

A person is silhouetted against a sunset over the ocean. The sun is low on the horizon, creating a bright, shimmering reflection on the water. The sky is a deep orange color, and the foreground is dark, suggesting a beach or a pier.

UNITRIN

Property & Casualty Insurance Group

Looking Ahead

ANNUAL REPORT 1998

Business Overview

The Unitrin family of insurance and finance companies serves clients in markets across the United States. More than 6 million policyholders and consumer finance customers have their basic insurance and financial needs met by a nationwide network of career agents and independent agents and loan representatives. As one of America's leading financial services providers, the Unitrin family specializes in property and casualty, life, health and accident insurance as well as consumer finance products. With over \$8 billion in assets, we employ nearly 8,500 associates.

Unitrin Property and Casualty Insurance

The Property and Casualty Insurance Group is made up of the Unitrin Business Insurance, Unitrin Specialty, Kemper Auto and Home and Unitrin Direct segments. Ranking among the 65 largest property and casualty groups in the nation, this group markets a variety of personal and commercial insurance products through thousands of independent agents and direct distribution channels.



Unitrin Life and Health Insurance

Unitrin's Life and Health Insurance Group offers life, health and accident insurance to customers through a national network of over 2,500 company-employed career agents and approximately 250 exclusive independent agents. Based on premiums, this group is one of the 100 largest life insurance providers in the country.

Consumer Finance

One of the oldest and most highly regarded companies of its kind in the western United States, Fireside Bank provides consumer finance services. Based in Pleasanton, California, and with 28 branches in California and loan production offices in 6 other states to serve customers, Fireside specializes in automobile loans, primarily for the purchase of pre-owned vehicles, and is one of the largest non-prime automobile finance sources in California.

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To Our Shareholders

February 2, 1999,

Your Company recorded net income of \$240.2 million, or \$3.51 per share, for the year ended December 31, 1998, nearly double the net income of \$123.6 million, or \$1.83 per share, recorded in 1997. Operating results improved in all six of our operating segments. Our Kemper Auto and Home, Multi Lines Insurance and Life and Health Insurance segments in particular improved substantially. Our Consumer Finance and Unitrin Specialty businesses again posted record earnings.

OPERATING RESULTS

Our Multi Lines insurance segment posted net income of \$47.0 million and a combined ratio of 95.0% in 1998, a significant improvement from net income of \$20.7 million after-tax and a combined ratio of 101.8% posted in 1997.

We have completed the task of re-underwriting our commercial lines business, non-renewing those classes of business where we do not believe that we could have achieved an adequate return. The results of the commercial lines re-underwrite project have been encouraging – the operating results posted by our commercial lines business improved from a loss of \$72.4 million before-tax in 1996, to a profit of \$13.2 million before-tax in 1997, and to a profit of \$19.1 million before-tax in 1998. Our commercial lines earned premiums, not surprisingly, shrunk from \$308.4 million in 1996 to \$250.8 million in 1997 and to \$196.0 million in 1998, despite the significant rate increases taken on our remaining commercial lines business. We believe that this smaller block of business gives us a good starting point to launch our new, stand-alone business unit – Unitrin Business Insurance (“UBI”). UBI is dedicated to serving the commercial lines agents previously served by our Multi Lines segment. The UBI challenge is to provide these agents with state-of-the-art commercial lines automation and insurance products and to grow the business profitably while achieving efficient economies of scale.

INVESTMENT RESULTS

We continue to strive to manage our investment portfolio prudently, balancing the risk associated with our concentrated equity holdings in Northrop and UNOVA with a conservative fixed income portfolio comprised primarily of high grade-corporate and municipal bonds, agencies and treasuries. Consolidated net investment income increased by \$29.3 million, primarily the result of a higher base of fixed maturity investments as cash flows from operations and the sale of a portion of our short-term investments were invested in longer-term fixed maturity investments. The yield on our fixed income portfolio continued to decline, albeit slightly, in 1998 as the proceeds from securities that matured or were called continued to be reinvested at lower rates. At the end of 1998, we still kept nearly \$700 million in relatively short-term investments – over 10% of our investment portfolio – positioning us to take advantage of any future rising interest rate environment.

