Report of Independent Registered Public Accounting Firm

TO THE SHAREHOLDERS AND BOARD OF DIRECTORS OF UNITRIN, INC.

We have audited the accompanying consolidated balance sheets of Unitrin, Inc. and subsidiaries (the "Company") as of December 31, 2007 and 2006, and the related consolidated statements of income, shareholders' equity and comprehensive income, and cash flows for each of the three years in the period ended December 31, 2007. Our audits also included the financial statement schedules listed in Item 15. We also have audited the Company's internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for these financial statements and financial statement schedules, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report on Internal Control. Our responsibility is to express an opinion on these financial statements and financial statement schedules and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Unitrin, Inc. and subsidiaries as of December 31, 2007 and 2006, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, such financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth herein. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

As discussed in Note 2 to the consolidated financial statements, the Company changed its method of accounting for uncertainty in income taxes in 2007 and defined benefit pension and other postretirement plans in 2006.

/s/ Deloitte & Touche LLP
Chicago, Illinois
February 4, 2008

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Item 8. Financial Statements and Supplementary Data.

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Unitrin, Inc. and its Subsidiaries**

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Unitrin, Inc. and Subsidiaries
Consolidated Balance Sheets

DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS	DECEMBER 31, 2007	DECEMBER 31, 2006
ASSETS		
Investments:		
Fixed Maturities at Fair Value (Amortized Cost: 2007 – $3,608.9; 2006 – $3,780.3)	$ 3,686.7	$ 3,832.9
Northrop Preferred Stock at Fair Value (Cost: 2007 – $177.5; 2006 – $177.5)	258.5	236.0
Northrop Common Stock at Fair Value (Cost: 2007 – $245.5; 2006 – $ 318.8)	447.5	500.3
Other Equity Securities at Fair Value (Cost: 2007 – $436.5; 2006 – $407.8)	597.6	569.3
Investee (Intermec) at Cost Plus Cumulative Undistributed Earnings (Fair Value: 2007 – $257.1; 2006 – $307.2)	90.7	92.7
Short–term Investments at Cost which Approximates Fair Value	658.7	465.2
Other	706.7	594.6
Total Investments	6,446.4	6,291.0
Cash	103.1	157.9
Automobile Loan Receivables at Cost (Fair Value: 2007 – $1,230.3; 2006 – $1,231.4)	1,213.5	1,227.0
Other Receivables	634.8	730.4
Deferred Policy Acquisition Costs	437.4	444.7
Goodwill	314.7	344.7
Other Assets	127.1	125.7
Assets of Discontinued Operations	128.0	–
Total Assets	$ 9,405.0	$ 9,321.4
LIABILITIES AND SHAREHOLDERS' EQUITY		
Insurance Reserves:		
Life and Health	$ 2,533.0	$ 2,486.1
Property and Casualty	1,322.9	1,432.6
Total Insurance Reserves	3,855.9	3,918.7
Certificates of Deposits at Cost (Fair Value: 2007 – $1,269.7; 2006 – $1,154.6)	1,274.3	1,162.7
Unearned Premiums	722.2	778.9
Liabilities for Income Taxes	262.5	285.1
Notes Payable at Amortized Cost (Fair Value: 2007 – $550.3; 2006 – $501.3)	560.1	504.5
Accrued Expenses and Other Liabilities	380.9	387.5
Liabilities of Discontinued Operations	51.3	–
Total Liabilities	7,107.2	7,037.4
Shareholders' Equity:		
Common Stock, $0.10 Par Value Per Share, 100 Million Shares Authorized, 64,254,818 and 66,991,352 Shares Issued and Outstanding at December 31, 2007 and 2006	6.4	6.7
Paid–in Capital	781.3	759.1
Retained Earnings	1,185.3	1,231.2
Accumulated Other Comprehensive Income	324.8	287.0
Total Shareholders' Equity	2,297.8	2,284.0
Total Liabilities and Shareholders' Equity	$ 9,405.0	$ 9,321.4

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

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Unitrin, Inc. and Subsidiaries
Consolidated Statements of Income

DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS	FOR THE YEARS ENDED DECEMBER 31, 2007	2006	2005
REVENUES			
Earned Premiums	$ 2,286.9	$ 2,290.5	$ 2,287.7
Automobile Finance Revenues	260.2	245.0	217.6
Net Investment Income	306.7	280.8	257.6
Other Income	3.5	14.4	9.5
Net Realized Investment Gains	62.5	26.5	56.9
Total Revenues	2,919.8	2,857.2	2,829.3
EXPENSES			
Policyholders' Benefits and Incurred Losses and Loss Adjustment Expenses	1,572.3	1,508.7	1,548.7
Insurance Expenses	705.8	712.0	736.6
Automobile Finance Expenses	272.5	154.2	130.5
Interest Expense on Certificates of Deposits	58.7	49.8	37.9
Interest and Other Expenses	66.9	62.5	64.0
Total Expenses	2,676.2	2,487.2	2,517.7
Income from Continuing Operations before Income Taxes and Equity in Net Income of Investee	243.6	370.0	311.6
Income Tax Expense	55.8	115.0	80.2
Income from Continuing Operations before Equity in Net Income of Investee	187.8	255.0	231.4
Equity in Net Income of Investee	1.2	9.2	5.3
Income from Continuing Operations	189.0	264.2	236.7
Discontinued Operations:			
Income from Discontinued Operations Before Income Taxes	37.1	21.3	21.3
Income Tax Expense	8.3	2.4	2.5
Income from Discontinued Operations	28.8	18.9	18.8
Net Income	$ 217.8	$ 283.1	$ 255.5
Income Per Share from Continuing Operations	$ 2.88	$ 3.89	$ 3.43
Income Per Share from Discontinued Operations	0.44	0.28	0.27
Net Income Per Share	$ 3.32	$ 4.17	$ 3.70
Income Per Share from Continuing Operations Assuming Dilution	$ 2.87	$ 3.87	$ 3.40
Income Per Share from Discontinued Operations Assuming Dilution	0.43	0.28	0.27
Net Income Per Share Assuming Dilution	$ 3.30	$ 4.15	$ 3.67

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

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Unitrin, Inc. and Subsidiaries
Consolidated Statements of Cash Flows

DOLLARS IN MILLIONS	FOR THE YEARS ENDED DECEMBER 31, 2007	2006	2005
OPERATING ACTIVITIES			
Net Income	$ 217.8	$ 283.1	$ 255.5
Adjustments to Reconcile Net Income to Net Cash Provided by Operations:			
Policy Acquisition Costs Deferred	(325.0)	(351.1)	(370.8)
Amortization of Deferred Policy Acquisition Costs	330.3	342.6	355.0
Equity in Net Income of Investee before Taxes	(2.0)	(14.3)	(8.2)
Equity in Earnings of Investment Partnerships and Limited Liability Companies	(25.5)	(18.9)	(10.0)
Distribution of Accumulated Earnings of Investment Partnerships and Limited Liability Companies	27.1	12.9	9.0
Amortization of Investment Securities and Depreciation of Investment Real Estate	6.2	7.2	11.6
Provision for Loan Losses	166.8	62.4	47.4
Depreciation of Property and Equipment	20.9	22.2	20.7
Decrease in Other Receivables	69.1	97.5	3.7
Increase (Decrease) in Insurance Reserves and Unearned Premiums	(110.2)	(54.6)	91.5
Increase (Decrease) in Liabilities for Income Taxes	(53.4)	(6.3)	21.3
Increase (Decrease) in Accrued Expenses and Other Liabilities	(11.7)	(33.2)	11.1
Net Realized Investment Gains	(62.5)	(26.5)	(56.9)
Other, Net	4.2	(16.6)	(4.2)
Net Cash Provided by Operating Activities	252.1	306.4	376.7
INVESTING ACTIVITIES			
Sales and Maturities of Fixed Maturities	614.1	559.1	551.0
Purchases of Fixed Maturities	(435.1)	(354.7)	(554.5)
Sales of Northrop Common Stock	132.0	17.5	11.1
Sales of Other Equity Securities	103.5	84.5	93.3
Purchases of Other Equity Securities	(132.5)	(170.1)	(57.5)
Acquisitions and Improvements of Investment Real Estate	(24.2)	(39.2)	(98.9)
Sales of Investment Real Estate	8.7	1.8	41.9
Acquisitions of Investment Partnerships and Limited Liability Companies	(97.9)	(65.7)	(29.2)
Change in Short-term Investments	(184.0)	63.3	(166.9)
Repayments of Automobile Loan Receivables	644.2	627.6	581.6
Acquisitions of Automobile Loan Receivables	(793.3)	(806.9)	(767.1)
Acquisition of Business, Net of Cash Acquired	(46.9)	–	–
Disposition of Business, Net of Cash Disposed	3.9	–	–
Other, Net	(15.4)	(3.3)	(24.2)
Net Cash Used by Investing Activities	(222.9)	(86.1)	(419.4)
FINANCING ACTIVITIES			
Certificates of Deposits Issued	361.3	350.9	294.2
Certificates of Deposits Withdrawals	(249.7)	(262.5)	(142.3)
Notes Payable Proceeds	354.8	40.0	40.0
Notes Payable Payments	(300.0)	(40.1)	(40.1)
Cash Dividends Paid	(119.9)	(119.8)	(117.4)
Common Stock Repurchases	(139.5)	(89.9)	(48.9)
Cash Exercise of Stock Options	5.1	6.8	15.7
Excess Tax Benefits from Share-based Awards	1.3	3.4	–
Other, Net	4.0	4.3	3.9
Net Cash Provided (Used) by Financing Activities	(82.6)	(106.9)	5.1
Increase (Decrease) in Cash	(53.4)	113.4	(37.6)
Cash, Beginning of Year	157.9	44.5	82.1
Cash, End of Year, Including Cash Reported in Discontinued Operations	$ 104.5	$ 157.9	$ 44.5
Cash, End of Year, Reported in Discontinued Operations	(1.4)	–	–
Cash, End of Year	$ 103.1	$ 157.9	$ 44.5

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

Unitrin, Inc. and Subsidiaries
Consolidated Statements of Shareholders' Equity and Comprehensive Income

	FOR THE YEARS ENDED DECEMBER 31, 2007, 2006 AND 2005										
DOLLARS AND SHARES IN MILLIONS, EXCEPT PER SHARE AMOUNT	NUMBER OF SHARES		COMMON STOCK		PAID-IN CAPITAL		RETAINED EARNINGS		ACCUMULATED OTHER COMPRE-HENSIVE INCOME (LOSS)		TOTAL SHAREHOLDERS' EQUITY
BALANCE, DECEMBER 31, 2004	68.8	$	6.9	$	621.4	$	1,160.8	$	249.6	$	2,038.7
Net Income	–		–		–		255.5		–		255.5
Other Comprehensive Income (note 13)	–		–		–		–		1.6		1.6
Total Comprehensive Income											257.1
Cash Dividends to Shareholders ($1.70 per share)	–		–		–		(117.4)		–		(117.4)
Repurchases of Common Stock	(1.0)		(0.1)		(10.6)		(38.2)		–		(48.9)
Stock-based Compensation Cost (notes 1, 2 and 11)	–		–		11.9		–		–		11.9
Exercise of Stock Options, Net of Shares Exchanged (note 11)	0.7		0.1		88.9		(72.5)		–		16.5
Other	–		–		(0.2)		–		–		(0.2)
BALANCE, DECEMBER 31, 2005	68.5	$	6.9	$	711.4	$	1,188.2	$	251.2	$	2,157.7
Net Income	–		–		–		283.1		–		283.1
Other Comprehensive Income (note 13)	–		–		–		–		43.1		43.1
Total Comprehensive Income											326.2
Cash Dividends to Shareholders ($1.76 per share)	–		–		–		(119.8)		–		(119.8)
Repurchases of Common Stock	(2.0)		(0.2)		(21.6)		(68.1)		–		(89.9)
Stock-based Compensation Cost (notes 2 and 11)	–		–		11.9		–		–		11.9
Share-based Awards, Net of Shares Exchanged (note 11)	0.5		–		57.6		(52.2)		–		5.4
Adjustment to Initially Apply SFAS No. 158, Net of Tax (note 2)	–		–		–		–		(7.3)		(7.3)
Other	–		–		(0.2)		–		–		(0.2)
BALANCE, DECEMBER 31, 2006	67.0	$	6.7	$	759.1	$	1,231.2	$	287.0	$	2,284.0
Net Income	–		–		–		217.8		–		217.8
Other Comprehensive Income (note 13)	–		–		–		–		40.1		40.1
Total Comprehensive Income											257.9
Cash Dividends to Shareholders ($1.82 per share)	–		–		–		(119.9)		–		(119.9)
Repurchases of Common Stock	(3.0)		(0.3)		(35.6)		(103.6)		–		(139.5)
Stock-based Compensation Cost (notes 2 and 11)	–		–		15.7		–		–		15.7
Share-based Awards, Net of Shares Exchanged (note 11)	0.3		–		42.5		(39.3)		–		3.2
Equity in Investee's Adjustment to Initially Apply SFAS No. 158, Net of Tax (note 2)	–		–		–		–		(2.3)		(2.3)
Equity in Cumulative Effect of Investee's Adoption of FIN 48	–		–		–		(0.9)		–		(0.9)
Other	–		–		(0.4)		–		–		(0.4)
BALANCE, DECEMBER 31, 2007	64.3	$	6.4	$	781.3	$	1,185.3	$	324.8	$	2,297.8

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

NOTE 1. BASIS OF PRESENTATION AND SIGNIFICANT ESTIMATES

The Consolidated Financial Statements included herein have been prepared on the basis of GAAP and include the accounts of Unitrin, Inc. and its subsidiaries. All significant intercompany accounts and transactions have been eliminated.

On December 7, 2007, the Company signed a definitive agreement to sell its Unitrin Business Insurance operations to AmTrust in a cash transaction. AmTrust will acquire the renewal rights to the Unitrin Business Insurance book of business and certain legal entities and selected other assets and workforce that the Company currently employs to write its Unitrin Business Insurance business. The transaction is subject to approvals by insurance regulators and certain federal agencies and other customary closing conditions and is expected to close in the first quarter of 2008. Under the provisions of 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. In accordance with SFAS No. 144, amounts reported in the Consolidated Statements of Income and related disclosures for prior periods have been reclassified to conform with the current presentation (see Note 4, "Discontinued Operations," to the Consolidated Financial Statements).

