Net Income	(45.7)	(23.7)	(8.3)	(3.1)
Unrealized Holding Gains (Losses)	60.6	45.8	48.7	158.7
Equity in Other Comprehensive Income (Loss) of Investee	0.3	(2.4)	0.5	0.6
Amortization of Unrecognized Postretirement Benefit Costs	(1.4)		(0.4)	
Other Comprehensive Income Before Tax	59.5	43.4	48.8	159.3
Income Tax Benefit (Expense):				
Unrealized Holding Gains and Losses Arising During the Period Before Reclassification Adjustment	(37.9)	(24.3)	(20.2)	(56.7)
Reclassification Adjustment for Amounts Included in Net Income	16.0	8.3	2.9	1.1
Unrealized Holding Gains and Losses	(21.9)	(16.0)	(17.3)	(55.6)
Equity in Other Comprehensive Loss of Investee	(0.1)	0.8	(0.1)	(0.3)
Amortization of Unrecognized Postretirement Benefit Costs	0.5		0.2	
Income Tax Benefit (Expense)	(21.5)	(15.2)	(17.2)	(55.9)
Other Comprehensive Income	$ 38.0	$ 28.2	$ 31.6	$ 103.4

Total Comprehensive Income for the nine months ended September 30, 2007 and 2006 was $236.9 million and $249.7 million, respectively. Total Comprehensive Income for the three months ended September 30, 2007 and 2006 was $95.9 million and $189.5 million, respectively.

The components of Accumulated Other Comprehensive Income at September 30, 2007 and December 31, 2006 were:

(Dollars in Millions)	Sept. 30, 2007	Dec. 31, 2006
Net Unrealized Gains on Investments, Net of Income Taxes	$ 332.9	$ 294.8
Net Unrealized Gains on Assets of Discontinued Operations, Net of Income Taxes	0.7	
Equity in Accumulated Other Comprehensive Loss of Investee, Net of Income Taxes	(2.7)	(0.5)
Net Unrecognized Postretirement Benefit Costs, Net of Income Taxes	(8.2)	(7.3)
Total Accumulated Other Comprehensive Income	$ 322.7	$ 287.0

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Note 8 Income from Investments

Net Investment Income for the nine and three months ended September 30, 2007 and 2006 was:

(Dollars in Millions)	Nine Months Ended Sept. 30, 2007	Nine Months Ended Sept. 30, 2006	Three Months Ended Sept. 30, 2007	Three Months Ended Sept. 30, 2006
Investment Income:				
Interest and Dividends on Fixed Maturities	$ 157.5	$ 158.2	$ 52.8	$ 53.4
Dividends on Northrop Preferred Stock	12.4	9.3	3.1	6.2
Dividends on Northrop Common Stock	7.3	6.4	2.3	2.2
Dividends on Other Equity Securities	13.8	7.9	2.8	2.6
Short-term Investments	26.2	19.4	7.8	6.8
Loans to Policyholders	10.0	9.8	3.3	3.3
Real Estate	23.0	20.7	8.0	6.9
Limited Partnerships and Limited Liability Companies	18.8	14.0	6.4	1.9
Other		0.1		0.1
Total Investment Income	269.0	245.8	86.5	83.4
Real Estate and Other Investment Expenses	18.8	16.7	5.7	5.6
Net Investment Income Including Discontinued Operations	250.2	229.1	80.8	77.8
Net Investment Income Reported in Discontinued Operations	(18.8)	(21.1)	(6.2)	(6.4)
Net Investment Income	$ 231.4	$ 208.0	$ 74.6	$ 71.4

Dividend income from the Company s investment in Northrop Grumman Corporation (Northrop) preferred stock increased for the nine months ended September 30, 2007 and decreased for the three months ended September 30, 2007, compared to the same periods in 2006, due to the timing of ex-dividend dates. Dividend income from other equity securities increased for the nine months ended September 30, 2007, compared to the same period in 2006, due primarily to a dividend of $5.2 million from the Company s equity investment in IRI Holdings, Inc. Short-term investment income increased for the nine months ended September 30, 2007, compared to the same period in 2006, due primarily to higher levels of short-term investments. The Company invested the proceeds from the issuance of its 6.00% Senior Notes in short-term investments until the principal on its 5.75% Senior Notes was repaid in the third quarter of 2007. Investment income from limited partnerships and limited liability companies increased for the nine and three months ended September 30, 2007, compared to the same periods in 2006, due primarily to higher levels of investments and higher yields on investments.

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Note 8 Income from Investments (continued)

The components of Net Realized Investment Gains for the nine and three months ended September 30, 2007 and 2006 were:

(Dollars in Millions)	Nine Months Ended Sept. 30, 2007	Nine Months Ended Sept. 30, 2006	Three Months Ended Sept. 30, 2007	Three Months Ended Sept. 30, 2006
Fixed Maturities:				
Gains on Dispositions	$ 2.6	$ 4.1	$ 1.4	$ 2.1
Losses on Dispositions	(3.8)	(4.4)	(0.1)	
Losses from Write-downs	(1.0)		(0.3)	
Northrop Common Stock:				
Gains on Dispositions	35.3	5.6	8.7	
Other Equity Securities:				
Gains on Dispositions	20.6	21.6	5.8	1.8
Losses on Dispositions	(1.0)	(1.1)	(0.5)	(0.3)
Losses from Write-downs	(7.0)	(2.1)	(6.7)	(0.4)
Real Estate:				
Gains on Dispositions	1.9			
Losses from Write-downs		(0.1)		(0.1)
Other Investments:				
Gains on Dispositions	4.6	0.4	4.3	0.1
Losses on Dispositions	(0.2)	(0.3)	(0.1)	(0.1)
Net Realized Investment Gains	$ 52.0	$ 23.7	$ 12.5	$ 3.1

Note 9 Pension Benefits and Postretirement Benefits Other Than Pensions

The components of Pension Expense for the nine and three months ended September 30, 2007 and 2006 were:

(Dollars in Millions)	Nine Months Ended Sept. 30, 2007	Nine Months Ended Sept. 30, 2006	Three Months Ended Sept. 30, 2007	Three Months Ended Sept. 30, 2006
Service Cost Benefits Earned	$ 10.1	$ 10.5	$ 3.4	$ 3.5
Interest Cost on Projected Benefit Obligations	15.0	14.2	5.0	4.7
Expected Return on Plan Assets	(18.5)	(17.0)	(6.2)	(5.7)
Net Amortization and Deferral	0.4	1.4	0.1	0.5
Total Pension Expense	$ 7.0	$ 9.1	$ 2.3	$ 3.0

Total Pension Expense presented above includes service cost benefits earned and reported in discontinued operations of $0.9 million and $0.3 million for the nine and three months ended September 30, 2007, respectively, and $1.1 million and $0.4 million for the nine and three months ended September 30, 2006, respectively.