We continued to sell a portion of our sizable equity investment in Northrop in 1998. We sold 5.3 million shares of Northrop common stock in 1998, generating pre-tax proceeds of approximately \$274

million. Combined with Northrop sales in 1997, we have now sold 7.4 million out of the 15.3 million shares of Northrop common stock that we received when Northrop purchased Litton in 1995. We have in no way lost confidence in the management of Northrop. Indeed, we still hold a combination of Northrop common stock, preferred stock and bonds with a market value of over \$650 million. Our sales were made to reduce the risk of our asset concentration in Northrop, and to take advantage of a relatively higher Northrop stock price. We may continue to sell down our Northrop holdings depending on future market prices and other capital needs.

CAPITAL STRUCTURE

We completed the capitalization of our Property and Casualty group in 1997, largely through redeploying cash and other assets from our Life and Health Insurance subsidiaries into our Property and Casualty Insurance subsidiaries. We believe that our Property and Casualty Insurance subsidiaries are now sufficiently capitalized to support future premium growth and to pay dividends to the Unitrin parent company out of future earnings. In fact, our Property and Casualty group paid dividends totaling \$50 million in the form of Northrop common stock to the Unitrin parent company in the second half of 1998.

We do not anticipate substantial changes to our capital structure in 1999. Debt to total capitalization was a modest 19.8% at the end of 1998 – that ratio falls to 18.6% if the market value of our holdings in UNOVA is taken into consideration. We plan to replace our \$360 million undrawn revolving credit agreement, which expires later this year, with a new facility some time around the middle of the year.

We believe that we have sufficient resources to maintain, or perhaps increase in the future, the amount of dividends paid to our shareholders. Operating company results are expected to more than cover future dividend payments for the foreseeable future.

We are pleased to take the opportunity in this report to highlight a few of our nearly 8,500 associates who practice what we preach – Getting it Right.

Richard C. Vie
Chairman of the Board
and Chief Executive Officer

Donald G. Southwell
President
and Chief Operating Officer



“We know how far we have come.”

Michael Yeoh

National Catastrophe
Claim Office Manager.

Getting It Right

Preparation is the key in an industry where natural disasters are inevitable.

Striving to get it right is at the core of Unitrin. The right preparation, the right response, the right opportunity, the right people, the right company. Each year, our aim is steady because our purpose is clear.

No single factor has been as important to the success of our business as the efforts and ethics of the nearly 8,500 associates we employ. Throughout each business unit, in offices across the country and in the field, they have contributed to a corporate culture of getting it right. You can recognize someone from the Unitrin family anywhere – it's the attitude of can-do, the willingness to help and the determination to get it right.

In 1998, as much as in any year of our history, we saw our associates meet the needs of customers and business partners, including the challenges brought forth by nature. We talked to some of them and heard firsthand how they are working to get it right every day.

Right Preparation

“We know how far we have come,” says Michael Yeoh, National Catastrophe Claim Office Manager. Several years ago he was assigned the responsibility for developing a central catastrophe office for what today is Unitrin's Kemper Auto and Home (“KAH”). “Our goal in having a national center was to streamline our approach to catastrophes and to enable us to apply critical resources quickly.”

The KAH catastrophe center, which Yeoh manages in Charlotte, North Carolina, allows his team to assess potential damage to KAH policyholders' homes and automobiles from hurricanes and other catastrophes.

“Other weather events, tornadoes, floods and storms just happen,” says Yeoh. “Actually, hurricanes give us some time for planning.” That planning has never been so needed or so valuable as in 1998 when the fury of four hurricane-force storms hit Florida and surrounding states in short succession.

As Hurricane Charley relentlessly gathered strength in tropical waters, the KAH catastrophe team planned and watched.

Yeoh and property line manager Wayne Gray huddled at the KAH catastrophe center, agreed on a number of assumptions and assembled their team. They recruited property specialists and large claims adjusters from KAH offices as far away as Syracuse, New York, and Scranton, Pennsylvania, to augment the team of contract adjusters.

When Hurricane Charley made landfall, KAH was ready, dispatching a team of adjusters from a staging area in southern Georgia.