The preparation of financial statements in conformity 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. Actual results could materially differ from those estimates and assumptions.

The fair values of Investments in Fixed Maturities, Investments in Equity Securities and Senior Notes Payable are estimated using quoted market prices where available. For securities not actively traded, fair values were estimated using values obtained from independent pricing services or broker dealers. The fair values of the Company's Investment in Investee and Investments in Northrop Preferred Stock and Northrop Common Stock are based on quoted market prices. The fair value of Automobile Loan Receivables is estimated by discounting the estimated future cash flows using the current rates at which loans would be made to borrowers with similar credit ratings and the same remaining maturities. The fair values of Certificates of Deposits have been estimated by discounting the future cash flows using the rates currently offered for deposits with similar remaining maturities. The carrying amounts reported in the Consolidated Balance Sheets approximate fair value for Cash, Short–term Investments and certain other assets and other liabilities because of their short–term nature.

The actual value at which such financial instruments could actually be sold or settled with a willing buyer or seller may differ from such estimated fair values depending on a number of factors including, but not limited to, current and future economic conditions, the quantity sold or settled, the presence of an active market and the availability of a willing buyer or seller.

The Reserve for Loan Losses is estimated using the Company's estimate of ultimate charge–offs and recoveries of loans based on past experience adjusted for current economic conditions. Such charge–offs and recoveries emerge over several years. Accordingly, the Company's actual ultimate net charge–off could materially differ from the Company's estimate due to a variety of factors including, but not limited to, trends and future conditions in the macroeconomic, socioeconomic and regulatory environment, the timing of charge–offs and recoveries, the value of collateral and changes in the overall credit quality of the loan portfolio.

The process of estimating and establishing reserves for losses and LAE for property and casualty insurance is inherently uncertain and the actual ultimate net cost of a claim may vary materially from the estimated amount reserved. The reserving process is particularly imprecise for claims involving asbestos, environmental matters, mold, construction defect and other emerging and/or long–tailed exposures, which may not be discovered or reported until years after the insurance policy period has ended. Management considers a variety of factors, including, but not limited to, past claims experience, current claim trends and relevant legal, economic and social conditions, in estimating reserves. A change in any one or more factors is likely to result in the ultimate net claim cost to differ from the estimated reserve. Such changes in estimates may be material.

The process of determining whether or not an asset is impaired or recoverable relies on projections of future cash flows, operating results and market conditions. Projections are inherently uncertain and, accordingly, actual future cash flows may differ materially from projected cash flows. As a result, the Company's assessment of the impairment of long-lived assets or the recoverability of assets such as Goodwill and Deferred Policy Acquisition Costs is susceptible to the risk inherent in making such projections.

NOTE 2. SUMMARY OF ACCOUNTING POLICIES

Investments

Investments in Fixed Maturities include bonds, notes and redemptive preferred stocks at fair value and are classified as available for sale. Investments in Equity Securities include common and non-redemptive preferred stocks and other equity interests at fair value and are classified as available for sale. Other equity interests consist of limited partnership interests in partnerships which the Company's interest is deemed minor under applicable accounting standards. Unrealized appreciation or depreciation, net of applicable deferred income taxes, on fixed maturities and equity securities is reported in Accumulated Other Comprehensive Income included in Shareholders' Equity. Short-term Investments include fixed maturities which mature within one year from the date of purchase, money market mutual funds, Federal funds sold and repurchase agreements at cost, which approximates fair value. Other Investments primarily include loans to policyholders, real estate, investments in certain limited liability investment companies and partnerships and mortgage loans. Loans to policyholders and mortgage loans are carried at unpaid principal balance. Real estate is carried at cost, net of accumulated depreciation. Investments in limited liability investment companies and limited partnerships in which the Company's interest is not deemed minor under applicable accounting standards are accounted for under the equity method of accounting. Gains and losses on sales of investments are computed on the specific identification method and are reported in the Consolidated Statements of Income in the period in which the sales occur. The Company regularly reviews its investment portfolio for factors that may indicate that a decline in fair value of an investment is other than temporary. Losses arising from other than temporary declines in fair value are computed on the specific identification method and reported in the Consolidated Statements of Income in the period that the decline is determined to be other than temporary.

Investment in Investee is accounted for under the equity method of accounting in the accompanying financial statements. The Company's voting percentage and share of earnings or losses of an investee is determined using the most recent and sufficiently timely publicly available audited financial statements and subsequent unaudited interim reports, which results in accounting on a three-month-delay basis. The Company recognizes into income its equity share of changes in an investee's reported net assets resulting from an investee's issuance of stock that is not part of a broader corporate reorganization.

Automobile Loan Receivables

Automobile Loan Receivables consists primarily of sub-prime loans to residents of California and other western and midwestern states. Automobile Loan Receivables is stated net of unearned discount, deferred loan fees and costs and reserve for loan losses. Unearned discount arises when the loan amount includes unearned precomputed interest. The Reserve for Loan Losses is maintained at a level which considers such factors as actual and expected loan loss experience and economic conditions to provide for estimated loan losses. Additions to the Reserve for Loan Losses are charged to expense. Actual loan losses or recoveries are charged or added, respectively as the case may be, to the Reserve for Loan Losses when incurred or received.

Deferred Policy Acquisition Costs

Costs directly associated with the acquisition of business, principally commissions and certain premium taxes and policy issuance costs, are deferred. Costs deferred on property and casualty insurance products and health insurance products are amortized over the term of the related policies. Costs deferred on traditional life insurance products are primarily amortized over the anticipated premium-paying period of the related policies in proportion to the ratio of the annual premiums to the total premiums anticipated, which is estimated using the same assumptions used in calculating policy reserves.

The Company accounts for the present value of the future profits embedded in life insurance in force acquired ("VIF") based on actuarial estimates of the present value of estimated net cash flows. VIF is classified as Deferred Policy Acquisition Costs in the Consolidated Balance Sheets. VIF is amortized using the effective interest method using interest rates consistent with the rates in the underlying insurance contracts. The Company estimates that it will record VIF amortization, net of interest, of $3.0 million, $2.7 million, $2.4 million, $2.2 million and $2.0 million in each of the next five years.

Goodwill

The Company accounts for Goodwill pursuant to the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets*. Accordingly, Goodwill is not amortized, but rather is tested annually for recoverability or when certain triggering events require testing. The Company tests Goodwill in the first quarter of its fiscal year. During the first quarters of 2007, 2006 and 2005, the Company tested Goodwill for recoverability and determined that Goodwill was fully recoverable.

Insurance Reserves

Reserves for losses and LAE on property and casualty coverage represent the estimated claim cost and loss adjustment expense necessary to cover the ultimate net cost of investigating and settling all losses incurred and unpaid. Such estimates are based on individual case estimates for reported claims and estimates for incurred but not reported losses. These estimates are adjusted in the aggregate for ultimate loss expectations based on historical experience patterns and current economic trends, with any change in the probable ultimate liabilities being reported in the Consolidated Statements of Income in the period of change. Such changes in estimates may be material.

For traditional life insurance products, the reserves for future policy benefits are estimated on the net level premium method based on rates for expected mortality, lapse rates and interest rates, including provisions for adverse mortality. These assumptions vary by such characteristics as plan, age at issue and policy duration. Mortality assumptions are based on the Company's historical experience and industry standards. Interest rate assumptions principally range from 3% to 7%. Lapse rate assumptions are based on actual and industry experience. Benefit reserves for universal life-type products represent policy account balances before applicable surrender charges.

Other Receivables, Other Assets and Accrued Expenses and Other Liabilities

Other Receivables primarily include amounts due from policyholders, reinsurance recoverables and accrued investment income. Other Assets primarily include property and equipment, prepaid expenses, prepaid and accrued taxes and insurance licenses acquired. Other Liabilities primarily include outstanding checks, accrued salaries and commissions, pension benefits, postretirement medical benefits and accrued taxes, licenses and fees.

Recognition of Earned Premiums and Related Expenses

Property and casualty insurance and health insurance premiums are recognized and earned ratably over the periods to which the premiums relate.

Traditional life insurance premiums are recognized as revenue when due. Policyholders' benefits are associated with related premiums to result in recognition of profits over the periods that the benefits are provided.

Premium revenues for universal life–type products consist of charges for the cost of insurance, policy administration and policy surrenders that have been assessed against policy account balances during the period.

Policyholders' Benefits and Incurred Losses and Loss Adjustment Expenses include provisions for future policy benefits under life and certain accident and health insurance contracts and provisions for reported claims, estimates for claims incurred but not reported and loss adjustment expenses. Benefit payments in excess of policy account balances are expensed.

Reinsurance

In the normal course of business, Unitrin's insurance subsidiaries reinsure certain risks above certain retention levels with other insurance enterprises. Amounts recoverable from reinsurers for benefits and losses for which Unitrin's insurance subsidiaries have not been relieved of their legal obligations to the policyholder are included in Other Receivables.

Gains related to long–duration reinsurance contracts are deferred and amortized over the life of the underlying reinsured policies. Losses related to long–duration reinsurance contracts are recognized immediately. Any gain or loss associated with reinsurance agreements for which Unitrin's insurance subsidiaries have been legally relieved of their obligations to the policyholder is recognized in the period of relief.

Automobile Finance Revenues and Expenses

Automobile Finance Revenues primarily include interest on Automobile Loan Receivables and miscellaneous revenues related to the loans. Interest income, including amortization of unearned discount and deferred loan fees, on Automobile Loan Receivables is recorded as interest is earned, using the effective yield method over the contractual life of the loans.

Automobile Finance Expenses includes Provisions for Loan Losses and General and Administrative Expenses.

Interest Expense on Certificates of Deposits is recorded using the effective yield method.

Income Taxes

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period in which the change is enacted.

The Company accounts for uncertain tax positions in accordance with FIN 48. Accordingly, the Company reports a liability for unrecognized tax benefits resulting from uncertain tax positions taken or expected to be taken in a tax return. The Company recognizes interest and penalties, if any, related to unrecognized tax benefits in income tax expense.

Stock-based Compensation

At December 31, 2007, the Company had five stock-based compensation plans, which are more fully described in Note 11, "Long Term Equity Compensation Plans," to the Consolidated Financial Statements. Awards granted, modified or settled prior to January 1, 2003 are accounted for in the Company's Consolidated Financial Statements for the year ended December 31, 2005 under the recognition and measurement principles of Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations. Awards granted, modified or settled after January 1, 2003 are accounted for in the Company's Consolidated Financial Statements for the year ended December 31, 2005 under the fair value recognition provisions of SFAS No. 123. Had all awards granted, modified or settled prior to January 1, 2003 been accounted for in the Company's Consolidated Financial Statements for the year ended December 31, 2005 under the fair value recognition and measurement provisions of SFAS No. 123, net income for the year ended December 31, 2005 on a pro forma basis would have been $255.3 million, a pro forma decrease of $0.2 million from Net Income as reported. All awards are accounted for in the Company's Consolidated Financial Statements for the years ended December 31, 2007 and 2006 under the fair value recognition provisions of SFAS No. 123(R), *Share-Based Payment*.

Accounting Changes

In December 2004, the FASB issued SFAS No. 123(R), *Share-Based Payment*. SFAS No. 123(R) replaces SFAS No. 123, *Accounting for Stock-Based Compensation*, and supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*. SFAS No. 123(R) requires compensation costs related to share-based payment transactions to be recognized in the financial statements over the period that an employee provides service in exchange for the award. In 2006, the Company adopted SFAS No. 123(R) using the modified prospective method effective January 1, 2006. Under the modified prospective method, companies record prospectively the compensation cost for new and modified awards, on or after the date of adoption, over the requisite service period of such awards. In addition, companies record compensation cost prospectively for the unvested portion, at the date of adoption, of previously issued and outstanding awards over the remaining requisite service period of such awards. The Company previously adopted SFAS No. 123 in 2003. Accordingly, the incremental effect of adoption of SFAS No. 123(R) was insignificant.

In November 2005, the FASB issued FASB Staff Position ("FSP") FAS 123(R)-3, *Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards*. FSP FAS 123(R)-3 provides an alternative transition method for establishing the beginning balance of the pool of excess tax benefits available to absorb tax deficiencies recognized subsequent to the adoption of SFAS No. 123(R) (the "APIC Pool"). In 2006, the Company elected to adopt the alternative transition method provided in FSP FAS 123(R)-3 for establishing the beginning balance of the APIC Pool. This method consists of a computational component that establishes a beginning balance of the APIC Pool related to employee compensation and a simplified method to determine the subsequent impact on the APIC Pool of employee awards that are fully vested and outstanding upon the adoption of SFAS No. 123(R). The impact on the APIC Pool of partially vested awards was insignificant.

In June 2006, the FASB issued 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, 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 consolidated 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.

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 the Company's defined benefit postretirement plans and provided the required disclosures as of December 31, 2006. The initial recognition of the funded status of the Company's defined benefit postretirement plans resulted in a decrease in Shareholders' Equity of $7.3 million, which was net of a tax benefit of $5.5 million. 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.

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 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 has 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.

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 income; 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.

NOTE 3. ACQUISITION OF BUSINESS

On June 29, 2007, Trinity, a subsidiary of Unitrin, acquired 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 consolidated 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 finalized the allocation of the purchase price to the fair value of the assets acquired and the liabilities assumed in the fourth quarter of 2007. The fair value of the net assets acquired exceeded the purchase price. Accordingly, in accordance with SFAS No. 141, *Business Combinations*, such excess has been allocated to reduce the fair value of non–financial assets acquired. Based on the Company's allocation of the purchase price, assets acquired and liabilities assumed at the date of acquisition 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 4. DISCONTINUED OPERATIONS

The Company accounts for its Unitrin Business Insurance operations as discontinued operations in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long Lived Assets*, (see Note 1, "Basis of Presentation and Significant Estimates," to the Consolidated Financial Statements). In accordance with SFAS

No. 144, the Company has reclassified amounts reported in the Consolidated Statements of Income and related disclosures for prior periods to conform to the current presentation. Results for discontinued operations for the years ended December 31, 2007, 2006 and 2005, are presented below:

DOLLARS IN MILLIONS	2007	2006	2005
Earned Premiums	$171.5	$188.2	$190.6
Net Investment Income	25.3	28.2	28.2
Other Income	–	1.9	–
Total Revenues	196.8	218.3	218.8
Incurred Losses and Loss Adjustment Expenses	71.6	108.8	116.6
Insurance Expenses	88.1	88.2	80.9
Income from Discontinued Operations before Income Taxes	37.1	21.3	21.3
Income Tax Expense	8.3	2.4	2.5
Income from Discontinued Operations	$ 28.8	$ 18.9	$ 18.8

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 Consolidated Statements of Income exclude indirect overhead expenses of $4.9 million, $5.8 million and $5.0 million for the years ended December 31, 2007, 2006 and 2005, 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 $13.6 million, $14.7 million and $14.2 million for the years ended December 31, 2007, 2006 and 2005, respectively.