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Note 9 Pension Benefits and Postretirement Benefits Other Than Pensions (continued)

The components of Postretirement Benefits Other than Pension (Income) Expense for the nine and three months ended September 30, 2007 and 2006 were:

	Nine Months Ended		Three Months Ended	
(Dollars in Millions)	**Sept. 30, 2007**	**Sept. 30, 2006**	**Sept. 30, 2007**	**Sept. 30, 2006**
Service Cost Benefits Earned	$ 0.1	$ 0.1	$	$
Interest Cost on Projected Benefit Obligations	1.5	1.9	0.5	0.6
Net Amortization and Deferral	(1.8)	(1.4)	(0.6)	(0.4)
Total Postretirement Benefits Other than Pension (Income) Expense	$ (0.2)	$ 0.6	$ (0.1)	$ 0.2

Note 10 Long-term Equity Compensation Plans

The Company has four stock option plans, all of which have been approved by the Company s shareholders. Stock options to purchase the Company s common stock are granted at prices equal to the fair market value of the Company 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 Company stock. Options granted to directors are exercisable one year from the date of grant and expire ten years from the date of grant. At September 30, 2007, options to purchase 5,359,442 shares of the Company s common stock were outstanding and options to purchase 1,514,825 shares of the Company 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, in order 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.

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 the Company 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 September 30, 2007, 247,000 shares of restricted stock having a weighted-average grant-date fair value of $46.90 per share have been awarded, of which 16,488 shares were forfeited and 17,640 were tendered to satisfy tax withholding obligations. 787,128 common shares remain 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 in order 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

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Note 10 Long-term Equity Compensation Plans (continued)

made 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. The assumptions used in the Black-Scholes pricing model for options granted during the nine months ended September 30, 2007 and 2006 were as follows:

	Nine Months Ended Sept. 30, 2007	Nine Months Ended Sept. 30, 2006
Range of Valuation Assumptions		
Expected Volatility	17.47% -22.55%	19.27% -23.60%
Risk Free Interest Rate	4.26% -4.94%	4.30% -5.14%
Expected Dividend Yield	3.51% -4.18%	3.55% -4.25%
Weighted-Average Expected Life		
Employee Grants	2 -7 years	2 -7 years
Director Grants	4 -6 years	4 -6 years

Option and SAR activity for the nine months ended September 30, 2007 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	5,244,954	$ 45.50		
Granted	1,417,013	49.34		
Exercised	(1,148,373)	43.40		
Forfeited or Expired	(154,152)	49.41		
Outstanding at September 30, 2007	5,359,442	$ 46.85	5.32	$ 16.3
Vested and Expected to Vest	5,258,836	$ 46.85	5.27	$ 16.0
Exercisable at September 30, 2007	3,706,953	$ 46.17	4.89	$ 14.1

The weighted-average grant-date fair values of options granted during the nine months ended September 30, 2007 and 2006 were $6.42 per option and $6.58 per option, respectively. Total intrinsic value of stock options exercised was $6.6 million and $8.0 million for the nine months ended September 30, 2007 and 2006, respectively. Cash received from option exercises was $3.3 million and $4.0 million for the nine months ended September 30, 2007 and 2006, respectively. Total tax benefits realized for tax deductions from option exercises were $2.3 million and $3.0 million for the nine months ended September 30, 2007 and 2006, respectively.

The grant-date fair values of restricted stock awards are determined using the closing price of Unitrin common stock on the date of grant. The total fair value of restricted stock that vested during the nine months ended September 30, 2007 was $1.5 million and the tax benefits for tax deductions realized from the vesting of restricted stock was $0.5 million.

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Note 10 Long-term Equity Compensation Plans (continued)

The total fair value of restricted stock that vested during the nine months ended September 30, 2006 was $0.9 million and the tax benefits for tax deductions realized from the vesting of restricted stock was $0.3 million. Activity related to nonvested restricted stock for the nine months ended September 30, 2007 is presented below:

	Restricted Shares	Weighted-Average Grant-Date Fair Value Per Share
Nonvested Balance at Beginning of the Year	109,426	$ 46.29
Granted	114,600	47.30
Vested	(35,874)	48.77
Forfeited	(14,463)	47.48
Nonvested Balance at September 30, 2007	173,689	$ 46.34

For equity compensation awards with a graded vesting schedule, the Company recognizes compensation expense on a straight-line basis over the requisite service period for each separately vesting portion of the awards as if each award were, in substance, multiple awards. Compensation expense is recognized only for those awards expected to vest, with forfeitures estimated at the date of grant based on the Company s historical experience and future expectations. Share-based compensation expense for all of the Company s long-term equity-based compensation plans was $12.4 million and $3.3 million for the nine and three months ended September 30, 2007, respectively. Share-based compensation expense for all of the Company s long-term equity-based compensation plans was $9.4 million and $2.7 million for the nine and three months ended September 30, 2006, respectively. Total unamortized compensation expense related to nonvested awards of such plans at September 30, 2007 was $11.5 million, which is expected to be recognized over a weighted-average period of 1.4 years.

Note 11 Income Taxes

The Company and all of its subsidiaries file a consolidated Federal income tax return. In addition, the Company and/or its subsidiaries file income tax returns in various state jurisdictions. At September 30, 2007, the Company s consolidated Federal Income tax returns are no longer subject to examination for years before 2004. Except for one state tax jurisdiction, at September 30, 2007, the Company or its subsidiaries are no longer subject to state income examinations by tax authorities for years before 2004 for any major tax jurisdictions. In such state tax jurisdiction, two of the Companies subsidiaries were subject to examination for the 2002 tax year at September 30, 2007. Neither the Company s consolidated Federal tax return nor any significant state tax returns are currently under examination.