Little did Gray and Yeoh know that they would regroup and redeploy their teams three more times over the next six weeks, coping with mandatory evacuations that added to the challenge of reaching customers quickly.

“Our goal is to provide the best possible service to our policyholders,” Gray says. “That means making contact with our customers ASAP, evaluating the damage and making them whole. We work hard to provide top quality service. And we get some great feedback from our customers.”

“We achieve our results through our people.”



Jeff Zacek
Chief Actuary
Unitrin Direct



Fran Rugari
Customer Service
Representative
Unitrin Direct

It's All About The Right People

Delivering the right service, creating the right value—when you have the right people aboard, it's a natural progression.

Jeff Zacek was an actuary with Valley Insurance when Unitrin acquired the company in 1993. Jeff has filled some critical assignments in financial and claims, and has been the institutional memory of Valley Insurance as its operations were integrated with Unitrin's Multi Lines. Then in 1997, he was presented the right opportunity to return to his core expertise and serve as Chief Actuary with Unitrin Direct.

He agrees that his previous assignments broadened and stretched him. “Now, with one product I can dig into the details to really see how the product is performing.” Since Unitrin Direct is sold directly to consumers, he's contributed to a rapid quote process. “We have to minimize the time it takes to complete an application, while still making an informed decision to get the right price. It's all about maximizing the transaction process.”

Brian Crumbaker, Senior Vice President with Unitrin Direct, coaches his direct reports to grow and develop as he leads Unitrin Direct in the right direction. “I want my team to see me as a tool for their success.” He's proud of the phenomenal year that Unitrin Direct has had – 30% growth while achieving profitability in the fourth quarter of 1998, three years ahead of the initial long-term business plan.

To Crumbaker, the right employees drive results. “That's the management challenge, to create an environment where people want to do their best work. It means hiring the most talented people, getting them aboard properly, and giving them the right tools and training. Ideally, we can help to instill a sense of ownership in our company and our success. We achieve our results through our people. When they feel a sense of ownership in our success, it's quite contagious.”

Determined to Hear the Right Ring

When a Vista call center agent gets up to post a new policy, other agents nearby may pause and briefly look up to acknowledge the agent's contribution to the team. At the same time, they remain focused and determined to achieve the team's goals along with their personal goals.

Steve Tom is on a call, building rapport with a potential customer named Roger. He is quoting against another affordable insurer. “Should we write this policy for you?” Tom asks. He goes on, “Yes, I realize it's a few dollars more, but you'll be backed by a financially strong company.” The caller demurs and Steve responds, “Well Roger, you have a heck of a deal there. I'm not sure if the other company has quoted your vehicle for business use. But you're right, you have a good deal.” Disappointed, Tom picks up another call, as if it was the first customer he had talked to that day. He's smiling as he describes the coverage and help he can provide.

Michelle Patacsil, customer service manager, is just three days

“I think it's the right way to think about my job, to put myself in the customer's shoes.”

back from maternity leave, glancing at her picture of four-month-old Tyler. “It's hard being back but I missed my people.” Then she is on her feet, talking to her colleagues. “Our customer scores on satisfaction and quality are above the 90th percentile and we did it together as a team.”

Customer service representative Fran Rugari is on the phone explaining a rate increase. “You're right,” she says, tabbing through screens. “You have not had any at-fault accidents. That increase is a rate increase. I know that's disheartening. What we're finding is that we are still competitive even with this increase.” The customer thanks her for checking and decides to stay with Unitrin Direct.

“I think it's the right way to think about my job, to put myself in the customer's shoes,” says Rugari. “I buy insurance too. Yes, occasionally you get someone who is really upset. In that situation, I take deep breaths, remain really calm and try to be even nicer. It usually turns out all right.”