The components of Assets of Discontinued Operations and Liabilities of Discontinued Operations at December 31, 2007 were:

DOLLARS IN MILLIONS	
Assets:	
Investments:	
Fixed Maturities at Fair Value (Amortized Cost—$29.7)	$ 31.1
Short–term Investments at Cost which Approximates Fair Value	5.3
Total Investments	36.4
Cash	1.4
Other Receivables	39.5
Deferred Policy Acquisition Costs	15.0
Goodwill	30.0
Other Assets	5.7
Total Assets of Discontinued Operations	128.0
Liabilities:	
Unearned Premiums	50.8
Accrued Expenses and Other Liabilities	0.5
Total Liabilities of Discontinued Operations	51.3
Net Assets of Discontinued Operations	$ 76.7

The Company will retain Property and Casualty Insurance Reserves for unpaid insured losses and LAE that have occurred and will occur prior to closing 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 Consolidated Balance Sheet at December 31, 2007 include $342.2 million for unpaid insured losses and LAE 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 5. INVESTMENTS

The amortized cost and estimated fair values of the Company's Investments in Fixed Maturities at December 31, 2007, were:

		GROSS UNREALIZED		
DOLLARS IN MILLIONS	AMORTIZED COST	GAINS	LOSSES	FAIR VALUE
U.S. Government and Government Agencies and Authorities	$ 1,099.8	$ 16.5	$ (7.6)	$ 1,108.7
States, Municipalities and Political Subdivisions	1,321.9	43.8	(1.6)	1,364.1
Corporate Securities:				
Bonds and Notes	1,107.9	36.7	(11.4)	1,133.2
Redemptive Preferred Stocks	79.3	1.5	(0.1)	80.7
Investments in Fixed Maturities	$ 3,608.9	$ 98.5	$ (20.7)	$ 3,686.7

The amortized cost and estimated fair values of the Company's Investments in Fixed Maturities at December 31, 2006, were:

		GROSS UNREALIZED		
DOLLARS IN MILLIONS	AMORTIZED COST	GAINS	LOSSES	FAIR VALUE
U.S. Government and Government Agencies and Authorities	$ 1,226.7	$ 9.1	$ (36.3)	$ 1,199.5
States, Municipalities and Political Subdivisions	1,358.5	50.3	(0.8)	1,408.0
Corporate Securities:				
Bonds and Notes	1,187.8	42.5	(12.3)	1,218.0
Redemptive Preferred Stocks	7.3	0.1	–	7.4
Investments in Fixed Maturities	$ 3,780.3	$ 102.0	$ (49.4)	$ 3,832.9

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Unitrin, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements—(Continued)

The amortized cost and estimated fair values of the Company's Investments in Fixed Maturities at December 31, 2007, by contractual maturity, were:

DOLLARS IN MILLIONS		AMORTIZED COST		FAIR VALUE
Due in One Year or Less	$	122.4	$	123.2
Due after One Year to Five Years		199.8		207.1
Due after Five Years to Fifteen Years		1,425.6		1,465.7
Due after Fifteen Years		1,588.1		1,618.4
Asset-backed Securities Not Due at a Single Maturity Date		273.0		272.3
Investments in Fixed Maturities	$	3,608.9	$	3,686.7

The expected maturities of the Company's Investments in Fixed Maturities may differ from the contractual maturities because debtors may have the right to call or prepay obligations with or without call or prepayment penalties. Investments in Asset-backed Securities Not Due at a Single Maturity Date were concentrated in securities issued by U.S. government agencies and authorities at December 31, 2007.

Gross unrealized gains and gross unrealized losses on the Company's Investments in Northrop Preferred Stock, Northrop Common Stock and Other Equity Securities at December 31, 2007, were:

DOLLARS IN MILLIONS		COST		GROSS UNREALIZED GAINS		GROSS UNREALIZED LOSSES		FAIR VALUE
Northrop Preferred Stock	$	177.5	$	81.0	$	–	$	258.5
Northrop Common Stock	$	245.5	$	202.0	$	–	$	447.5
Other Equity Securities:								
Preferred Stocks	$	82.2	$	8.0	$	(2.8)	$	87.4
Common Stocks		324.9		156.5		(4.3)		477.1
Other Equity Interests		29.4		3.8		(0.1)		33.1
Total Other Equity Securities	$	436.5	$	168.3	$	(7.2)	$	597.6

Gross unrealized gains and gross unrealized losses on the Company's Investments in Northrop Preferred Stock, Northrop Common Stock and Other Equity Securities at December 31, 2006, were:

DOLLARS IN MILLIONS		COST		GROSS UNREALIZED GAINS		GROSS UNREALIZED LOSSES		FAIR VALUE
Northrop Preferred Stock	$	177.5	$	58.5	$	–	$	236.0
Northrop Common Stock	$	318.8	$	181.5	$	–	$	500.3
Other Equity Securities:								
Preferred Stocks	$	56.3	$	12.5	$	(0.1)	$	68.7
Common Stocks		328.8		149.3		(1.9)	$	476.2
Other Equity Interests		22.7		1.7		–		24.4
Total Other Equity Securities	$	407.8	$	163.5	$	(2.0)	$	569.3

Unitrin, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements—(Continued)

An aging of unrealized losses on the Company's Investments in Fixed Maturities and Other Equity Securities at December 31, 2007, is presented below:

DOLLARS IN MILLIONS	LESS THAN 12 MONTHS FAIR VALUE	LESS THAN 12 MONTHS UNREALIZED LOSSES	12 MONTHS OR LONGER FAIR VALUE	12 MONTHS OR LONGER UNREALIZED LOSSES	TOTAL FAIR VALUE	TOTAL UNREALIZED LOSSES
Fixed Maturities:						
U.S. Government and Government Agencies and Authorities	$ 24.2	$ (0.1)	$ 536.0	$ (7.5)	$ 560.2	$ (7.6)
States, Municipalities and Political Subdivisions	112.7	(1.2)	22.2	(0.4)	134.9	(1.6)
Corporate Securities:						
Bonds and Notes	211.8	(3.1)	161.9	(8.3)	373.7	(11.4)
Redemptive Preferred Stocks	3.8	(0.1)	-	-	3.8	(0.1)
Total Fixed Maturities	352.5	(4.5)	720.1	(16.2)	1,072.6	(20.7)
Other Equity Securities:						
Preferred Stocks	15.0	(2.8)	2.9	-	17.9	(2.8)
Common Stocks	38.8	(4.2)	0.6	(0.1)	39.4	(4.3)
Other Equity Interests	5.2	(0.1)	–	-	5.2	(0.1)
Total Other Equity Securities	59.0	(7.1)	3.5	(0.1)	62.5	(7.2)
Total	$ 411.5	$ (11.6)	$ 723.6	$ (16.3)	$ 1,135.1	$ (27.9)

An aging of unrealized losses on the Company's Investments in Fixed Maturities and Other Equity Securities at December 31, 2006, is presented below:

DOLLARS IN MILLIONS	LESS THAN 12 MONTHS FAIR VALUE	LESS THAN 12 MONTHS UNREALIZED LOSSES	12 MONTHS OR LONGER FAIR VALUE	12 MONTHS OR LONGER UNREALIZED LOSSES	TOTAL FAIR VALUE	TOTAL UNREALIZED LOSSES
Fixed Maturities:						
U.S. Government and Government Agencies and Authorities	$ 113.0	$ (0.6)	$ 965.1	$ (35.7)	$ 1,078.1	$ (36.3)
States, Municipalities and Political Subdivisions	50.5	(0.5)	8.8	(0.3)	59.3	(0.8)
Corporate Securities:						
Bonds and Notes	198.9	(3.3)	171.2	(9.0)	370.1	(12.3)
Redemptive Preferred Stocks	1.0	–	1.3	–	2.3	-
Total Fixed Maturities	363.4	(4.4)	1,146.4	(45.0)	1,509.8	(49.4)
Other Equity Securities:						
Preferred Stocks	4.6	(0.1)	2.9	-	7.5	(0.1)
Common Stocks	21.6	(1.7)	2.6	(0.2)	24.2	(1.9)
Total Other Equity Securities	26.2	(1.8)	5.5	(0.2)	31.7	(2.0)
Total	$ 389.6	$ (6.2)	$ 1,151.9	$ (45.2)	$ 1,541.5	$ (51.4)

Unrealized losses on fixed maturities were $20.7 million at December 31, 2007, of which $16.2 million related to fixed maturities that have continued in an unrealized loss position for more than 12 months. These fixed maturities are concentrated in U.S. Government and Government Agencies and Authorities and investment–grade corporate bonds and notes, which the Company fully expects to recover.

Unrealized losses on fixed maturities were $49.4 million at December 31, 2006, of which $45.0 million related to fixed maturities that have continued in an unrealized loss position for more than 12 months. These fixed maturities are concentrated in U.S. Government and Government Agencies and Authorities and investment-grade corporate bonds and notes, which the Company fully expects to recover.

The Company regularly reviews its investment portfolio for factors that may indicate that a decline in fair value of an investment is other than temporary. Based on evaluations at December 31, 2007 and 2006, of the prospects of the issuers, including, but not limited to, the length of time and magnitude of the unrealized loss, and the credit ratings of the issuers of the investments in the above fixed maturities, and the Company's intentions to sell or ability to hold the investments, the Company concluded that the declines in the fair values of the Company's investments in fixed maturities at the respective evaluation dates are temporary.

For substantially all equity securities with an unrealized loss that has continued for more than 12 months, such unrealized loss was less than 10% of the Company's carrying value of each equity security, which the Company expects to recover. The Company considers various factors when considering if a decline in the fair value of an equity security is other than temporary including, but not limited to:

a) The length of time and magnitude of the unrealized loss;

b) The volatility of the investment;

c) Analyst recommendations and price targets;

d) Opinions of the Company's external investment managers;

e) Market liquidity; and

f) The Company's intentions to sell or ability to hold the investments.

Based on evaluations of these factors at December 31, 2007 and 2006, the Company concluded that the declines in the fair values of the Company's investments in equity securities at the respective evaluation dates are temporary.

The carrying value, fair value and approximate voting percentage for the Company's investment in the common stock of Intermec, which is accounted for under the equity method of accounting and reported as Investment in Investee in the Company's Consolidated Balance Sheets, at December 31, 2007 and 2006, were:

DOLLARS IN MILLIONS	2007	2006
Carrying Value	$ 90.7	$ 92.7
Fair Value	$257.1	$307.2
Approximate Voting Percentage	20.7%	20.4%

Equity in Net Income of Investee was $1.2 million, $9.2 million and $5.3 million for the years ended December 31, 2007, 2006 and 2005, respectively. Intermec recognized the financial impact of SFAS No. 158 in its financial statements at December 31, 2006. Intermec initially applied the provisions of FIN 48 on January 1, 2007. 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 and recognized a decrease of $0.9 million, which was net of a tax benefit of $0.5 million, to the Company's Shareholders' Equity in the second quarter of 2007 for its pro rata share of the impact of Intermec's adoption of FIN 48.

Prior to the periods presented in the Consolidated Financial Statements, the Company determined that a decline in the fair value of its investment in Intermec was other than temporary under applicable accounting standards.

Accordingly, the Company reduced the carrying value of its investment in Intermec to its then current estimated realizable value and allocated the reduction to the Company's proportionate share of Intermec's non–current assets. Accordingly, the Company's reported equity in the net income of Intermec differs from the Company's proportionate share of Intermec's reported results to the extent that such results include depreciation, amortization or other charges related to such non–current assets. During the first quarter of 2005, the Company estimated that Intermec had subsequently fully recognized in its financial statements the amortization, depreciation or write–downs of such non–current assets. Accordingly, for periods beginning after the first quarter of 2005, Equity in Net Income of Investee equals the Company's proportionate share of Intermec's results. The fair value of the Company's investment in Intermec subsequently recovered such that the fair value exceeded the carrying value of the Company's investment in Intermec by $166.4 million and $214.5 million at December 31, 2007 and 2006, respectively. In accordance with applicable accounting standards, such excess is not recorded in the Consolidated Financial Statements.