The Company adopted the provisions of FIN 48 on January 1, 2007. As a result of adoption, current income taxes receivable increased by $9.2 million, current income taxes payable decreased $0.1 million, deferred income tax liabilities decreased $23.4 million and the liability for unrecognized tax benefits increased by $32.7 million. There was no effect on the Company s Shareholders Equity upon adoption of FIN 48. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

(Dollars in Millions)	Liability for Unrecognized Tax Benefits
Balance at January 1, 2007	$ 32.7
Reductions for Tax Positions of Current Period	(5.7)
Additions for Tax Positions of Prior Years	28.2
Reduction for Expiration of 2003 Federal Statute of Limitations	(23.2)
Balance at September 30, 2007	$ 32.0

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Note 11 Income Taxes (continued)

Included in the balance of unrecognized tax benefits at September 30, 2007 and January 1, 2007 are tax positions of $16.7 million and $18.8 million, respectively, for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. Because of the impact of deferred income tax accounting, other than for interest and penalties, the disallowance of the shorter deductibility period would not affect the effective income tax rate but would accelerate the payment of cash to the taxing authority to an earlier period. In the fourth quarter of 2007, $8.7 million of the $32.0 million of unrecognized tax benefits will be recognized due to the expiration of a state s statute of limitations. Other than the amount that will be recognized in the fourth quarter of 2007, there are no circumstances where it is reasonably possible that a significant increase or decrease in unrecognized tax benefits will occur within the twelve month period ending September 30, 2008.

The Company recognizes interest and penalties, if any, related to unrecognized tax benefits in income tax expense. The liability for unrecognized tax benefits included accrued interest of $8.7 million and $7.1 million at September 30, 2007 and January 1, 2007, respectively. Tax expense for the nine months ended September 30, 2007 includes interest expense of $1.6 million, which is net of an interest benefit of $1.9 million resulting from the expiration of the 2003 federal statute of limitations.

Income taxes paid were $75.4 million and $94.8 million for the nine months ended September 30, 2007 and 2006, respectively.

The components of Liabilities for Income Taxes at September 30, 2007 and December 31, 2006 were:

(Dollars in Millions)	Sept. 30, 2007	Dec. 31, 2006
Current Income Taxes Payable	$ 31.5	$ 0.1
Deferred Income Taxes	241.5	285.0
Liability for Unrecognized Tax Benefits	32.0	
Liabilities for Income Taxes	$ 305.0	$ 285.1

Note 12 Business Segments

The Company is engaged, through its subsidiaries, in the property and casualty insurance, life and health insurance and consumer finance businesses. The Company conducts its continuing operations through five operating segments: Kemper, Unitrin Specialty, Unitrin Direct, Life and Health Insurance and Consumer Finance. The Company uses the registered trademark, Kemper, under license, for personal lines insurance only, from Lumbermens Mutual Casualty Company, which is not affiliated with the Company

The Company s Kemper segment provides preferred and standard risk personal automobile and homeowners insurance through networks of independent agents. The Unitrin Specialty segment provides automobile insurance to individuals and businesses in the non-standard and specialty markets through networks of independent agents. The non-standard automobile insurance market consists of individuals and companies that have difficulty obtaining standard or preferred risk insurance, usually because of their driving records. Unitrin Direct markets personal automobile insurance through direct mail, television and the Internet through web insurance portals, click-thrus and its own website. In addition, Merastar, which is included in the Unitrin Direct segment from the date of its acquisition (see Note 2, Acquisition of Business, to the Condensed Consolidated Financial Statements), specializes in the sale of personal automobile and homeowners insurance through employer-sponsored voluntary benefit programs. The Life and Health Insurance segment provides individual life, accident, health and hospitalization insurance. The Company s Life and Health Insurance employee-agents also market property insurance products under common management. The Consumer Finance segment makes consumer loans primarily for the purchase of pre-owned automobiles and offers certificates of deposits.

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Note 12 Business Segments (continued)

It is the Company s management practice to allocate certain corporate expenses to its insurance operations. In accordance with SFAS No. 144, the Company is not permitted to allocate certain corporate expenses to discontinued operations. Accordingly, such amounts that the Company is not permitted to allocate to discontinued operations are reported in Other Expense, Net. The Company considers the management of certain investments, Northrop common and preferred stock, Baker Hughes, Inc. common stock and Intermec common stock, to be a corporate responsibility. Accordingly, the Company does not allocate income from these investments to its operating segments. The Company does not allocate Net Realized Investment Gains to its operating units.

Segment Revenues for the nine and three months ended September 30, 2007 and 2006 were:

	Nine Months Ended		Three Months Ended	
(Dollars in Millions)	**Sept. 30, 2007**	**Sept. 30, 2006**	**Sept. 30, 2007**	**Sept. 30, 2006**
Revenues:				
Kemper:				
Earned Premiums	$ 693.9	$ 708.1	$ 232.8	$ 237.6
Net Investment Income	35.4	36.7	12.1	11.5
Other Income	0.4	0.3	0.2	0.1
Total Kemper	729.7	745.1	245.1	249.2
Unitrin Specialty:				
Earned Premiums	338.2	333.3	113.7	111.7
Net Investment Income	15.6	16.3	5.3	5.0
Other Income	0.1			
Total Unitrin Specialty	353.9	349.6	119.0	116.7
Unitrin Direct:				
Earned Premiums	186.1	168.9	71.3	57.7
Net Investment Income	6.8	6.7	2.6	2.1
Other Income	0.3	0.2	0.1	
Total Unitrin Direct	193.2	175.8	74.0	59.8
Life and Health Insurance:				
Earned Premiums	494.4	509.0	162.1	168.1
Net Investment Income	148.0	132.1	47.2	43.8
Other Income	0.7	11.0	0.2	11.0
Total Life and Health Insurance	643.1	652.1	209.5	222.9
Consumer Finance	197.8	184.3	67.9	64.3
Total Segment Revenues	2,117.7	2,106.9	715.5	712.9
Unallocated Dividend Income	19.9	15.9	5.5	8.5
Net Realized Investment Gains	52.0	23.7	12.5	3.1
Other	6.9	2.2	1.9	1.1
Total Revenues	$ 2,196.5	$ 2,148.7	$ 735.4	$ 725.6

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Note 12 Business Segments (continued)

Segment Operating Profit for the nine and three months ended September 30, 2007 and 2006 was:

(Dollars in Millions)	Nine Months Ended Sept. 30, 2007	Nine Months Ended Sept. 30, 2006	Three Months Ended Sept. 30, 2007	Three Months Ended Sept. 30, 2006
Segment Operating Profit (Loss):				
Kemper	$ 71.4	$ 112.7	$ 35.0	$ 46.4
Unitrin Specialty	30.1	28.3	9.8	8.9
Unitrin Direct	(25.0)	(5.9)	(7.3)	(3.6)
Life and Health Insurance	125.9	102.7	39.2	47.2
Consumer Finance	7.4	38.0	(8.9)	10.5
Total Segment Operating Profit	209.8	275.8	67.8	109.4
Unallocated Dividend Income	19.9	15.9	5.5	8.5
Net Realized Investment Gains	52.0	23.7	12.5	3.1
Other Expense, Net	(21.1)	(24.4)	(6.4)	(7.6)
Income from Continuing Operations Before Income Taxes and Equity in Net Income of Investee	$ 260.6	$ 291.0	$ 79.4	$ 113.4

Segment Net Income for the nine and three months ended September 30, 2007 and 2006 was:

(Dollars in Millions)	Nine Months Ended Sept. 30, 2007	Nine Months Ended Sept. 30, 2006	Three Months Ended Sept. 30, 2007	Three Months Ended Sept. 30, 2006
Segment Net Income (Loss):				
Kemper	$ 52.8	$ 79.6	$ 24.9	$ 32.3
Unitrin Specialty	22.4	21.3	7.3	6.8
Unitrin Direct	(15.0)	(2.7)	(4.2)	(2.0)
Life and Health Insurance	80.7	66.5	24.2	30.6
Consumer Finance	4.3	22.0	(5.2)	5.8
Total Segment Net Income	145.2	186.7	47.0	73.5
Net Income (Loss) From:				
Unallocated Dividend Income	17.6	14.0	4.9	7.5
Net Realized Investment Gains	33.7	15.4	8.1	2.0
Other Expense, Net	(13.5)	(16.3)	(3.3)	(4.6)
Income from Continuing Operations Before Equity in Net Income of Investee	183.0	199.8	56.7	78.4
Equity in Net Income of Investee	0.7	8.6	0.9	1.4
Income from Continuing Operations	$ 183.7	$ 208.4	$ 57.6	$ 79.8

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Note 12 Business Segments (continued)

Earned Premiums by product line for the nine and three months ended September 30, 2007 and 2006 were:

(Dollars in Millions)	Nine Months Ended Sept. 30, 2007	Nine Months Ended Sept. 30, 2006	Three Months Ended Sept. 30, 2007	Three Months Ended Sept. 30, 2006
Life	$ 293.6	$ 301.8	$ 96.3	$ 99.3
Accident and Health	118.6	119.3	39.1	39.5
Property and Casualty:				
Personal Lines:				
Automobile	888.0	872.0	306.3	294.1
Homeowners	295.6	300.6	99.4	100.6
Other Personal	35.8	36.3	12.3	11.7
Total Personal Lines	1,219.4	1,208.9	418.0	406.4
Commercial Automobile	81.0	89.3	26.5	29.9
Total Earned Premiums	$ 1,712.6	$ 1,719.3	$ 579.9	$ 575.1

Note 13 Related Party Transactions

One of Unitrin s directors, Mr. Fayez Sarofim, is the Chairman of the Board, President and the majority shareholder of Fayez Sarofim & Co. (FS&C), a registered investment advisory firm. Unitrin s subsidiary, Trinity, and FS&C are parties to an agreement under which FS&C provides investment management services. In addition, FS&C provides investment management services with respect to certain funds of the Company s pension plans. The agreements governing these arrangements are terminable by either party at any time upon 30 days advance written notice.

Under these investment advisory arrangements, FS&C is entitled to a fee calculated and payable quarterly based upon the fair market value of the assets under management. At September 30, 2007, Trinity and the Company s pension plans had $229.9 million and $101.5 million, respectively, in investments managed by FS&C. During the first nine months of 2007, Trinity and the Company s pension plans paid $0.6 million in the aggregate to FS&C. During the first nine months of 2006, Trinity and the Company s pension plans paid $0.5 million in the aggregate to FS&C.

With respect to the Company s 401(k) Savings Plan, one of the investment choices afforded to participants is the Dreyfus Appreciation Fund, an open-end, diversified managed investment fund. FS&C provides investment management services to the Dreyfus Appreciation Fund as a sub-investment advisor. According to published reports filed by FS&C with the SEC, the Dreyfus Appreciation Fund pays monthly fees to FS&C according to a graduated schedule computed at an annual rate based on the value of the Dreyfus Appreciation Fund s average daily net assets. The Company does not compensate FS&C for services provided to the Dreyfus Appreciation Fund. As of September 30, 2007, participants in the Company s 401(k) Savings Plan had allocated $27.0 million for investment in the Dreyfus Appreciation Fund, representing 9.5% of the total amount invested in the Company s 401(k) Savings Plan.

The Company believes that the transactions described above have been entered into on terms no less favorable to the Company than could have been negotiated with non-affiliated third parties.

As described in Note 15, Relationships with Mutual Insurance Holding Companies and Mutual Insurance Companies, to the Condensed Consolidated Financial Statements, the Company also has certain relationships with mutual insurance holding companies and mutual insurance companies. Such companies are owned by the policyholders of such companies or their insurance subsidiaries.

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Note 14 Legal Proceedings

In the ordinary course of their businesses, the Company and its subsidiaries are involved in a number of legal proceedings, including lawsuits and regulatory examinations. Some of these proceedings include matters particular to the Company or one or more of its subsidiaries, while other matters pertain to business practices in the industries in which the Company or its subsidiaries operate. Many of these matters raise complicated issues and are subject to uncertainties and difficulties, including but not limited to: (i) the underlying facts of the matter; (ii) unsettled questions of law; (iii) issues unique to the jurisdiction where the matter is pending; (iv) damage claims, including claims for punitive damages, that are disproportionate to the actual economic loss incurred; and (v) the general legal and regulatory environment faced by large corporations generally and the insurance and banking sectors specifically. Additionally, some of the lawsuits seek class action status that, if granted, could expose the Company or its subsidiaries to potentially significant liability by virtue of the size of the putative classes. Accordingly, the outcomes of these matters are difficult to predict, and the amounts or ranges of potential loss at particular points in time are in most cases difficult or impossible to ascertain with any degree of certainty.