financial review

Financial Highlights

DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS

	1998	1997	1996	1995	1994
FOR THE YEAR					
Earned Premiums	\$ 2,485.2	\$ 2,457.2	\$ 1,878.0	\$ 1,561.2	\$ 1,442.1
Consumer Finance Revenues	202.8	195.7	171.8	159.1	141.7
Net Investment Income	261.2	231.9	221.9	236.5	220.9
Other Income	13.1	25.1	39.8	8.8	8.0
Net Realized Investment Gains (Losses)	78.5	33.9	(13.3)	568.2	140.5
Total Revenues	\$ 3,040.8	\$ 2,943.8	\$ 2,298.2	\$ 2,533.8	\$ 1,953.2
Net Income (Loss)	\$ 240.2	\$ 123.6	\$ (8.2)	\$ 380.9	\$ 91.0
Net Income (Loss) Per Share	\$ 3.51	\$ 1.83	\$ (0.12)	\$ 5.64	\$ 1.32
Net Income (Loss) Per Share Assuming Dilution	\$ 3.48	\$ 1.82	\$ (0.12)	\$ 5.60	\$ 1.32
Repurchases of Unitrin Common Stock	\$ –	\$ 1.4	\$ 9.4	\$ 26.6	\$ 122.3
Dividends to Shareholders:					
Cash	113.5	112.2	112.4	108.0	103.1
Spin-off of Curtiss-Wright at Fair Value	–	–	–	196.1	–
Total Capital Returned to Shareholders	\$ 113.5	\$ 113.6	\$ 121.8	\$ 330.7	\$ 225.4
Dividends to Shareholders (per share):					
Cash	\$ 1.66	\$ 1.66	\$ 1.66	\$ 1.60	\$ 1.50
Spin-off of Curtiss-Wright at Fair Value	–	–	–	2.91	–
AT YEAR END					
Investments	\$ 6,007.5	\$ 5,782.9	\$ 5,303.8	\$ 5,127.5	\$ 4,233.5
Total Assets	8,790.3	8,536.8	7,705.6	7,133.7	6,165.8
Insurance Reserves	3,844.0	3,691.4	3,191.4	2,857.6	2,642.8
Notes Payable	502.8	495.7	377.1	254.8	180.0
Shareholders' Equity	2,038.7	1,818.9	1,802.4	1,916.8	1,701.2
Book Value Per Share	\$ 29.62	\$ 26.84	\$ 26.66	\$ 28.38	\$ 25.15
Fair Value Per Share of Investments in Investees in Excess of Carrying Value	2.34	2.16	0.11	0.08	6.00
Adjusted Book Value Per Share	\$ 31.96	\$ 29.00	\$ 26.77	\$ 28.46	\$ 31.15
Shares of Unitrin Common Stock Outstanding (in millions of shares)	68.8	67.8	67.6	67.5	67.6
Number of Associates Employed	8,480	8,796	8,739	7,664	7,425

Code of Ethics for Senior Financial Officers

Unitrin's Code of Ethics for Senior Financial Officers applies to Unitrin, Inc.'s Chief Executive Officer, Chief Financial Officer, Chief Accounting Officer, or persons performing similar functions, and recognizes the important and unique leadership role that those officers hold with regard to Unitrin's corporate governance. Unitrin's Code of Ethics for Senior Financial Officers provides principles to which those officers are expected to adhere and advocate, thereby ensuring that shareholders' interests are appropriately protected and preserved. The provisions of this code consist of the principles listed below which supplement, but do not replace, the Code of Business Conduct and Ethics applicable to all employees. The officers covered by this Code of Ethics for Senior Financial Officers are required to:

Act with honesty and integrity, avoiding actual or apparent conflicts of interest between personal and professional relationships.

Proactively promote ethical behavior as a responsible partner among peers in the work environment.

Provide full, fair, accurate, timely and understandable disclosure in reports and documents filed with the Securities and Exchange Commission and in other public communications by Unitrin.

Comply with applicable rules and regulations of federal, state and local governments, and other appropriate private and public regulatory agencies.

Act in good faith, responsibly, with due care, competence and diligence, without misrepresenting material facts or allowing one's independent judgment to be subordinated.

Respect the confidentiality of information acquired in the course of one's work except when authorized or legally obligated to disclose; such confidential information will not be used for personal advantage.

Understand one's responsibility to promptly report violations of this code to the Chief Legal Officer or other appropriate individuals in accordance with the Code of Business Conduct and Ethics.

Acknowledge accountability for adherence to this code, and that any material violation of the code may subject one to disciplinary action up to and including termination.