The carrying values of the Company's Other Investments at December 31, 2007 and 2006, were:

DOLLARS IN MILLIONS	2007	2006
Loans to Policyholders	$191.4	$188.3
Real Estate	243.0	230.5
Limited Partnerships and Limited Liability Companies	265.2	169.3
Other	7.1	6.5
Total	$706.7	$594.6

NOTE 6. AUTOMOBILE LOAN RECEIVABLES AND CERTIFICATES OF DEPOSITS

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 December 31, 2007 and 2006, were:

DOLLARS IN MILLIONS	2007	2006
Sales Contracts and Loans Receivables	$1,390.8	$1,331.3
Unearned Discounts and Deferred Fees	(28.9)	(35.5)
Net Automobile Loan Receivables Due	1,361.9	1,295.8
Reserve for Loan Losses	(148.4)	(68.8)
Automobile Loan Receivables	$1,213.5	$1,227.0

An aging of Net Automobile Loan Receivables Due at December 31, 2007 and 2006, is presented below:

DOLLARS IN MILLIONS	AMOUNT DEC. 31, 2007	AS A PERCENTAGE OF NET AUTOMOBILE LOAN RECEIVABLES DUE DEC. 31, 2007	AMOUNT DEC. 31, 2006	AS A PERCENTAGE OF NET AUTOMOBILE LOAN RECEIVABLES DUE DEC. 31, 2006
Current	$ 833.1	61.2%	$ 782.7	60.4%
Past Due:				
Less than 30 Days	356.7	26.2	346.1	26.7
30 Days to 59 Days	111.1	8.1	111.6	8.6
60 Days to 89 Days	45.8	3.4	38.5	3.0
90 Days and Greater	15.2	1.1	16.9	1.3
Net Automobile Loan Receivables Due	1,361.9	100.0%	1,295.8	100.0%
Reserve for Loan Losses	(148.4)		(68.8)	
Automobile Loan Receivables	$ 1,213.5		$ 1,227.0	

Activity in the Reserve for Loan Losses for the years ended December 31, 2007, 2006 and 2005, was:

DOLLARS IN MILLIONS	2007	2006	2005
Reserve for Loan Losses—At Beginning of Year	$ 68.8	$ 62.6	$ 56.6
Provision for Loan Losses	166.8	62.4	47.4
Net Charge–off:			
Automobile Loan Receivables Charged–off	(139.4)	(105.6)	(82.5)
Automobile Loan Receivables Recovered	52.2	49.4	41.1
Net Charge–off	(87.2)	(56.2)	(41.4)
Reserve for Loan Losses—At End of Year	$ 148.4	$ 68.8	$ 62.6

The weighted–average interest rates on Certificates of Deposits were 4.91% and 4.72% at December 31, 2007 and 2006, respectively. The range of interest rates on Certificates of Deposits was 2.35% to 5.85% at December 31, 2007 and 2.10% to 5.85% at December 31, 2006. Certificates of Deposits are generally fixed in maturity. The contractual maturities of Certificates of Deposits at December 31, 2007 and 2006, were:

DOLLARS IN MILLIONS	2007	2006
Due in One Year or Less	$ 422.5	$ 479.5
Due after One Year to Three Years	414.9	341.3
Due after Three Years to Five Years	433.9	326.5
Due after Five Years	3.0	15.4
Total Certificates of Deposits	$ 1,274.3	$ 1,162.7

NOTE 7. PROPERTY AND CASUALTY INSURANCE RESERVES

Property and Casualty Insurance Reserve activity for the years ended December 31, 2007, 2006 and 2005, was:

DOLLARS IN MILLIONS	2007	2006	2005
Beginning Property and Casualty Insurance Reserves:			
Gross of Reinsurance at Beginning of Year	$1,432.6	$1,531.5	$1,510.7
Less Reinsurance Recoverables at Beginning of Year	137.9	208.9	228.9
Property and Casualty Insurance Reserves, Net of Reinsurance at Beginning of Year	1,294.7	1,322.6	1,281.8
Acquired, Net of Reinsurance	24.7	–	–
Incurred Losses and LAE related to:			
Current Year:			
Continuing Operations	1,290.6	1,221.3	1,267.2
Discontinued Operations	117.3	134.6	131.1
Total Incurred Losses and LAE related to Current Year	1,407.9	1,355.9	1,398.3
Prior Years:			
Continuing Operations	(55.4)	(65.8)	(77.6)
Discontinued Operations	(45.7)	(25.8)	(14.5)
Total Incurred Losses and LAE related to Prior Years	(101.1)	(91.6)	(92.1)
Total Incurred Losses and LAE	1,306.8	1,264.3	1,306.2
Paid Losses and LAE related to:			
Current Year:			
Continuing Operations	831.3	730.3	734.3
Discontinued Operations	42.2	53.7	44.5
Total Paid Losses and LAE related to Current Year	873.5	784.0	778.8
Prior Years:			
Continuing Operations	433.6	431.2	387.2
Discontinued Operations	81.0	77.0	99.4
Total Paid Losses and LAE related to Prior Years	514.6	508.2	486.6
Total Paid Losses and LAE	1,388.1	1,292.2	1,265.4
Property and Casualty Insurance Reserves, Net of Reinsurance at End of Year	$1,238.1	$1,294.7	$1,322.6
Plus Reinsurance Recoverables at End of Year	84.8	137.9	208.9
Property and Casualty Insurance Reserves, Gross of Reinsurance at End of Year	$1,322.9	$1,432.6	$1,531.5

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 Consolidated Statements of Income in the period of change.

In 2007, the Company reduced its property and casualty insurance reserves by $101.1 million to record favorable development of losses and LAE from prior accident years. Personal lines insurance losses and LAE and commercial lines insurance losses and LAE developed favorably by $44.4 million and $56.7 million, respectively, in 2007. The reserve reductions were primarily due to the emergence of more favorable loss trends than expected for the 2006, 2005 and 2004 accident years, partially due to the improvements in the Company's claims handling procedures. In 2006, the Company reduced its property and casualty insurance reserves by $91.6 million to record favorable development of losses and LAE from prior accident years. Personal lines insurance losses and LAE and commercial lines insurance losses and LAE developed favorably by $63.6 million and $28.0 million, respectively, in 2006. 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. In 2005, the Company reduced its property and casualty insurance reserves by $92.1 million to record favorable development of losses and LAE from prior accident years. Personal lines insurance losses and LAE and commercial lines insurance losses and LAE developed favorably by $73.1 million and $19.0 million, respectively, in 2005. The reserve reductions were primarily due to the emergence of more favorable loss trends than expected for the 2004 and 2003 accident years, partially due to improvements in the Company's claims handling procedures.

The Company cannot predict whether or not losses and LAE will develop favorably or unfavorably from the amounts reported in the Company's 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.

Reinsurance recoverables on property and casualty insurance reserves were $84.8 million and $137.9 million at December 31, 2007 and 2006, respectively. These reinsurance recoverables are concentrated with several reinsurers, the vast majority of which are highly rated by one or more of the principal investor and/or insurance company rating agencies. While most of the reinsurance recoverables were unsecured at December 31, 2007 and 2006, the agreements with the reinsurers generally provide for some form of collateralization upon the occurrence of certain events. The largest reinsurance recoverable on property and casualty insurance is from General Security National Insurance Company ("GSNIC"), a subsidiary of SCOR. In 2002, the Company acquired two insurance companies from SCOR. Under the agreement governing the acquisition of these insurance companies, SCOR and/or GSNIC are responsible for all liabilities of these insurance companies incurred prior to the acquisition. Reinsurance recoverables at December 31, 2007 and 2006, included $45.7 million and $93.5 million, respectively, from GSNIC.

NOTE 8. NOTES PAYABLE

Total debt outstanding at December 31, 2007 and 2006, was:

DOLLARS IN MILLIONS	2007	2006
Senior Notes Payable at Amortized Cost:		
6.00% Senior Notes due May 15, 2017	**$355.0**	$ –
4.875% Senior Notes due November 1, 2010	**199.1**	198.8
5.75% Senior Notes due July 1, 2007	**–**	299.6
Mortgage Note Payable at Amortized Cost	**6.0**	6.1
Total Debt Outstanding	**$560.1**	$504.5

Interest Expense, including facility fees and accretion of discount, for the years ended December 31, 2007, 2006 and 2005, was:

DOLLARS IN MILLIONS	2007	2006	2005
Notes Payable under Revolving Credit Agreements	$ 0.4	$ 0.5	$ 0.5
Senior Notes Payable:			
6.00% Senior Notes due May 15, 2017	14.1	–	–
4.875% Senior Notes due November 1, 2010	10.0	10.0	10.0
5.75% Senior Notes due July 1, 2007	9.0	18.0	17.9
Mortgage Note Payable	0.4	0.4	0.4
Interest Expense before Capitalization of Interest	33.9	28.9	28.8
Capitalization of Interest	(0.3)	–	–
Total Interest Expense	$33.6	$28.9	$28.8

Interest Paid, including facility fees, for the years ended December 31, 2007, 2006 and 2005, was:

DOLLARS IN MILLIONS	2007	2006	2005
Notes Payable under Revolving Credit Agreements	$ 0.2	$ 0.5	$ 0.7
Senior Notes Payable:			
6.00% Senior Notes due May 15, 2017	11.1	–	–
4.875% Senior Notes due November 1, 2010	9.8	9.8	9.8
5.75% Senior Notes due July 1, 2007	17.2	17.2	17.2
Mortgage Note Payable	0.4	0.4	0.4
Total Interest Paid	$38.7	$27.9	$28.1

On June 24, 2005, the Company entered into a five–year, $325 million, unsecured, revolving credit agreement, expiring June 30, 2010, with a group of financial institutions. The agreement provides for fixed and floating rate advances for periods up to one year at various interest rates. The agreement also contains various financial covenants, including limits on total debt to total capitalization and minimum risk–based capital ratios for the Company's largest insurance subsidiaries. The proceeds from advances under the revolving credit facility may be used for general corporate purposes. The new revolving credit agreement replaced the Company's former $360 million revolving credit agreement which would have expired on August 30, 2005, but was terminated as of June 24, 2005. The Company had no outstanding advances under its unsecured revolving credit agreements at December 31, 2007 and 2006. Undrawn letters of credit issued pursuant to the unsecured, revolving credit agreement were $13.1 million at both December 31, 2007 and 2006. Accordingly, the amounts available for future borrowing were $311.9 million at both December 31, 2007 and 2006.

In 2007, the Company issued $360 million of its 6.00% Senior Notes due May 15, 2017. 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 $354.8 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 on July 1, 2007.

In 2003, the Company issued $200 million of its 4.875% Senior Notes due November 1, 2010 for an effective yield of 5.04%. The 4.875% 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.

In 2002, the Company issued $300 million of its 5.75% Senior Notes due July 1, 2007 for an effective yield of 5.99%. The 5.75% Senior Notes were retired in 2007.

NOTE 9. LEASES

The Company leases certain office space under non-cancelable operating leases, with initial terms typically ranging from 1 to 10 years, along with options that permit renewals for additional periods. The Company also leases certain equipment under non-cancelable operating leases, with initial terms typically ranging from 1 to 5 years. Minimum rent is expensed on a straight-line basis over the term of the lease.

Net rental expense for operating leases for the years ended December 31, 2007, 2006 and 2005, was:

DOLLARS IN MILLIONS	2007	2006	2005
Minimum Rental Expense	$26.8	$25.7	$23.1
Less Sublease Rental Income	–	(0.1)	(0.1)
Net Rental Expense	$26.8	$25.6	$23.0

Future minimum lease payments under operating leases at December 31, 2007, were:

DOLLARS IN MILLIONS	OPERATING LEASES
2008	$ 26.3
2009	25.5
2010	21.6
2011	18.1
2012	12.7
2013 and Thereafter	49.8
Total Future Payments	$ 154.0

The total of minimum rentals to be received in the future under non-cancelable subleases was $1.3 million at December 31, 2007. Capital leases are not material.

NOTE 10. SHAREHOLDERS' EQUITY

The Company is authorized to issue 20 million shares of $0.10 par value preferred stock and 100 million shares of $0.10 par value common stock. No preferred shares were issued or outstanding at December 31, 2007 and 2006.

On August 4, 2004, the Board of Directors declared a dividend distribution of one preferred share purchase right for each outstanding share of common stock of Unitrin, pursuant to a shareholder rights plan. The rights have a term of 10 years. The description and terms of the rights are set forth in a rights agreement between Unitrin and Computershare Trust Company, N.A., as rights agent.

At December 31, 2007, there are approximately 3.4 million shares of the Company's outstanding common stock that can be repurchased under the outstanding repurchase authorization of the Company's Board of Directors. Common stock can be repurchased in the open market or in privately negotiated transactions from time to time subject to market conditions and other factors. The Company repurchased and retired 3.0 million shares of its common stock in open market transactions at an aggregate cost of $139.5 million in 2007. The Company repurchased and retired approximately 2.0 million shares of its common stock in open market transactions at an aggregate cost of $89.9 million in 2006. Common Stock, Paid-in Capital and Retained Earnings were reduced on a pro rata basis for the cost of the repurchased shares.

Various state insurance laws restrict the amount that an insurance subsidiary may pay in the form of dividends, loans or advances without the prior approval of regulatory authorities. Also, that portion of an insurance subsidiary's net equity which results from differences between statutory insurance accounting practices and GAAP would not be available for cash dividends, loans or advances. Unitrin's subsidiaries paid dividends of $239.8 million in cash and securities to Unitrin in 2007. In 2008, Unitrin's insurance subsidiaries would be able to pay approximately $162.5 million in dividends to Unitrin without prior regulatory approval. The Company does not expect Fireside Bank to pay a dividend in 2008. Retained Earnings at December 31, 2007, also includes $54.4 million representing the undistributed equity in the net income and accumulated other comprehensive income of investee.

Unitrin's insurance subsidiaries are required to file financial statements prepared on the basis of statutory insurance accounting practices which is a comprehensive basis of accounting other than GAAP. Statutory capital and surplus for the Company's life and health insurance subsidiaries was approximately $340 million and was $320.8 million at December 31, 2007 and 2006, respectively. Statutory capital and surplus for the Company's property and casualty insurance subsidiaries was approximately $1,145 million and was $1,184.3 million at December 31, 2007 and 2006, respectively. Statutory net income for the Company's life and health insurance subsidiaries was income of approximately $62 million, was income of $84.9 million and was a loss of $15.0 million for the years ended December 31, 2007, 2006 and 2005, respectively. Statutory net income for the Company's property and casualty insurance subsidiaries was approximately $120 million, was $170.5 million and was $106.7 million for the years ended December 31, 2007, 2006 and 2005, respectively. Statutory capital and surplus and statutory net income exclude Fireside Bank and parent company operations.