The Company believes that resolution of its pending legal proceedings will not have a material adverse effect on the Company s financial position. However, given the unpredictability of the legal process, there can be no assurance that one or more of these matters will not produce a loss which could have a material adverse effect on the Company s financial results for any given period.

Note 15 Relationships with Mutual Insurance Holding Companies and Mutual Insurance Companies

Effective January 1, 2007, Trinity and Milwaukee Insurance Company (MIC) entered into a new quota share reinsurance agreement whereby Trinity assumes 100% of policy liabilities occurring on MIC s direct book of business on or after January 1, 2007, which business is administered by the Unitrin Business Insurance unit and the Kemper segment. Prior to January 1, 2007, Trinity and MIC were parties to a quota share reinsurance agreement whereby Trinity assumed 95% of the business written by MIC (administered by the Unitrin Business Insurance unit and the Kemper segment) and 95% of the business that MIC assumed from First NonProfit Insurance Company (FNP). The new quota share reinsurance agreement amended the 95% quota share reinsurance agreement so that policy liabilities occurring on MIC s in-force direct book of business prior to January 1, 2007 remain ceded under the 95% agreement, as do FNP policy liabilities incurred prior to January 1, 2007. In connection with the new quota share reinsurance agreement, Trinity transferred to MIC the unearned premium reserves maintained by Trinity related to the FNP business, net of a ceding commission. MIC is owned by Mutual Insurers Holding Company (MIHC), which in turn is owned by MIC s policyholders. Effective July 1, 2001, MIC and FNP (through its predecessor, First NonProfit Mutual Insurance Company) are parties to a quota share reinsurance agreement whereby MIC assumed 80% of certain business written or assumed by FNP. Pursuant to an amendment to the MIC/FNP reinsurance agreement, which became effective January 15, 2003, FNP agrees to arrange for its parent company, First NonProfit Mutual Holding Company (FNMHC), to nominate a simple majority to the FNMHC board of directors selected by MIC. On January 15, 2003, FNMHC elected five employees of the Company, as selected by MIC, to the FNMHC board of directors pursuant to the terms of the amendment. All such employees continued to serve as directors of FNMHC until 2006, when they resigned from the FNMHC board of directors. FNP is owned by FNMHC, which in turn is owned by FNP s policyholders. Five employees of the Company also serve as directors of MIHC s nine member board of directors. Two employees of the Company also serve as directors of MIC, but together do not constitute a majority of MIC s board of directors.

Trinity and Capitol County Mutual Fire Insurance Company (Capitol), and Trinity and Capitol s wholly-owned subsidiary, Old Reliable Casualty Company (ORCC), are parties to quota share reinsurance agreements whereby Trinity assumes 100% of the business written by Capitol and ORCC, respectively. Capitol is a mutual insurance company and, accordingly, is owned by its policyholders. Five employees of the Company serve as directors of Capitol s five member board of directors. Nine employees of the Company also serve as directors of ORCC s nine member board of directors.

The Reliable Life Insurance Company (Reliable), a wholly-owned subsidiary of Unitrin, provides certain administrative services to Capitol and ORCC. In addition, agents appointed by Reliable and employed by Unitrin s subsidiary, United Insurance Company of America (United), are also appointed by Capitol and ORCC to sell property insurance products. United also provides claims administration services to ORCC. The Company also provides certain investment services to Capitol and ORCC.

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Item 2. Management s Discussion and Analysis of Results of Operations and Financial Condition
Summary of Results

Net Income was $198.9 million ($3.02 per common share) and $64.3 million ($0.99 per common share) for the nine and three months ended September 30, 2007, respectively, compared to $221.5 million ($3.25 per common share) and $86.1 million ($1.27 per common share) for the same periods in 2006. Income from Continuing Operations was $183.7 million ($2.79 per common share) and $57.6 million ($0.89 per common share) for the nine and three months ended September 30, 2007, respectively, compared to $208.4 million ($3.06 per common share) and $79.8 million ($1.18 per common share) for the same periods in 2006. As discussed throughout this Management s Discussion and Analysis of Results of Operations and Financial Condition, Income from Continuing Operations decreased for the nine and three months ended September 30, 2007 due primarily to lower operating results in the aggregate in the Company s operating segments and lower Equity in Net Income of Investee, partially offset by higher Net Realized Investment Gains. Income from Discontinued Operations was $15.2 million and $6.7 million for the nine and three months ended September 30, 2007, respectively, compared to $13.1 million and $6.3 million for the same periods in 2006.

Total Revenues were $2,196.5 million and $2,148.7 million for the nine months ended September 30, 2007 and 2006, respectively, an increase of $47.8 million. Total Revenues were $735.4 million and $725.6 million for the three months ended September 30, 2007 and 2006, respectively, an increase of $9.8 million.

Earned Premiums were $1,712.6 million and $1,719.3 million for the nine months ended September 30, 2007 and 2006, respectively, a decrease of $6.7 million. Earned Premiums decreased due to decreased Earned Premiums in the Life and Health Insurance segment and the Kemper segment, partially offset by increased Earned Premiums in the Unitrin Direct segment and the Unitrin Specialty segment.

Earned Premiums were $579.9 million and $575.1 million for the three months ended September 30, 2007 and 2006, respectively, an increase of $4.8 million. Earned Premiums increased due to increased Earned Premiums in the Unitrin Direct segment and the Unitrin Specialty segment, partially offset by decreased Earned Premiums in the Life and Health Insurance segment and the Kemper segment.

Consumer Finance Revenues increased by $13.5 million and $3.6 million for the nine and three months ended September 30, 2007, respectively, compared to the same periods in 2006, due primarily to higher levels of loans outstanding, partially offset by lower portfolio interest rates.

Net Investment Income increased by $23.4 million for the nine months ended September 30, 2007, compared to the same period in 2006, due in part to an increase in dividend income from the Company s investment in Northrop Grumman Corporation (Northrop) preferred stock of $3.1 million due to the timing of the ex-dividend date and a dividend of $5.2 million from the Company s equity investment in IRI Holdings, Inc. (IRI). Excluding the impact of the increase in dividend income on Northrop preferred stock and the IRI dividend, Net Investment Income increased for the nine months ended September 30, 2007, due primarily to higher yields on investments and higher levels of investments. Net Investment Income increased by $3.2 million for the three months ended September 30, 2007, compared to the same period in 2006, due primarily to higher yields on investments, partially offset by lower dividend income of $3.1 million from Northrop due to the timing of the ex-dividend date.