Consolidated Balance Sheet

DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS

1998

1997

ASSETS

Investments:

Fixed Maturities at Fair Value (Amortized Cost: 1998-\$3,994.0; 1997-\$3,531.6)	\$ 4,132.4	\$ 3,634.7
Northrop Grumman Preferred Stock at Fair Value (Cost: 1998-\$177.5; 1997-\$177.5)	234.3	220.9
Northrop Grumman Common Stock at Fair Value (Cost: 1998-\$341.5; 1997-\$572.2)	430.3	633.9
Other Equity Securities at Fair Value (Cost: 1998-\$323.7; 1997-\$342.7)	423.4	432.8
Investee (UNOVA) at Cost Plus Cumulative Undistributed Earnings	71.9	64.7
Short-term Investments at Cost which Approximates Fair Value	356.7	495.5
Other	358.5	300.4

Total Investments	6,007.5	5,782.9
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Cash	82.1	65.7
Consumer Finance Receivables at Cost (Fair Value: 1998-\$979.2; 1997-\$906.7)	971.5	904.8
Other Receivables	819.0	899.4
Deferred Policy Acquisition Costs	422.0	400.2
Goodwill	344.7	344.7
Other Assets	143.5	139.1

Total Assets	\$ 8,790.3	\$ 8,536.8
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LIABILITIES AND SHAREHOLDERS' EQUITY

Insurance Reserves:

Life and Health	\$ 2,333.3	\$ 2,265.1
Property and Casualty	1,510.7	1,426.3

Total Insurance Reserves	3,844.0	3,691.4
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Certificates of Deposits and Savings Accounts at Cost	922.4	915.2
Unearned Premiums	807.6	794.7
Accrued and Deferred Income Taxes	250.7	382.0
Notes Payable at Amortized Cost (Fair Value: 1998-\$516.6; 1997-\$519.4)	502.8	495.7
Accrued Expenses and Other Liabilities	424.1	438.9

Total Liabilities	6,751.6	6,717.9
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Shareholders' Equity:

Common Stock	6.9	6.8
Paid-in Capital	621.4	537.8
Retained Earnings	1,160.8	1,079.8
Accumulated Other Comprehensive Income	249.6	194.5

Total Shareholders' Equity	2,038.7	1,818.9
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Total Liabilities and Shareholders' Equity	\$ 8,790.3	\$ 8,536.8
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Corporate Information

BOARD OF DIRECTORS

Richard C. Vie
Chairman of the Board
and Chief Executive Officer

James E. Annable
Economic Advisor to the President,
J.P. Morgan Chase Corporation

Eric J. Draut
Executive Vice President
and Chief Financial Officer

Donald V. Fites
Retired Chairman
and Chief Executive Officer,
Caterpillar Inc.

Douglas G. Geoga
President,
Global Hyatt Corporation

Reuben L. Hedlund
Managing Director,
Hedlund & Hanley L.L.C.

Jerrold V. Jerome
Retired Executive

William E. Johnston
Retired President
and Chief Operating Officer
Morton International, Inc.

Wayne Kauth
Independent Financial Consultant

Fayez S. Sarofim
Chairman and President,
Fayez Sarofim & Co.

Donald G. Southwell
President
and Chief Operating Officer

OFFICERS

Richard C. Vie
Chairman of the Board
and Chief Executive Officer

Donald G. Southwell
President and Chief Operating Officer

Eric J. Draut
Executive Vice President
and Chief Financial Officer

Scott Renwick
Senior Vice President,
General Counsel and Secretary

David F. Bengston
Vice President

Edward J. Konar
Vice President

Richard Roeske
Vice President
and Chief Accounting Officer

John M. Boschelli
Treasurer

OPERATING MANAGEMENT

Scott Carter
President, Unitrin Direct
Chicago, Illinois

Roger W. Cole
President, Reserve National
Insurance Company
Oklahoma City, Oklahoma

James J. Collins
President, Career Agency
Property Program
St. Louis, Missouri

Ronald E. Greco
Vice President and Corporate Actuary,
Unitrin Services Company
Chicago, Illinois



UNITRIN

Property & Casualty Insurance Group

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