NOTE 11. LONG TERM EQUITY COMPENSATION PLANS

Unitrin has adopted a number of long-term equity-based compensation plans to attract, motivate and retain key employees and/or directors of the Company. The Company's stock option plans provide for the grant of stock options and stock settled stock appreciation rights ("SARs"). In addition, restricted stock and restricted stock units may be granted under the Company's 2005 Restricted Stock and Restricted Stock Unit Plan. Options outstanding and available for future grants under all of the Company's stock option plans at December 31, 2007, are:

	OPTIONS OUTSTANDING	WEIGHTED-AVERAGE EXERCISE PRICE	OPTIONS AVAILABLE FOR FUTURE GRANTS
1995 Director Plan	218,177	$ 43.32	112,000
2002 Option Plan	2,691,820	47.27	1,656,056
1997 Option Plan	2,244,232	46.87	–
1990 Option Plan	121,729	48.02	–
Total Stock Option Plans	5,275,958	$ 46.95	1,768,056

The Company has four stock option plans, all of which have been approved by the Company's shareholders. Stock options to purchase the Unitrin's common stock granted to employees and directors are granted at prices equal to the fair market value of the Unitrin's common stock on the date of grant. Employee options generally vest over a period of three and one-half years and expire ten years from the date of grant. The Compensation Committee of the Board of Directors, or the Board's authorized designee, has sole discretion to determine the persons to whom options are granted, the number of shares covered by such options and the exercise price, vesting and expiration dates of such options. Options are non-transferable and are exercisable in installments. Prior to 2003, only non-qualified stock options had been granted. However, beginning in 2003, non-qualified stock options granted to employees were coupled with tandem stock appreciation rights ("Tandem SARs"), settled in Unitrin common stock.

Under the 1995 Director Plan, each new member of the Board of Directors who is not employed by the Company receives an initial option to purchase 4,000 shares of the Company's common stock immediately upon becoming a director. Thereafter, on the date of each of the Company's annual meetings of shareholders, each such eligible director automatically receives an annual grant of options to purchase 4,000 shares of common stock for so long as they remain eligible directors. Options granted under the 1995 Director Plan are exercisable one year from the date of grant at an exercise price equal to the fair market value of the Unitrin's common stock on the date of grant and expire 10 years from the date of grant.

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 the Unitrin's 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 the Unitrin's 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 December 31, 2007, 251,500 shares of restricted stock having a weighted-average grant date fair value of $46.97 have been awarded, of which 17,188 shares were forfeited and 17,640 were tendered to satisfy tax withholding obligations. 783,328 common shares remain available for future grants under the Company's restricted stock plan.

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's common stock on the date of grant for original grants made after December 31, 2005. For Restorative Options, the annualized yield on Unitrin's common stock for the month prior to the grant of the Restorative Option is used for restorative grants made after December 31, 2005. For all grants made in years prior to 2006, the dividend yield on Unitrin's common stock was a 5-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 years ended December 31, 2007, 2006 and 2005, were as follows:

	2007	2006	2005
RANGE OF VALUATION ASSUMPTIONS			
Expected Volatility	17.47% – 22.55%	18.79% – 23.60%	19.31% – 24.26%
Risk Free Interest Rate	3.31% – 4.94%	4.30% – 5.14%	2.66% – 4.38%
Expected Dividend Yield	3.51% – 4.18%	3.55% – 4.25%	4.44% – 4.65%
WEIGHTED–AVERAGE EXPECTED LIFE			
Employee Grants	2 – 7 years	2 – 7 years	1 – 7 years
Director Grants	4 – 6 years	4 – 6 years	8 years

Option and SAR activity for the year ended December 31, 2007, is presented below:

	SHARES SUBJECT TO OPTIONS	WEIGHTED–AVERAGE EXERCISE PRICE PER SHARE	WEIGHTED–AVERAGE REMAINING CONTACTUAL LIFE (IN YEARS)	AGGREGATE INTRINSIC VALUE ($ IN MILLIONS)
Outstanding at Beginning of the Year	5,244,954	$ 45.50		
Granted	1,475,708	49.38		
Exercised	(1,262,090)	43.42		
Forfeited or Expired	(182,614)	49.22		
Outstanding at December 31, 2007	5,275,958	$ 46.95	5.01	$ 10.8
Vested and Expected to Vest	5,195,672	$ 46.96	4.97	$ 10.6
Exercisable at December 31, 2007	3,933,584	$ 46.47	4.54	$ 9.8

The weighted–average grant–date fair values of options granted during 2007, 2006 and 2005 were $6.39, $5.79 and $4.95, respectively. Total intrinsic value of stock options exercised was $7.4 million, $14.3 million and $27.2 million for the years ended December 31, 2007, 2006 and 2005, respectively. Cash received from option exercises was $5.1 million, $6.8 million and $15.7 million for the years ended December 31, 2007, 2006 and 2005, respectively. Total tax benefits realized for tax deductions from option exercises were $2.6 million, $5.2 million and $9.5 million for the years ended December 31, 2007, 2006 and 2005, respectively.

Activity related to nonvested restricted stock for the year ended December 31, 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	119,100	47.42
Vested	(35,874)	48.77
Forfeited	(15,163)	47.56
Nonvested Balance at December 31, 2007	177,489	$ 46.44

The total fair value of restricted stock that vested during the year ended December 31, 2007 was $1.5 million. Tax benefits for tax deductions realized from such vesting of restricted stock were $0.5 million.

For 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 $15.7 million, $11.9 million and $11.9 million for the years ended December 31, 2007, 2006 and 2005, respectively. Total unamortized compensation expense related to nonvested awards of such plans at December 31, 2007 was $8.7 million, which is expected to be recognized over a weighted–average period of approximately 1.6 years.

NOTE 12. NET INCOME PER SHARE

Net Income Per Share and Net Income Per Share Assuming Dilution for the years ended December 31, 2007, 2006 and 2005, were:

DOLLARS AND SHARES IN MILLIONS, EXCEPT PER SHARE AMOUNTS	2007	2006	2005
Income from Continuing Operations	**$189.0**	$264.2	$236.7
Income from Discontinued Operations	**28.8**	18.9	18.8
Dilutive Effect on Income from Continuing Operations from Investee's Equivalent Shares	**(0.1)**	(0.2)	–
Net Income Assuming Dilution	**$217.7**	$282.9	$255.5
Weighted–Average Common Shares Outstanding	**65.6**	67.9	69.0
Dilutive Effect of Unitrin Share–based Compensation Plans	**0.3**	0.3	0.5
Weighted–Average Common Shares and Equivalent Shares Outstanding Assuming Dilution	**65.9**	68.2	69.5
Income Per Share from Continuing Operations	**$ 2.88**	$ 3.89	$ 3.43
Income Per Share from Discontinued Operations	**0.44**	0.28	0.27
Net Income Per Share	**$ 3.32**	$ 4.17	$ 3.70
Income Per Share from Continuing Operations Assuming Dilution	**$ 2.87**	$ 3.87	$ 3.40
Income Per Share from Discontinued Operations Assuming Dilution	**0.43**	0.28	0.27
Net Income Per Share Assuming Dilution	**$ 3.30**	$ 4.15	$ 3.67

Options outstanding at December 31, 2007, 2006 and 2005, to purchase 3.7 million, 1.2 million and 1.3 million common shares, respectively, of Unitrin common stock were excluded from the computation of Net Income Per Share Assuming Dilution in 2007, 2006 and 2005, respectively, because the exercise price exceeded the average market price.

NOTE 13. OTHER COMPREHENSIVE INCOME

Other Comprehensive Income for the years ended December 31, 2007, 2006 and 2005, was:

DOLLARS IN MILLIONS	2007	2006	2005
Other Comprehensive Income before Income Taxes:			
Unrealized Holding Gains (Losses) Arising During the Year	$121.4	$ 93.8	$ 19.6
Reclassification Adjustment for Amounts Included in Net Income	(52.2)	(25.5)	(17.5)
Unrealized Holding Gains (Losses)	69.2	68.3	2.1
Unrecognized Postretirement Benefit Costs Arising During the Year	(5.0)	–	–
Amortization of Unrecognized Postretirement Benefit Costs	(2.0)	–	–
Net Unrecognized Postretirement Benefit Costs	(7.0)	–	–
Equity in Other Comprehensive Income (Loss) of Investee	1.2	(2.1)	0.3
Other Comprehensive Income before Income Taxes	63.4	66.2	2.4
Income Tax Benefit (Expense):			
Unrealized Holding Gains and Losses Arising During the Year	(43.2)	(32.8)	(6.8)
Reclassification Adjustment for Amounts Included in Net Income	18.3	9.0	6.1
Unrealized Holding Gains (Losses)	(24.9)	(23.8)	(0.7)
Unrecognized Postretirement Benefit Costs Arising During the Year	1.4	–	–
Amortization of Unrecognized Postretirement Benefit Costs	0.6	–	–
Net Unrecognized Postretirement Benefit Costs	2.0	–	–
Equity in Other Comprehensive (Income) Loss of Investee	(0.4)	0.7	(0.1)
Income Tax Benefit (Expense)	(23.3)	(23.1)	(0.8)
Other Comprehensive Income	$ 40.1	$ 43.1	$ 1.6

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

DOLLARS IN MILLIONS	2007	2006
Net Unrealized Gains on Investments, Net of Income Taxes	$338.2	$294.8
Net Unrealized Gains on Assets of Discontinued Operations, Net of Income Taxes	0.9	–
Equity in Accumulated Other Comprehensive Loss of Investee, Net of Income Taxes	(2.1)	(0.5)
Net Unrecognized Postretirement Benefit Costs, Net of Income Taxes	(12.2)	(7.3)
Total Accumulated Other Comprehensive Income	$324.8	$287.0

NOTE 14. INCOME FROM INVESTMENTS

Net Investment Income for the years ended December 31, 2007, 2006 and 2005, was:

DOLLARS IN MILLIONS	2007	2006	2005
Investment Income:			
Interest and Dividends on Fixed Maturities	$209.8	$213.6	$212.2
Dividends on Northrop Preferred Stock	15.5	9.3	12.4
Dividends on Northrop Common Stock	9.4	8.6	8.0
Dividends on Other Equity Securities	19.2	12.4	11.7
Short-term Investments	34.3	27.5	13.8
Loans to Policyholders	13.5	13.2	12.7
Real Estate	30.3	28.0	25.3
Limited Partnerships and Limited Liability Companies	25.8	18.9	9.9
Other	-	0.1	0.2
Total Investment Income	357.8	331.6	306.2
Investment Expenses:			
Real Estate	24.0	21.1	19.2
Other Investment Expenses	1.8	1.5	1.2
Total Investment Expenses	25.8	22.6	20.4
Net Investment Income Including Discontinued Operations	332.0	309.0	285.8
Net Investment Income Reported in Discontinued Operations	(25.3)	(28.2)	(28.2)
Net Investment Income	$306.7	$280.8	$257.6

Dividend income from the Company's investment in Northrop preferred stock increased by $6.2 million for year ended December 31, 2007, compared to the same period in 2006, due to the timing of ex-dividend dates. Dividend income from the Company's investment in Northrop preferred stock decreased by $3.1 million for year ended December 31, 2006, compared to the same period in 2005, due to the timing of ex-dividend dates. Dividend income from other equity securities increased by $6.8 million for the year ended December 31, 2007, compared to the same period in 2006, due primarily to a special dividend of $5.2 million from the Company's equity investment in IRI Holdings, Inc. Short-term investment income increased for the year ended December 31, 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. Short-term investment income increased for the year ended December 31, 2006, compared to the same period in 2005, due primarily to higher yields on short-term investments and, to a lesser extent, higher levels of short-term investments. Investment income from limited partnerships and limited liability companies increased for the year ended December 31, 2007, compared to the same period in 2006, and for the year ended December 31, 2006, compared to the same period in 2005, due primarily to higher levels of investments and higher yields on investments.

The components of Net Realized Investment Gains for the years ended December 31, 2007, 2006 and 2005, were:

DOLLARS IN MILLIONS	2007	2006	2005
Fixed Maturities:			
Gains on Dispositions	$ 5.1	$ 5.0	$ 2.7
Losses on Dispositions	(4.0)	(4.4)	(1.7)
Losses from Write–downs	(10.4)	–	(2.4)
Northrop Common Stock:			
Gains on Dispositions	58.6	5.6	4.0
Other Equity Securities:			
Gains on Dispositions	30.6	23.2	25.8
Losses on Dispositions	(5.1)	(1.1)	(3.0)
Losses from Write–downs	(22.6)	(2.8)	(7.9)
Real Estate:			
Gains on Dispositions	4.8	0.9	39.4
Losses from Write–downs	–	(0.1)	–
Southern States:			
Gain on Disposition	4.0	–	–
Other Investments:			
Gains on Dispositions	1.7	0.6	0.4
Losses on Dispositions	(0.2)	(0.4)	(0.4)
Net Realized Investment Gains	$ 62.5	$26.5	$56.9

Net Realized Investment Gains for the years ended December 31, 2007, 2006 and 2005, include pretax losses of $33.0 million, $2.8 million and $10.3 million, respectively, from other than temporary declines in the fair values of investments. Pretax losses from write–downs of fixed maturities for the year ended December 31, 2007, included a pretax loss of $8.3 million related to an issuer that had defaulted. Pretax losses from write–downs of other equity securities for the year ended December 31, 2007, was precipitated in part to the overall decline in the stock market in the second half of 2007. The Company wrote down the value of various holdings of equity securities. The Company cannot anticipate when or if similar investment losses may occur in the future.

On July 9, 2007, Republic Companies purchased Southern States, a directly owned subsidiary of Unitrin, from the Company. Net Realized Investment Gains for the year ended December 31, 2007, includes a pretax gain of $4.0 million for the year ended December 31, 2007 resulting from this sale.

NOTE 15. INSURANCE EXPENSES

Insurance Expenses for the years ended December 31, 2007, 2006 and 2005, were:

DOLLARS IN MILLIONS	2007	2006	2005
Commissions	$ 363.0	$ 389.4	$ 411.6
General Expenses	293.8	285.7	292.5
Taxes, Licenses and Fees	45.6	45.5	47.0
Total Costs Incurred	702.4	720.6	751.1
Policy Acquisition Costs:			
Deferred	(297.0)	(316.8)	(337.4)
Amortized	300.4	308.2	322.9
Net Policy Acquisition Costs Deferred	3.4	(8.6)	(14.5)
Insurance Expenses	$ 705.8	$ 712.0	$ 736.6

Commissions for servicing policies are expensed as incurred, rather than deferred and amortized.