Net Realized Investment Gains were $52.0 million and $12.5 million for the nine and three months ended September 30, 2007, respectively, compared to $23.7 million and $3.1 million for the same periods in 2006. Net Realized Investment Gains in 2007 included increased sales of a portion of the Company s investment in Northrop common stock.

Critical Accounting Estimates

The Company s subsidiaries conduct their businesses in three industries: property and casualty insurance, life and health insurance and consumer finance. Accordingly, the Company is subject to several industry-specific accounting principles under accounting principles generally accepted in the United States of America (GAAP). The preparation of financial statements in accordance with GAAP requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The process of estimation is inherently uncertain. Accordingly, actual results could ultimately differ materially from the estimated amounts reported in a company s financial statements. Different assumptions are likely to result in different estimates of reported amounts.

Critical Accounting Estimates (continued)

The Company s critical accounting policies most sensitive to estimates include the valuation of investments, the valuation of reserves for property and casualty insurance incurred losses and loss adjustment expenses (LAE), the valuation of the reserve for loan losses, the assessment of recoverability of goodwill, and the valuation of postretirement benefit obligations. The Company s critical accounting policies with respect to the valuation of investments, the valuation of reserves for property and casualty insurance incurred losses and LAE, the valuation of the reserve for loan losses, the assessment of recoverability of goodwill, and the valuation of postretirement benefit obligations are described in the Company s Management s Discussion and Analysis of Results of Operations and Financial Condition presented in its Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission (SEC) for the year ended December 31, 2006 (the 2006 Annual Report). There has been no material change, subsequent to December 31, 2006, to information previously disclosed with respect to the Company s critical accounting policies.

The caption entitled Critical Accounting Estimates in the Company s Management s Discussion and Analysis of Results of Operations and Financial Condition presented in the 2006 Annual Report describes the Company s process for determining loss and LAE reserves. The final step in the quarterly loss and LAE reserving process involves a comprehensive review of the actuarial indications by the Company s senior actuary and senior management who apply their collective judgment and determine the appropriate estimated level of reserves to record. Numerous factors are considered in this determination process, including, but not limited to, the assessed reliability of key loss trends and assumptions that may be significantly influencing the current actuarial indications, changes in claim handling practices or other changes that affect the timing of payment or development patterns, changes in the mix of business, the maturity of the accident year, pertinent trends observed over the recent past, the level of volatility within a particular line of business, the improvement or deterioration of actuarial indications in the current period as compared to prior periods, and the amount of reserves related to third-party pools for which the Company does not have access to the underlying data and, accordingly, relies on calculations provided by such pools. Total recorded reserves for losses and LAE were 2.9% and 3.9% higher than the actuarial indication of reserves at September 30, 2007 and December 31, 2006, respectively. Total recorded reserves as a percentage of the actuarial indication of reserves decreased in total in the first nine months of 2007 due primarily to the Company s senior actuary and senior management placing greater reliance on the actuarial indications in determining the appropriate estimated level of reserves.

Catastrophe Reinsurance

The Company maintains three separate catastrophe reinsurance programs for its property and casualty insurance businesses. Coverage for each reinsurance program is provided in three layers.

The annual program covering the Company s Unitrin Direct, Unitrin Specialty and Unitrin Business Insurance operations provides, effective January 1, 2007, reinsurance coverage of 100% of reinsured catastrophe losses of $36 million above retention of $4 million. In 2006, the annual program covering these segments also provided reinsurance coverage of 100% of reinsured catastrophe losses of $36 million above retention of $4 million. The aggregate annual premium, excluding reinstatement premium, for the 2007 annual program covering these segments is $2.6 million, compared to an annual cost of $1.9 million, excluding reinstatement premium, for the 2006 annual program. The 2007 and 2006 annual programs covering these segments do not include Merastar Insurance Company (Merastar). The annual program covering Merastar was effective on March 31, 2007 and provides reinsurance coverage of 97.5% of reinsured catastrophe losses of $7.25 million above retention of $0.75 million. The aggregate annual premium, excluding reinstatement premium, for the Merastar annual program is $0.4 million.

The annual program covering the property insurance operations of the Company s Life and Health Insurance segment was changed to provide, effective January 1, 2007, reinsurance coverage of 100% of reinsured catastrophe losses of $120 million above retention of $10 million. In 2006, the annual program covering this segment provided reinsurance coverage of 100% of reinsured catastrophe losses of $90 million above retention of $10 million. The aggregate annual premium, excluding reinstatement premium, for the 2007 annual program covering this segment is $9.3 million, compared to an annual cost of $6.1 million, excluding reinstatement premium, for the 2006 annual program.

The Company has established, effective April 1, 2007, a new annual program covering the Company s Kemper segment on terms that are different from the prior annual program. Under the new annual program, the first layer provides reinsurance coverage of approximately 62% of reinsured catastrophe losses of $30 million above retention of $40 million. The second layer under the new annual program provides reinsurance coverage of approximately 90% of reinsured catastrophe losses of $80 million above retention of $70 million. The third layer under the new annual

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Catastrophe Reinsurance (continued)

program provides reinsurance coverage of approximately 90% of reinsured catastrophe losses of $100 million above retention of $150 million. Under the prior annual program, which was effective July 1, 2006 and was terminated effective with the new annual program, the first layer provided reinsurance coverage of approximately 65% of reinsured catastrophe losses of $30 million above retention of $40 million. The second layer under the prior annual program provided reinsurance coverage of approximately 88% of reinsured catastrophe losses of $80 million above retention of $70 million. The third layer under the prior annual program provided reinsurance coverage of approximately 80% of reinsured catastrophe losses of $100 million above retention of $150 million. The aggregate annual premium, excluding reinstatement premium, for Kemper s new annual program is $20.1 million, compared to an annual cost of $19.5 million, excluding reinstatement premium, for the prior program.

In addition, in the event that the Company s incurred catastrophe losses and LAE covered by any of its three catastrophe reinsurance programs exceed the retention for that particular program, each of the programs requires one reinstatement of such coverage. In such an instance, the Company is required to pay a reinstatement premium to the reinsurers to reinstate the full amount of reinsurance available under such program. The reinstatement premium is a percentage of the original premium based on the ratio of the losses exceeding the Company s retention to the reinsurers coverage limit. In addition to these programs, the Company purchases reinsurance from the Florida Hurricane Catastrophe Fund for hurricane losses in the state of Florida at retentions lower than those described above.