NOTE 16. INCOME TAXES

Current, deferred and unrecognized tax amounts as presented in the Consolidated Balance Sheets at December 31, 2007 and 2006, were:

DOLLARS IN MILLIONS	2007	2006
Liabilities for Income Taxes:		
Current Income Taxes	$ 31.1	$ 0.1
Deferred Income Taxes	211.3	285.0
Unrecognized Tax Benefits	20.1	–
Liabilities for Income Taxes	$262.5	$285.1
Tax Amounts Included in Other Assets:		
Current Income Taxes	$ 1.5	$ 1.2
Deferred Income Taxes	15.7	7.4
Total Tax Asset Included in Other Assets	$ 17.2	$ 8.6

The tax effects of temporary differences that give rise to significant portions of the Company's Net Deferred Tax Liability at December 31, 2007 and 2006, were:

DOLLARS IN MILLIONS	2007	2006
Deferred Tax Assets:		
Insurance Reserves	$ 94.9	$ 66.5
Unearned Premium Reserves	53.7	53.4
Tax Capitalization of Policy Acquisition Costs	70.5	70.2
Reserve for Loan Losses	61.8	29.0
Payroll and Employee Benefit Accruals	51.2	39.4
Other	26.9	27.6
Total Deferred Tax Assets	359.0	286.1
Deferred Tax Liabilities:		
Deferred Policy Acquisition Costs	158.3	156.0
Northrop Preferred Stock	88.2	80.5
Northrop Common Stock	153.5	171.4
Investee (Intermec)	28.5	28.2
Other Investments	101.8	103.5
Other	24.3	24.1
Total Deferred Tax Liabilities	554.6	563.7
Net Deferred Tax Liability	$195.6	$277.6

A deferred tax asset valuation allowance was not required as of December 31, 2007 and 2006. Income taxes paid were $116.9 million and $125.4 million in 2007 and 2006, respectively.

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 the Company's 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		(9.7)
Additions for Tax Positions of Prior Years		28.4
Reduction for Lapse of 2003 Federal Statute of Limitations		(23.2)
Reduction for Lapse of 2002 State Statute of Limitations		(8.1)
Balance at December 31, 2007	$	20.1

For the years ended December 31, 2007, 2006 and 2005, all of Unitrin's subsidiaries are eligible to file a consolidated Federal income tax return with Unitrin. The statute of limitations related to the consolidated Federal income tax return is closed for all tax years up to and including 2003. The expiration of the statute of limitations related to the various state income tax returns that the Company and subsidiaries file, varies by state. The Company's consolidated Federal tax return and any significant state tax returns are not currently under examination.

Included in the balance of unrecognized tax benefits at December 31, 2007 and January 1, 2007 are tax positions of $12.7 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.

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 $6.8 million and $7.1 million at December 31, 2007 and January 1, 2007, respectively. Tax expense for the year ended December 31, 2007 includes an interest benefit of $0.3, which is comprised of an interest benefit of $4.0 million resulting from the expiration of the statutes of limitations referred to above, and interest expense of $3.7 million on unrecognized tax benefits for prior years.

The components of Income Tax Expense from Continuing Operations for the years ended December 31, 2007, 2006 and 2005, were:

DOLLARS IN MILLIONS	2007	2006	2005
Current Tax Expense	$151.2	$110.1	$66.5
Deferred Tax Expense (Benefit)	(82.7)	4.9	13.7
Unrecognized Tax Expense (Benefit)	(12.7)	–	–
Income Tax Expense	$ 55.8	$115.0	$80.2

Unitrin, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements—(Continued)

A reconciliation of the Statutory Federal Income Tax Expense and Rate to the Company's Effective Income Tax Expense and Rate from Continuing Operations for the years ended December 31, 2007, 2006 and 2005, was:

	2007		2006		2005	
DOLLARS IN MILLIONS	AMOUNT	RATE	AMOUNT	RATE	AMOUNT	RATE
Statutory Federal Income Tax Expense and Rate	$ 85.2	35.0%	$ 129.5	35.0%	$ 109.1	35.0%
Tax Exempt Income and Dividends Received Deduction	(21.6)	(8.8)	(19.2)	(5.2)	(19.1)	(6.1)
State Income Taxes	(8.9)	(3.7)	4.3	1.2	3.9	1.2
Other, Net	1.1	0.4	0.4	0.1	(13.7)	(4.4)
Effective Income Tax Expense and Rate	$ 55.8	22.9%	$ 115.0	31.1%	$ 80.2	25.7%

During 2007, a benefit of $5.3 million was recorded for state income taxes related to the tax year that ended on December 31, 2002, due to the expiration of a state's statute of limitations.

During 2005, a benefit of $14 million was recorded primarily for Federal income tax adjustments related to the tax years ended December 31, 2002 and December 31, 2001, due to the settlement of these years with the Internal Revenue Service.

Comprehensive Income Tax Expense included in the Consolidated Financial Statements for the years ended December 31, 2007, 2006 and 2005, was:

DOLLARS IN MILLIONS	2007	2006	2005
Income Tax Expense:			
Continuing Operations	$55.8	$115.0	$80.2
Discontinued Operations	8.3	2.4	2.5
Equity in:			
Net Income of Investee	0.7	5.1	2.9
Other Comprehensive Income of Investee	0.4	(0.7)	0.1
Unrealized Appreciation on Securities	24.9	24.0	0.7
Tax Effects from Benefit Plans –SFAS 158	(2.0)	–	–
Tax Effects from Long–Term Equity Compensation included in Paid–in Capital	(0.6)	(3.0)	(8.0)
Other	(0.2)	(0.1)	(0.1)
Comprehensive Income Tax Expense	$87.3	$142.7	$78.3

NOTE 17. PENSION BENEFITS AND POSTRETIREMENT BENEFITS OTHER THAN PENSIONS

The Company sponsors two qualified defined benefit pension plans (the "Pension Plans") covering most of its employees. Certain participation in one of the Pension Plans requires or required employee contributions of 3% of pay, as defined, per year. Benefits for the contributory plan are based on compensation during plan participation and the number of years of participation. Benefits for the non–contributory plan are based on years of service and final average pay, as defined. The Company funds the Pension Plans in accordance with the requirements of the Employee Retirement Income Security Act of 1974, as amended ("ERISA").

The Company sponsors several other postretirement employee benefit plans ("OPEB") that provide medical, dental and/or life insurance benefits to approximately 1,000 retired and 800 active employees ("the OPEB Plans"). The Company generally is self-insured for the benefits under the OPEB Plans. The medical plans generally provide for a limited number of years of medical insurance benefits at retirement based on the participant's attained age at retirement and number of years of service until specified dates and are generally contributory, with most contributions adjusted annually.

Changes in Fair Value of Plan Assets and Changes in Benefit Obligations (the Projected Benefit Obligation in the case of the Pension Plans and the Accumulated Benefit Obligation in the case of the OPEB Plans) for the years ended December 31, 2007 and 2006, were:

DOLLARS IN MILLIONS	PENSION PLANS		OPEB PLANS	
	2007	2006	2007	2006
Fair Value of Plan Assets at Beginning of Year	$ 363.7	$ 323.2	$ –	$ –
Actual Return on Plan Assets	19.6	32.4	–	–
Contributions by the Company	–	25.0	4.2	4.5
Contributions by Plan Participants	0.1	0.1	1.3	1.2
Benefits Paid	(17.4)	(17.0)	(5.5)	(5.7)
Fair Value of Plan Assets at End of Year	366.0	363.7	–	–
Benefit Obligations at Beginning of Year	355.7	351.6	44.9	47.5
Service Cost Benefits Earned During the Year	13.4	14.1	0.1	0.1
Interest Cost on Benefit Obligations	20.0	18.9	2.1	2.5
Contributions by Plan Participants	0.1	0.1	1.3	1.2
Benefits Paid	(17.4)	(17.0)	(5.5)	(5.7)
Actuarial (Gains) Losses	5.5	(12.0)	(5.5)	(0.7)
Benefit Obligations at End of Year	377.3	355.7	37.4	44.9
Funded Status—Plan Assets in Excess (Deficit) of Benefit Obligations	$ (11.3)	$ 8.0	$ (37.4)	$ (44.9)
Amount Recognized in Accumulated Other Comprehensive Income:				
Accumulated Actuarial Gain (Loss)	$ (48.0)	$ (38.2)	$ 27.3	$ 24.3
Prior Service Cost	0.9	1.1	–	–
Amount Recognized in Accumulated Other Comprehensive Income	$ (47.1)	$ (37.1)	$ 27.3	$ 24.3

The Accumulated Benefit Obligation for the Pension Plans was $350.7 million and $325.7 million at December 31, 2007 and 2006, respectively.

The Company estimates that Pension Expense for the year ended December 31, 2008, will include expense of $1.0 million resulting from the amortization of the related accumulated actuarial loss included in Accumulated Other Comprehensive Income at December 31, 2007.

The Company estimates that OPEB Expense for the year ended December 31, 2008, will include income of $2.0 million resulting from the amortization of the related accumulated actuarial gain included in Accumulated Other Comprehensive Income at December 31, 2007.

The measurement dates of the assets and liabilities of all plans presented above for 2007 and 2006 were December 31, 2007 and December 31, 2006, respectively.

The assumed health care cost trend rate used in measuring the Accumulated Benefit Obligation for the OPEB Plans at December 31, 2007, was 8% in 2007, gradually declining to 5% in the year 2011 and remaining at that level thereafter for medical benefits and 10% in 2007, gradually declining to 5% in the year 2013 and remaining at that level thereafter for prescription drug benefits. The assumed health care cost trend rate used in measuring the Accumulated Benefit Obligation for the OPEB Plans at December 31, 2006, was 9% in 2006, gradually declining to 5% in the year 2011 and remaining at that level thereafter for medical benefits and 11% in 2006, gradually declining to 5% in the year 2013 and remaining at that level thereafter for prescription drug benefits.

A one-percentage point increase in the assumed health care cost trend rate for each year would increase the Accumulated Benefit Obligation for the OPEB Plans at December 31, 2007, by $2.7 million and 2007 OPEB expense by $0.2 million. A one-percentage point decrease in the assumed health care cost trend rate for each year would decrease the Accumulated Benefit Obligation for the OPEB Plans at December 31, 2007, by $2.4 million and 2007 OPEB expense by approximately $0.1 million.

The OPEB Plans were unfunded at December 31, 2007 and 2006. Weighted-average asset allocations for the Pension Plans at December 31, 2007 and 2006, by asset category were:

ASSET CATEGORY	2007	2006
Cash and Short-term Investments	8%	11%
U.S. Government and Government Agencies and Authorities	19	21
Corporate Bonds and Notes	18	15
Equity Securities	42	41
Other Assets	13	12
Total	100%	100%

The investment objective of the Pension Plans is to produce current income and long-term capital growth through a combination of equity and fixed income investments which, together with appropriate employer contributions and any required employee contributions, is adequate to provide for the payment of the benefit obligations of the Pension Plans. The assets of the Pension Plans may be invested in both fixed income and equity investments. Fixed income investments may include cash and short-term instruments, U.S. Government securities, corporate bonds, mortgages and other fixed income investments. Equity investments may include various types of stock, such as large cap, mid cap and small cap stocks, and may also include investments in investment companies and Unitrin common stock (subject to Section 407 and other requirements of ERISA). The Pension Plans have not invested in Unitrin common stock.

The trust investment committee for the Pension Plans periodically reviews the performance of the Pension Plans' investments and asset allocation. Several external investment managers, one of which is Fayez Sarofim & Co. ("FS&C"), manage the equity investments of the trust for the Pension Plans. One of Unitrin's directors, Mr. Fayez Sarofim, is Chairman of the Board, President and the majority shareholder of FS&C, a registered investment advisory firm (see Note 22, "Related Parties," to the Consolidated Financial Statements). Each manager is allowed to exercise investment discretion, subject to limitations, if any, established by the trust investment committee for the Pension Plans. All other investment decisions are made by the Company, subject to general guidelines as set by the trust investment committee for the Pension Plans.

The Company determines its Expected Long Term Rate of Return on Plan Assets based primarily on the Company's expectations of future returns for the Pension Plans' investments, based on target allocations of the Pension Plans' investments. Additionally, the Company considers historical returns on comparable fixed income investments and equity investments and adjusts its estimate as deemed appropriate.

Unitrin, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements—(Continued)

The components of Pension Expense for the years ended December 31, 2007, 2006 and 2005, were:

DOLLARS IN MILLIONS	2007	2006	2005
Service Cost Benefits Earned During the Year	$ 13.4	$ 14.1	$ 12.7
Interest Cost on Projected Benefit Obligation	20.0	18.9	18.3
Expected Return on Plan Assets	(24.6)	(22.7)	(20.5)
Net Amortization and Deferral	0.5	1.8	(0.1)
Pension Expense Recognized	9.3	12.1	10.4
Unrecognized Pension Loss Arising During the Year	10.4	—	—
Amortization of Accumulated Unrecognized Pension Loss	(0.5)	—	—
Comprehensive Pension Expense	$ 19.2	$ 12.1	$ 10.4

Total Pension Expense Recognized presented above includes service cost benefits earned and reported in discontinued operations of $1.2 million, $1.5 million and $2.0 million for the years ended December 31, 2007, 2006 and 2005, respectively.

The components of OPEB Expense for the years ended December 31, 2007, 2006 and 2005, were:

DOLLARS IN MILLIONS	2007	2006	2005
Service Cost Benefits Earned During the Year	$ 0.1	$ 0.1	$ 0.2
Interest Cost on Accumulated Benefit Obligation	2.1	2.5	2.7
Net Amortization and Deferral	(2.5)	(1.9)	(1.8)
OPEB (Income) Expense Recognized	(0.3)	0.7	1.1
Unrecognized OPEB Gain Arising During the Year	(5.4)	—	—
Amortization of Accumulated Unrecognized OPEB Gain	2.5	—	—
Comprehensive OPEB (Income) Expense	$(3.2)	$ 0.7	$ 1.1

The actuarial assumptions used to develop the components of both Pension Expense and OPEB Expense for the years ended December 31, 2007, 2006 and 2005, were:

	2007	2006	2005
Discount Rate	5.75%	5.50%	6.00%
Rate of Increase in Future Compensation Levels	4.10	4.10	4.06
Expected Long Term Rate of Return on Plan Assets	7.00	7.00	7.00

The actuarial assumptions used to develop the components of both Pension Projected Benefit Obligation and OPEB Accumulated Benefit Obligation at December 31, 2007 and 2006, were:

	2007	2006
Discount Rate	5.75%	5.75%
Rate of Increase in Future Compensation Levels	4.12	4.10

The Company does not expect to be required to contribute to its Pension Plans in 2008, but could make a voluntary contribution pursuant to the maximum funding limits under ERISA. The Company expects to contribute $4.2 million to its OPEB Plans to fund benefit payments in 2008.

The following benefit payments (net of participant contributions), which consider expected future service, as appropriate, are expected to be paid:

	YEARS ENDING DECEMBER 31,											
DOLLARS IN MILLIONS		2008		2009		2010		2011		2012		2013–2017
Pension Benefits	$	17.5	$	18.3	$	19.3	$	20.2	$	21.5	$	127.2
OPEB Benefits:												
Excluding Modernization Act Subsidy	$	4.6	$	4.5	$	4.5	$	4.4	$	4.3	$	19.5
Expected Modernization Act Subsidy		(0.4)		(0.4)		(0.4)		(0.4)		(0.4)		(1.7)
OPEB Benefits	$	4.2	$	4.1	$	4.1	$	4.0	$	3.9	$	17.8

The Company also sponsors several defined contribution benefit plans covering most of its employees. The Company made contributions to those plans of $6.8 million, $7.2 million and $6.9 million in 2007, 2006 and 2005, respectively. Under these plans, the participants have several investment alternatives, including Unitrin's common stock and the Dreyfus Appreciation Fund. FS&C is a sub–investment advisor of the Dreyfus Appreciation Fund. One of Unitrin's directors, Mr. Fayez Sarofim, is the Chairman of the Board, President and majority shareholder of FS&C (see Note 22, "Related Parties," to the Consolidated Financial Statements). Participants invested $23.3 million, or 8.5%, of the total investments in the defined contribution benefit plans in Unitrin's common stock and $25.3 million, or 9.2%, of the total investments in the defined contribution benefit plans in the Dreyfus Appreciation Fund at December 31, 2007.

NOTE 18. BUSINESS SEGMENTS

The Company is engaged, through its subsidiaries, in the property and casualty insurance, life and health insurance and automobile finance businesses. The Company conducts its operations through five operating segments: Kemper, Unitrin Specialty, Unitrin Direct, Life and Health Insurance and Fireside Bank.

The Kemper segment provides preferred and standard risk personal automobile insurance, homeowners insurance and other personal insurance through independent agents. The Unitrin Specialty segment provides automobile insurance to individuals and businesses in the non–standard and specialty market through 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 3, "Acquisition of Business," to the 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 Fireside Bank segment makes sub–prime automobile loans primarily for the purchase of pre–owned automobiles and offers certificates of deposits.

The Company's earned premiums and automobile finance revenues are derived in the United States. The accounting policies of the segments are the same as those described in Note 2, "Summary of Accounting Policies," to the Consolidated Financial Statements. Capital expenditures for long–lived assets by operating segment are immaterial.

The Company also does not allocate insurance reserves from its 2002 acquisition of certain insurance companies from SCOR (see Note 7, "Property and Casualty Insurance Reserves," to the Consolidated Financial Statements). It is also 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, including Northrop preferred and common stock, Baker Hughes common stock and Intermec common stock, to be a corporate responsibility. Accordingly, the Company does not allocate dividend income from these investments to its operating segments. The Company does not allocate Net Realized Investment Gains to its operating segments.

Segment Assets at December 31, 2007 and 2006, were:

DOLLARS IN MILLIONS	2007	2006
SEGMENT ASSETS		
Kemper	**$ 1,457.0**	$ 1,442.1
Unitrin Specialty	**651.2**	665.0
Unitrin Direct	**318.1**	238.5
Life and Health Insurance	**3,910.6**	3,831.9
Fireside Bank	**1,450.3**	1,366.4
Corporate and Other, Net	**1,617.8**	1,777.5
Total Assets	**$ 9,405.0**	$ 9,321.4

Unitrin, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements—(Continued)

Segment Revenues for the years ended December 31, 2007, 2006 and 2005, were:

DOLLARS IN MILLIONS	2007	2006	2005
REVENUES			
Kemper:			
Earned Premiums	$ 926.3	$ 944.6	$ 945.7
Net Investment Income	48.4	49.1	48.1
Other Income	0.5	0.4	0.6
Total Kemper	975.2	994.1	994.4
Unitrin Specialty:			
Earned Premiums	449.3	444.4	453.2
Net Investment Income	21.2	21.8	20.6
Other Income	0.1	–	–
Total Unitrin Specialty	470.6	466.2	473.8
Unitrin Direct:			
Earned Premiums	257.6	225.9	221.3
Net Investment Income	9.7	9.0	8.6
Other Income	0.4	0.4	0.2
Total Unitrin Direct	267.7	235.3	230.1
Life and Health Insurance:			
Earned Premiums	653.7	675.6	667.5
Net Investment Income	190.6	178.3	157.1
Other Income	1.2	11.2	6.2
Total Life and Health Insurance	845.5	865.1	830.8
Fireside Bank:			
Interest, Loan Fees and Earned Discounts	251.2	237.3	210.5
Other Automobile Finance Revenues	9.0	7.7	7.1
Automobile Finance Revenues	260.2	245.0	217.6
Net Investment Income	4.9	3.9	3.7
Total Fireside Bank	265.1	248.9	221.3
Total Segment Revenues	2,824.1	2,809.6	2,750.4
Unallocated Dividend Income	25.2	18.2	20.9
Net Realized Investment Gains	62.5	26.5	56.9
Other	8.0	2.9	1.1
Total Revenues	$ 2,919.8	$ 2,857.2	$ 2,829.3

Unitrin, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements—(Continued)

Segment Operating Profit for the years ended December 31, 2007, 2006 and 2005, was:

DOLLARS IN MILLIONS	2007	2006	2005
SEGMENT OPERATING PROFIT (LOSS)			
Kemper	$ 92.6	$132.1	$ 79.4
Unitrin Specialty	37.3	38.6	42.7
Unitrin Direct	(40.4)	(10.1)	1.5
Life and Health Insurance	160.2	152.4	91.7
Fireside Bank	(66.0)	44.8	52.9
Total Segment Operating Profit	183.7	357.8	268.2
Unallocated Dividend Income	25.2	18.2	20.9
Net Realized Investment Gains	62.5	26.5	56.9
Other Expense, Net	(27.8)	(32.5)	(34.4)
Income from Continuing Operations before Income Taxes and Equity in Net Income of Investee	$243.6	$370.0	$311.6

Segment Net Income for the years ended December 31, 2007, 2006 and 2005, was:

DOLLARS IN MILLIONS	2007	2006	2005
SEGMENT NET INCOME (LOSS)			
Kemper	$ 69.3	$ 94.5	$ 60.0
Unitrin Specialty	28.3	29.0	31.3
Unitrin Direct	(24.3)	(4.9)	2.6
Life and Health Insurance	103.2	99.5	60.0
Fireside Bank	(38.8)	26.1	30.8
Total Segment Net Income	137.7	244.2	184.7
Net Income (Loss) From:			
Unallocated Dividend Income	22.2	16.0	18.4
Net Realized Investment Gains	40.5	17.2	37.0
Other Expense, Net	(12.6)	(22.4)	(8.7)
Income from Continuing Operations before Equity in Net Income of Investee	187.8	255.0	231.4
Equity in Net Income of Investee	1.2	9.2	5.3
Income from Continuing Operations	$189.0	$264.2	$236.7

Amortization of Deferred Policy Acquisition Costs by Operating Segment for the years ended December 31, 2007, 2006 and 2005, was:

DOLLARS IN MILLIONS	2007	2006	2005
Kemper	$163.5	$165.4	$168.7
Unitrin Specialty	56.6	60.9	66.6
Unitrin Direct	11.0	10.4	9.0
Life and Health Insurance	69.3	71.5	78.6
Total Amortization	$300.4	$308.2	$322.9

Earned Premiums by product line for the years ended December 31, 2007, 2006 and 2005, were:

DOLLARS IN MILLIONS	2007	2006	2005
EARNED PREMIUMS			
Life	**$ 387.8**	$ 400.7	$ 401.3
Accident and Health	**157.9**	158.3	160.5
Property and Casualty:			
Personal Lines:			
Automobile	**1,192.3**	1,163.6	1,176.4
Homeowners	**394.6**	401.3	380.9
Other Personal	**48.3**	48.3	47.3
Total Personal Lines	**1,635.2**	1,613.2	1,604.6
Commercial Lines:			
Automobile	**106.0**	118.3	121.3
Total Earned Premiums	**$ 2,286.9**	$ 2,290.5	$ 2,287.7

NOTE 19. CATASTROPHE REINSURANCE

Total catastrophe losses and LAE (including development), net of reinsurance recoveries, were $43.3 million, $59.8 million and $94.5 million for the years ended December 31, 2007, 2006 and 2005, respectively. Total Catastrophe losses and LAE (including development), net of reinsurance recoveries, reported in continuing operations were $39.4 million, $56.9 million and $89.3 million for the years ended December 31, 2007, 2006 and 2005, respectively. Catastrophe losses and LAE (including development), net of reinsurance recoveries, reported in discontinued operations were $3.9 million, $2.9 million and $5.2 million for the years ended December 31, 2007, 2006 and 2005, respectively. Catastrophes and storms are inherent risks of the property and casualty insurance business. These catastrophic events and natural disasters include hurricanes, tornadoes, earthquakes, hailstorms, wildfires, high winds and winter storms. Such events result in insured losses that are, and will continue to be, a material factor in the results of operations and financial position of the Company's property and casualty insurance companies. Further, because the level of these insured losses occurring in any one year cannot be accurately predicted, these losses may contribute to material year-to-year fluctuations in the results of the operations and financial position of these companies. Specific types of catastrophic events are more likely to occur at certain times within the year than others. This factor adds an element of seasonality to property and casualty insurance claims. The Company has adopted the industry-wide catastrophe classifications of storms and other events promulgated by ISO to track and report losses related to catastrophes. ISO classifies a disaster as a catastrophe when the event causes $25.0 million or more in direct losses to property and affects a significant number of policyholders and insurers. ISO-classified catastrophes are assigned a unique serial number recognized throughout the insurance industry. The segment discussions that follow utilize ISO's definition of catastrophes.

The Company manages its exposure to catastrophes and other natural disasters through a combination of geographical diversification and reinsurance. To limit its exposures to catastrophic events, the Company maintains three separate primary catastrophe reinsurance programs for its property and casualty insurance businesses. Coverage for each primary catastrophe reinsurance program is provided in three layers. In addition to these programs, the Company purchases reinsurance from the FHCF for hurricane losses in Florida at retentions lower than those described below for the Company's primary catastrophe reinsurance programs.

The Kemper 2007 Program covers the Company's Kemper segment and became effective on April 1, 2007. The first layer of reinsurance provides coverage of approximately 62% of reinsured catastrophe losses of $30 million above retention of $40 million. The second layer of reinsurance provides coverage of approximately 90% of reinsured catastrophe losses of $80 million above retention of $70 million. The third layer of reinsurance provides coverage of approximately 90% of reinsured catastrophe losses of $100 million above retention of $150 million. The prior annual program covering the Kemper segment, which was effective July 1, 2006, was terminated effective with the Kemper 2007 Program. The first layer of reinsurance coverage under the prior annual program provided coverage of approximately 65% of reinsured catastrophe losses of $30 million above retention of $40 million. The second layer of reinsurance coverage under the prior annual program provided coverage of approximately 88% of reinsured catastrophe losses of $80 million above retention of $70 million. The third layer of reinsurance coverage under the prior annual program provided coverage of approximately 80% of reinsured catastrophe losses of $100 million above retention of $150 million.

The annual program covering the Company's Unitrin Direct and Unitrin Specialty segments and Unitrin Business Insurance provided, 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 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 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.

In addition, in the event that the Company's incurred catastrophe losses and LAE covered by any of its three primary 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.

Catastrophe reinsurance premiums for the Company's primary reinsurance programs and the FHCF reduced earned premiums for the years ended December 31, 2007, 2006 and 2005, by the following:

DOLLARS IN MILLIONS	2007	2006	2005
Kemper:			
Ceded Reinsurance Premiums for Initial Catastrophe Coverage	$19.4	$15.4	$10.8
Ceded Reinsurance Premiums to Reinstate Catastrophe Coverage	–	0.3	3.1
Total Ceded Catastrophe Reinsurance Premiums	19.4	15.7	13.9
Unitrin Specialty:			
Ceded Reinsurance Premiums for Initial Catastrophe Coverage	0.2	0.2	0.2
Ceded Reinsurance Premiums to Reinstate Catastrophe Coverage	–	–	–
Total Ceded Catastrophe Reinsurance Premiums	0.2	0.2	0.2
Unitrin Direct:			
Ceded Reinsurance Premiums for Initial Catastrophe Coverage	1.1	0.5	0.4
Ceded Reinsurance Premiums to Reinstate Catastrophe Coverage	–	–	–
Total Ceded Catastrophe Reinsurance Premiums	1.1	0.5	0.4
Life and Health Insurance:			
Ceded Reinsurance Premiums for Initial Catastrophe Coverage	8.5	5.9	2.8
Ceded Reinsurance Premiums to Reinstate Catastrophe Coverage	–	0.2	2.4
Total Ceded Catastrophe Reinsurance Premiums	8.5	6.1	5.2
Total Ceded Catastrophe Reinsurance Premiums	$29.2	$22.5	$19.7

The Company did not incur any catastrophe losses above any of the retention levels of its primary catastrophe reinsurance programs in 2007 and 2006. The Company incurred catastrophe losses from two catastrophes in 2005, Hurricanes Katrina and Rita, above the retention levels of its primary catastrophe reinsurance programs. The Life and Health Insurance segment's estimated total losses from Hurricane Katrina also have exceeded the maximum coverage available under its primary reinsurance program. The Company's total incurred losses to date before reinsurance recoveries from these two hurricanes is $200.2 million. Total reinsurance recoveries under the Company's primary catastrophe reinsurance programs for these two hurricanes is $126.7 million. The Company initially recognized a loss of $64.7 million, net of reinsurance recoveries, in 2005 for these two hurricanes and has subsequently recognized adverse development of $4.2 million in 2006 and additional adverse development of $4.6 million in 2007.