Kemper

	Nine Months Ended		Three Months Ended	
(Dollars in Millions)	**Sept. 30, 2007**	**Sept. 30, 2006**	**Sept. 30, 2007**	**Sept. 30, 2006**
Earned Premiums:				
Automobile	$ 446.2	$ 459.1	$ 149.3	$ 154.6
Homeowners	212.0	212.7	71.3	71.3
Other Personal	35.7	36.3	12.2	11.7
Total Earned Premiums	693.9	708.1	232.8	237.6
Net Investment Income	35.4	36.7	12.1	11.5
Other Income	0.4	0.3	0.2	0.1
Total Revenues	729.7	745.1	245.1	249.2
Incurred Losses and LAE	460.3	424.6	143.3	131.6
Insurance Expenses	198.0	207.8	66.8	71.2
Operating Profit	71.4	112.7	35.0	46.4
Income Tax Expense	18.6	33.1	10.1	14.1
Net Income	$ 52.8	$ 79.6	$ 24.9	$ 32.3
Ratio Based on Earned Premiums				
Incurred Loss and LAE Ratio (excluding Catastrophes)	63.6%	55.9%	60.5%	52.6%
Incurred Catastrophe Loss and LAE Ratio	2.7%	4.1%	1.1%	2.8%
Total Incurred Loss and LAE Ratio	66.3%	60.0%	61.6%	55.4%
Incurred Expense Ratio	28.5%	29.3%	28.7%	30.0%
Combined Ratio	94.8%	89.3%	90.3%	85.4%

(Dollars in Millions)	**Dec. 31,**

	Sept. 30, 2007	2006
Insurance Reserves:		
Personal Automobile	$ 391.8	$ 399.9
Homeowners	88.6	106.6
Other Personal	30.0	27.6
Insurance Reserves	$ 510.4	$ 534.1

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Kemper (continued)

(Dollars in Millions)	Sept. 30, 2007	Dec. 31, 2006
Insurance Reserves:		
Loss Reserves:		
Case	$ 261.0	$ 238.6
Incurred but Not Reported	163.0	200.8
Total Loss Reserves	424.0	439.4
LAE Reserves	86.4	94.7
Insurance Reserves	$ 510.4	$ 534.1

	Nine Months Ended		Three Months Ended	
(Dollars in Millions)	Sept. 30, 2007	Sept. 30, 2006	Sept. 30, 2007	Sept. 30, 2006
Favorable Loss and LAE Reserve Development, Net (excluding Catastrophes)	$ 36.3	$ 54.8	$ 11.1	$ 20.7
Favorable (Adverse) Catastrophe Loss and LAE Reserve Development, Net	9.3	(0.4)	2.9	(0.2)
Total Favorable Loss and LAE Reserve Development, Net	$ 45.6	$ 54.4	$ 14.0	$ 20.5
Loss and LAE Reserve Development as a Percentage of Insurance Reserves at Beginning of Year	8.5%	9.8%	2.6%	3.7%

Earned Premiums in the Kemper segment decreased by $14.2 million and $4.8 million for the nine and three months ended September 30, 2007, respectively, compared to the same periods in 2006. Earned premiums on automobile insurance decreased by $12.9 million and $5.3 million, respectively, due primarily to lower volume. Earned premiums on homeowners insurance decreased by $0.7 million for the nine months ended September 30, 2007, due primarily to lower volume and higher cost of reinsurance, partially offset by higher average premium rates, while remaining flat for the third quarter. Other personal insurance earned premiums decreased by $0.6 million for the nine months ended September 30, 2007, due primarily to higher cost of reinsurance, partially offset by higher volume. Other personal insurance earned premiums increased by $0.5 million for the three months ended September 30, 2007 due primarily to higher volume.

The Kemper segment is reducing its exposures to natural disasters by reducing or limiting its homeowners insurance and other property insurance business in certain coastal areas of the United States. In 2006, the Kemper segment began exiting the personal insurance market in Florida. Accordingly, the Kemper segment is no longer writing new homeowners and automobile insurance policies in the state of Florida and is not offering to renew existing policies on their anniversary dates. In addition, in certain coastal territories of Louisiana, Mississippi, New York (principally Long Island), and Texas, the Kemper segment is employing a strategy of increasing or adding hurricane deductibles to homeowners insurance policies and increasing the rates charged for homeowners insurance to cover the additional catastrophe risk and reinsurance costs inherent to homes located in these coastal areas.

Net Investment Income decreased by $1.3 million for the nine months ended September 30, 2007 compared to the same period in 2006 due to lower levels of investments, partially offset by higher yields on investments. For the three months ended September 30, 2007, Net Investment Income increased by $0.6 due to higher yields on investments, partially offset by lower levels of investments.

Operating Profit in the Kemper segment decreased by $41.3 million and $11.4 million for the nine and three months ended September 30, 2007, respectively, compared to the same periods in 2006, due primarily to higher incurred losses and LAE, partially offset by lower insurance expenses.

Incurred losses and LAE increased for the nine months ended September 30, 2007, due primarily to higher non-catastrophe incurred losses and LAE, and to a lesser extent the impact of lower favorable loss and LAE reserve development (which recognizes changes in estimates of prior year loss and LAE reserves in the current period),

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Kemper (continued)

partially offset by lower catastrophe losses and LAE, due largely to higher favorable catastrophe loss and LAE reserve development. Automobile insurance incurred losses and LAE increased due primarily to higher non-catastrophe losses and LAE and the impact of lower favorable loss and LAE reserve development. Loss and LAE reserve development on automobile insurance had a favorable effect of $23.5 million for the nine months ended September 30, 2007, compared to a favorable effect of $39.7 million for the same period in 2006. Catastrophe losses and LAE (including development) on automobile insurance were $2.5 million for the nine months ended September 30, 2007, compared to $4.0 million for the same period in 2006. Homeowners insurance incurred losses and LAE increased due primarily to higher non-catastrophe losses and LAE, partially offset by the impact of higher favorable loss and LAE reserve development due largely to higher favorable catastrophe loss and LAE reserve development. Loss and LAE reserve development on homeowners insurance had a favorable effect of $19.1 million (including favorable development of $8.5 million for catastrophes) for the nine months ended September 30, 2007, compared to a favorable effect of $9.7 million for the same period in 2006. Catastrophe losses and LAE (including development) on homeowners insurance were $15.5 million for the nine months ended September 30, 2007, compared to $23.6 million for the same period in 2006. Favorable loss and LAE reserve development on other insurance was $3.0 million for the nine months ended September 30, 2007, compared to $5.0 million for the same period in 2006.