The Company's estimates for Hurricanes Katrina and Rita include estimates for both direct losses and LAE and indirect losses from residual market assessments. The process of estimating and establishing reserves for catastrophe losses is inherently uncertain and the actual ultimate cost of a claim, net of actual reinsurance recoveries, may vary materially from the estimated amount reserved. The Company's estimates of direct catastrophe losses are generally based on inspections by claims adjusters and historical loss development experience for areas that have not been inspected or for claims that have not yet been reported. The Company's estimates of direct catastrophe losses are based on the coverages provided by its insurance policies. The Company's homeowners insurance policies do not provide coverage for losses caused by floods, but generally provide coverage for physical damage caused by wind or wind-driven rain. Accordingly, the Company's estimates of direct losses for homeowners insurance do not include losses caused by flood. Depending on the policy, automobile insurance may provide coverage for losses caused by flood. Estimates of the number of and severity of claims ultimately reported are influenced by many variables including, but not limited to, repair or reconstruction costs and determination of cause of loss, that are difficult to quantify and will influence the final amount of claim settlements. All these factors, coupled with the impact of the availability of labor and material on costs, require significant judgment in the reserve setting process. A change in any one or more of these factors is likely to result in an ultimate net claim cost different from the estimated reserve. The Company's estimates of indirect losses from residual market assessments are based on a variety of factors including, but not limited to, actual or estimated assessments provided by or received from the assessing entity, insurance industry estimates of losses and estimates of the Company's market share in the assessable states. Actual assessments may differ materially from these estimated amounts.

NOTE 20. OTHER REINSURANCE

In addition to the reinsurance programs described in Note 19, "Catastrophe Reinsurance," to the Consolidated Financial Statements, Unitrin's insurance subsidiaries utilize other reinsurance arrangements to limit their maximum loss, provide greater diversification of risk and to minimize exposures on larger risks. The ceding of insurance does not discharge the primary liability of the original insurer. Accordingly, insurance reserve liabilities are reported gross of any estimated recovery from reinsurers in the Consolidated Balance Sheets. Amounts recoverable from reinsurers are estimated in a manner consistent with the insurance reserve liability and are included in Other Receivables in the Consolidated Balance Sheets.

Earned Premiums assumed and ceded on long–duration policies were not material for the years ended December 31, 2007, 2006 and 2005. Earned Premiums ceded on short–duration policies were not material for the years ended December 31, 2007, 2006 and 2005. Certain insurance subsidiaries assume business from other insurance companies and involuntary pools. Earned Premiums assumed on short–duration policies for the years ended December 31, 2007, 2006 and 2005 were:

DOLLARS IN MILLIONS	2007	2006	2005
Earned Premiums Assumed From:			
Capitol	$53.3	$56.2	$54.8
ORCC	10.8	11.3	–
Milwaukee Insurance Company	0.6	3.0	3.4
Other	2.5	2.3	11.8
Total Earned Premiums Assumed	$67.2	$72.8	$70.0

Effective January 1, 2007, Trinity, a subsidiary of Unitrin, 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 was owned by Mutual Insurers Holding Company ("MIHC"), which in turn was owned by MIC's policyholders. Similarly, FNP was owned by First NonProfit Mutual Holding Company ("FNMHC"), which was owned by FNP's policyholders. In November 2007, MIHC and FNMHC merged, and, accordingly, MIC and FNP became subsidiaries of the merged company. In the past, certain employees of the Company and its subsidiaries have been members of the boards of directors of one or more of MIC, MIHC, FNP and FHMHC. Effective in November 2007 and prior to the merger, the last remaining representatives of the Company resigned such board memberships. Accordingly, the only relationship that currently exists among the Company and/or its employees and these companies is the relationship of Trinity as a reinsurer of certain business pursuant to the above mentioned quota reinsurance agreement between Trinity and MIC.

Trinity and Capitol are parties to a quota share reinsurance agreement whereby, effective August 1, 2005, Trinity assumes 100% of the business written by Capitol. Prior to August 1, 2005, Trinity assumed 95% of the business written by Capitol. 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 Capitol's wholly owned subsidiary's, ORCC, nine member board of directors. Trinity and ORCC are parties to a quota share reinsurance agreement whereby, effective January 1, 2006, Trinity assumes 100% of the business written by ORCC. Prior to January 1, 2006, Trinity did not assume business written by ORCC. Reliable, a 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, are also appointed by Capitol and ORCC to sell property insurance products. United Insurance also provides claims administration services to ORCC. The Company also provides certain investment services to Capitol and ORCC.

NOTE 21. CONTINGENCIES

In the ordinary course of their businesses, Unitrin and its subsidiaries are involved in a number of legal proceedings including lawsuits and regulatory examinations and inquiries. Some of these proceedings include matters particular to the Company or one or more of its subsidiaries, while others pertain to business practices in the industries in which Unitrin or its subsidiaries operate. Some lawsuits seek class action status that, if granted, could expose Unitrin or its subsidiaries to potentially significant liability by virtue of the size of the putative classes. These matters can raise complicated issues and are subject to many uncertainties, 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 legal, regulatory and political environment faced by large corporations generally and the insurance and banking sectors specifically. 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.

During the course of 2007, Unitrin and certain of its subsidiaries, like many property and casualty insurers, were forced to defend a growing number of individual lawsuits, mass actions and statewide putative class actions in Louisiana and Texas arising out of Hurricanes Katrina and Rita. In these matters, the plaintiffs seek compensatory and punitive damages and equitable relief. The Company and its relevant subsidiaries believe they have meritorious defenses to these proceedings and are defending them vigorously.

Fireside Bank is defending two class action lawsuits in California state courts alleging that its post–repossession notices to defaulting borrowers failed to comply with certain aspects of California law. The plaintiffs seek: (i) compensatory damages, including a refund of deficiency balances collected from customers who received the allegedly defective notices; (ii) punitive damages; and (iii) equitable relief. A statewide class has been certified in one of these matters. Fireside Bank has successfully moved to have these two cases treated on a coordinated basis going forward. Fireside Bank is contesting the allegations that its post–repossession notices were deficient and believes it has meritorious defenses to these lawsuits.

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 environment, 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.

The legal and regulatory environment within which Unitrin and its subsidiaries conduct their business is often unpredictable. Industry practices that were considered legally–compliant and reasonable for years may suddenly be deemed unacceptable by virtue of an unexpected court or regulatory ruling. Anticipating such shifts in the law and the impact they may have on the Company and its operations is a difficult task.

NOTE 22. RELATED PARTIES

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. Certain of the Company's insurance company subsidiaries and FS&C are parties to agreements under which FS&C provides investment management services to these subsidiaries. In addition, FS&C provides investment management services with respect to certain funds of the Company's pension plans. The agreements governing those arrangements are terminable by either party at any time on 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. The Company and the Company's pension plans had $226.2 million and $99.6 million, respectively, in assets with FS&C for investment management at December 31, 2007. The Company and the Company's pension plans had $208.2 million and $92.4 million, respectively, in assets with FS&C for investment management at December 31, 2006. The Company and the Company's pension plans paid, in the aggregate, $0.8 million and $0.7 million to FS&C in 2007 and 2006.

With respect to the Company's 401(k) Savings Plan, one of the alternative investment choices afforded to participating employees 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 rendered to the Dreyfus Appreciation Fund. Participants in the Company's 401(k) Savings Plan had allocated $25.3 million for investment in the Dreyfus Appreciation Fund at December 31, 2007, representing 9% of the total amount invested in the Company's 401(k) Savings Plan. Participants in the Company's 401(k) Savings Plan had allocated $27.0 million for investment in the Dreyfus Appreciation Fund Plan at December 31, 2006, representing 10% of the total amount invested in the Company's 401(k) Savings.

During 2005, the Company's Life and Health Insurance segment paid $2.6 million to purchase the next generation of the segment's handheld computers from Intermec. During 2007, the Company's Life and Health Insurance segment paid $0.3 million to Intermec for maintenance of the handhelds.

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 20, "Other Reinsurance," to the Consolidated Financial Statements, the Company also has certain relationships with mutual insurance holding companies which are owned by the policy–holders of their insurance subsidiaries.

NOTE 23. QUARTERLY FINANCIAL INFORMATION

DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS	THREE MONTHS ENDED (UNAUDITED) MARCH 31, 2007	JUNE 30, 2007	SEPT. 30, 2007	DEC. 31, 2007	YEAR ENDED DEC. 31, 2007
Revenues:					
Earned Premiums	$ 562.5	$ 570.2	$ 579.9	$ 574.3	$ 2,286.9
Automobile Finance Revenues	63.0	64.9	66.5	65.8	260.2
Net Investment Income	78.6	80.2	76.0	71.9	306.7
Other Income	1.0	1.2	0.5	0.8	3.5
Net Realized Investment Gains	22.5	17.0	12.5	10.5	62.5
Total Revenues	727.6	733.5	735.4	723.3	2,919.8
Expenses:					
Policyholders' Benefits and Incurred Losses and Loss Adjustment Expenses	387.2	397.2	383.6	404.3	1,572.3
Insurance Expenses	171.6	174.2	179.6	180.4	705.8
Automobile Finance Expenses	42.1	43.7	61.5	125.2	272.5
Interest Expense on Certificates of Deposit	13.6	14.2	15.2	15.7	58.7
Interest and Other Expenses	16.1	20.0	16.1	14.7	66.9
Total Expenses	630.6	649.3	656.0	740.3	2,676.2
Income (Loss) from Continuing Operations before Income Taxes and Equity in Net Income of Investee	97.0	84.2	79.4	(17.0)	243.6
Income Tax Expense (Benefit)	30.0	24.9	22.7	(21.8)	55.8
Income from Continuing Operations before Equity in Net Income of Investee	67.0	59.3	56.7	4.8	187.8
Equity in Net (Loss) Income of Investee	0.4	(0.6)	0.9	0.5	1.2
Income from Continuing Operations	67.4	58.7	57.6	5.3	189.0
Discontinued Operations:					
Income from Discontinued Operations Before Income Taxes	5.8	3.7	8.7	18.9	37.1
Income Tax Expense	0.8	0.2	2.0	5.3	8.3
Income from Discontinued Operations	5.0	3.5	6.7	$ 13.6	$ 28.8
Net Income	$ 72.4	$ 62.2	$ 64.3	$ 18.9	$ 217.8
Income Per Share from Continuing Operations (a)	$ 1.01	0.89	$ 0.89	$ 0.08	$ 2.88
Income Per Share from Discontinued Operations (a)	0.07	0.05	0.10	0.21	0.44
Net Income Per Share (a)	$ 1.08	$ 0.94	$ 0.99	$ 0.29	$ 3.32
Income Per Share from Continuing Operations Assuming Dilution (a)	$ 1.01	$ 0.89	$ 0.88	$ 0.08	$ 2.87
Income Per Share from Discontinued Operations Assuming Dilution	0.07	0.05	0.10	0.21	0.43
Net Income Per Share Assuming Dilution (a)	$ 1.08	$ 0.94	$ 0.98	$ 0.29	$ 3.30

(a) *The sum of quarterly per share amounts does not equal per share amounts for the year due to differences in weighted−average shares and/or equivalent shares outstanding for each of the periods presented.*

Unitrin, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements—(Continued)

DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS	THREE MONTHS ENDED (UNAUDITED) MARCH 31, 2006	JUNE 30, 2006	SEPT. 30, 2006	DEC. 31, 2006	YEAR ENDED DEC. 31, 2006
Revenues:					
Earned Premiums	$ 567.0	$ 577.2	$ 575.1	$ 571.2	$ 2,290.5
Automobile Finance Revenues	57.5	60.7	63.3	63.5	245.0
Net Investment Income	68.6	69.8	72.4	70.0	280.8
Other Income	0.8	0.9	11.7	1.0	14.4
Net Realized Investment Gains	11.6	9.0	3.1	2.8	26.5
Total Revenues	705.5	717.6	725.6	708.5	2,857.2
Expenses:					
Policyholders' Benefits and Incurred Losses and Loss Adjustment Expenses	381.7	382.9	361.0	383.1	1,508.7
Insurance Expenses	175.7	181.0	182.0	173.3	712.0
Automobile Finance Expenses	34.3	35.3	40.5	44.1	154.2
Interest Expense on Certificates of Deposit	10.9	12.0	13.2	13.7	49.8
Interest and Other Expenses	15.9	15.8	15.5	15.3	62.5
Total Expenses	618.5	627.0	612.2	629.5	2,487.2
Income before Income Taxes and Equity in Net Income of Investee	87.0	90.6	113.4	79.0	370.0
Income Tax Expense	26.9	29.3	35.0	23.8	115.0
Income before Equity in Net Income of Investee	60.1	61.3	78.4	55.2	255.0
Equity in Net Income of Investee	5.4	1.8	1.4	0.6	9.2
Income from Continuing Operations	65.5	63.1	79.8	55.8	264.2
Discontinued Operations:					
Income (Loss) from Discontinued Operations Before Income Taxes	(1.0)	7.7	7.7	6.9	21.3
Income Tax Expense (Benefit)	(1.5)	1.4	1.4	1.1	2.4
Income from Discontinued Operations	0.5	6.3	6.3	5.8	18.9
Net Income	$ 66.0	$ 69.4	$ 86.1	$ 61.6	$ 283.1
Income Per Share from Continuing Operations	$ 0.95	$ 0.93	$ 1.18	$ 0.83	$ 3.89
Income Per Share from Discontinued Operations	0.01	0.09	0.09	0.09	0.28
Net Income Per Share	$ 0.96	$ 1.02	$ 1.27	$ 0.92	$ 4.17
Income Per Share from Continuing Operations Assuming Dilution (a)	$ 0.95	$ 0.92	$ 1.18	$ 0.83	$ 3.87
Income Per Share from Discontinued Operations Assuming Dilution (a)	0.01	0.09	0.09	0.08	0.28
Net Income Per Share Assuming Dilution	$ 0.96	$ 1.01	$ 1.27	$ 0.91	$ 4.15

(a) *The sum of quarterly per share amounts does not equal per share amounts for the year due to differences in weighted–average shares and equivalent shares outstanding for each of the periods presented.*