Incurred losses and LAE increased for the three months ended September 30, 2007, compared to the same period in 2006, due primarily to higher non-catastrophe incurred losses and LAE and the impact of lower favorable loss and LAE reserve development. Automobile insurance incurred losses and LAE increased due primarily to lower favorable loss and LAE reserve development and to a lesser extent higher non-catastrophe losses and LAE as a percentage of earned premiums in the current accident quarter. Loss and LAE reserve development on automobile insurance had a favorable effect of $7.3 million for the three months ended September 30, 2007, compared to a favorable effect of $17.5 million for the same period in 2006. Catastrophe losses and LAE (including development) on automobile insurance were $0.3 million for the three months ended September 30, 2007, compared to $1.1 million for the same period in 2006. Homeowners insurance incurred losses and LAE increased due primarily to higher non-catastrophe losses and LAE, partially offset by the impact of higher favorable loss and LAE reserve development. Loss and LAE reserve development on homeowners insurance had a favorable effect of $4.2 million (including favorable development of $2.7 million for catastrophes) for the three months ended September 30, 2007, compared to a favorable effect of $3.0 million for the same period in 2006. Catastrophe losses and LAE on homeowners insurance were $2.0 million for the three months ended September 30, 2007, compared to $5.5 million for the same period in 2006. Favorable loss and LAE reserve development on other insurance was $2.5 million for the three months ended September 30, 2007. Loss and LAE reserve development on other insurance was insignificant for the three months ended September 30, 2006.

The Kemper segment s actuaries continued to place greater weight on the emerging loss development trends in the actuarial indications. In addition, beginning in 2007, the Company s senior actuary and senior management began placing greater reliance on the actuarial indications in determining the appropriate estimated level of reserves. See the caption entitled Critical Accounting Estimates in the Company s Management s Discussion and Analysis of Results of Operations and Financial Condition presented in the 2006 Annual Report and in this Quarterly Report on Form 10-Q (the 2007 Quarterly Report) for additional information pertaining to the Company s process of estimating property and casualty insurance reserves for losses and LAE, development of property and casualty insurance losses and LAE and estimated variability of property and casualty insurance reserves for losses and LAE.

Insurance Expenses decreased by $9.8 million and $4.4 million for the nine and three months ended September 30, 2007, respectively, compared to the same periods in 2006, due primarily to lower commissions due to the lower earned premiums, lower premium taxes and other licensing and regulatory fees and assessments, and lower other underwriting expenses.

Net Income in the Kemper segment decreased by $26.8 million and $7.4 million for the nine and three months ended September 30, 2007, respectively, compared to the same periods in 2006, due primarily to the changes in Operating Profit. The Kemper segment s effective income tax rate differs from the federal statutory income tax rate due primarily to tax-exempt investment income and dividends received deductions. Tax-exempt investment income and dividends received deductions were $18.6 million and $6.2 million for the nine and three months ended September 30, 2007, respectively, compared to $19.0 million and $6.5 million for the same periods in 2006.

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Unitrin Specialty

(Dollars in Millions)	Nine Months Ended Sept. 30, 2007	Nine Months Ended Sept. 30, 2006	Three Months Ended Sept. 30, 2007	Three Months Ended Sept. 30, 2006
Earned Premiums:				
Personal Automobile	$ 257.2	$ 244.0	$ 87.2	$ 81.8
Commercial Automobile	81.0	89.3	26.5	29.9
Total Earned Premiums	338.2	333.3	113.7	111.7
Net Investment Income	15.6	16.3	5.3	5.0
Other Income	0.1			
Total Revenues	353.9	349.6	119.0	116.7
Incurred Losses and LAE	254.6	251.5	85.2	84.2
Insurance Expenses	69.2	69.8	24.0	23.6
Operating Profit	30.1	28.3	9.8	8.9
Income Tax Expense	7.7	7.0	2.5	2.1
Net Income	$ 22.4	$ 21.3	$ 7.3	$ 6.8
Ratio Based on Earned Premiums				
Incurred Loss and LAE Ratio (excluding Catastrophes)	75.2%	75.2%	74.9%	75.3%
Incurred Catastrophe Loss and LAE Ratio	0.1%	0.3%	0.0%	0.1%
Total Incurred Loss and LAE Ratio	75.3%	75.5%	74.9%	75.4%
Incurred Expense Ratio	20.5%	20.9%	21.1%	21.1%
Combined Ratio	95.8%	96.4%	96.0%	96.5%

(Dollars in Millions)	Sept. 30, 2007	Dec. 31, 2006
Insurance Reserves:		
Personal Automobile	$ 148.4	$ 151.9
Commercial Automobile	116.0	124.5
Other	15.0	17.0
Insurance Reserves	$ 279.4	$ 293.4

(Dollars in Millions)	Sept. 30, 2007	Dec. 31, 2006
Insurance Reserves:		
Loss Reserves:		
Case	$ 155.1	$ 162.4
Incurred but Not Reported	81.0	77.9
Total Loss Reserves	236.1	240.3
LAE Reserves	43.3	53.1

Insurance Reserves	$ 279.4	$ 293.4

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Unitrin Specialty (continued)

(Dollars in Millions)	Nine Months Ended Sept. 30, 2007	Nine Months Ended Sept. 30, 2006	Three Months Ended Sept. 30, 2007	Three Months Ended Sept. 30, 2006
Favorable Loss and LAE Reserve Development, Net (excluding Catastrophes)	$ 11.5	$ 6.2	$ 5.5	$ 0.6
Favorable (Adverse) Catastrophe Loss and LAE Reserve Development, Net		0.4		(0.1)
Total Favorable Loss and LAE Reserve Development, Net	$ 11.5	$ 6.6	$ 5.5	$ 0.5
Loss and LAE Reserve Development as a Percentage of Insurance Reserves at Beginning of Year	3.9%	2.2%	1.9%	0.2%