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WESCO FINANCIAL CORP

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DISCLOSURE INCORPORATED BETHESDA MD 20816

FOR 12/31/87

Quick Reference Chart to Contents of SEC Filings

REPORT CONTENTS	10-K	20-F	10-Q	8-K	10-C	6-K	Proxy Statement	Prospectus	Registration Statements '34 Act F-10 8-A	8-B	'33 Act "S" Type	ARS	Listing Application	N-SAR
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☐ Opinion	A	A	■						A			A		A
☐ Changes				A			■							
Compensation Plans														
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☐ Monetary	■		■				A	F	A		F		■	■
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☐ Background	■	■	■	■	■	■	A	A	■		A	■		
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☐ Interim Unaudited	■		A	■		F		F			F			
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Labor Contracts	■	■		■					F		F			
Legal Agreements	F	■		■					F		F			
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Loan Agreements	F			■			■		F		F			■
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☐ Content (Listing of Securities)														A
☐ Management														A
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Securities Structure	A	A			■			A	A		A			
Subsidiaries	A	A					■		A		A			
Underwriting				■				A			A			
Unregistered Securities	■			■			■	■			A			
Block Movements	■			F			■		A				■	

Legend **A** - *always included - included - if occurred or significant* **F** - *frequently included* ■ *special circumstances only*

TENDER OFFER/ACQUISITION REPORTS	13D	13 G	14D-1	14D-9	13E-3	13E-4
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Amount of Shares Owned	A	A				
Percent of Class Outstanding	A	A				
Financial Statements of Bidders			F		F	F
Purpose of Tender Offer			A	A	A	A
Source and Amount of Funds	A		A		A	
Identity and Background Information			A	A	A	
Persons Retained Employed or to be Compensated			A	A	A	A
Exhibits	F		F	F	F	F

5161 River Road ☐ Bethesda, MD 20816 ☐ 301/951-1300

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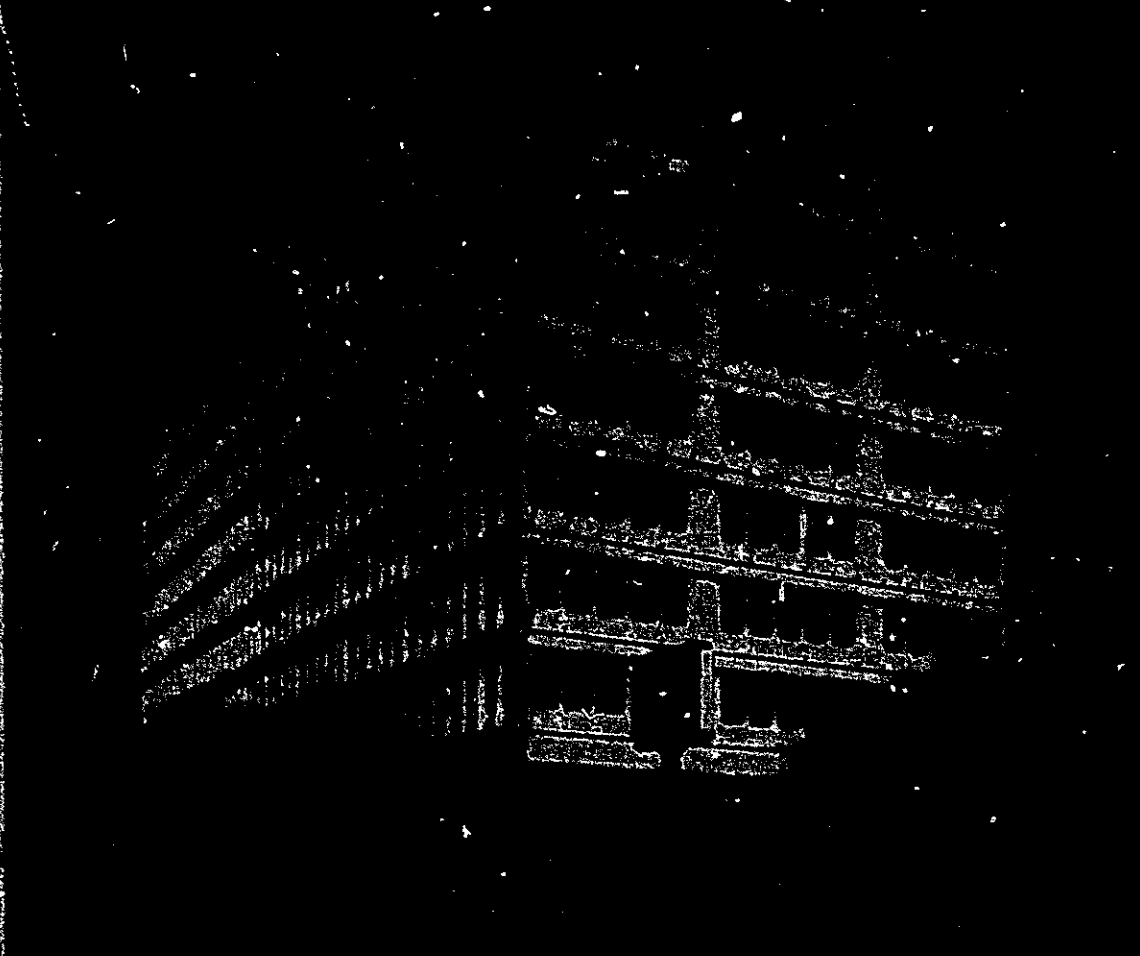
WESCO FINANCIAL CORPORATION

Annual Report 1987

Form 10-K Annual Report 1987



Headquarters building
of Wesco Financial Corporation
and Mutual Savings and Loan Association

BOARD OF DIRECTORS

Charles T. Munger
Chairman of the Board, President, Wesco Financial Corporation; Chairman of the Board, Blue Chip Stamps (trading stamps, parent of Wesco Financial Corporation); Vice Chairman of the Board, Berkshire Hathaway Inc. (insurance, candy, retailing, manufacturing, newspaper and encyclopedia publishing, parent of Blue Chip Stamps); Chairman of the Board, Daily Journal Corporation (publisher of specialty newspapers in California); Director, Salomon Inc (a financial services holding company)

William T. Caspers*
Personal investments

Harold R. Dettman
Vice President, Wesco Financial Corporation; President, Mutual Savings and Loan Association

James N. Gamble*
Investment counseling and trust administration

Elizabeth Caspers Peters
Personal investments

David K. Robinson*
Partner of Hahn & Hahn, attorneys at law

*Audit Committee member

EXECUTIVE OFFICERS OF WESCO FINANCIAL CORPORATION AND MUTUAL SAVINGS AND LOAN ASSOCIATION

Charles T. Munger
Chairman of the Board and President, Wesco

Harold R. Dettman
Vice President, Wesco; President, Mutual Savings

John R. Armetta
Vice President, Wesco; Senior Vice President, Mutual Savings

Robert E. Sahm
Vice President, Wesco

Jeffrey L. Jacobson
Vice President and Chief Financial Officer, Wesco and Mutual Savings

Jeanne Leach
Treasurer, Wesco; Vice President and Controller, Mutual Savings

Dolores Henderson
Secretary, Wesco and Mutual Savings

Robert D. Aston
Vice President, Wesco; Senior Vice President, Mutual Savings

Dolly Russo
Senior Vice President and Branch Manager, Mutual Savings

Legal Counsel

Hahn & Hahn

LISTED ON

American Stock Exchange
Pacific Stock Exchange

TRANSFER AGENTS AND REGISTRARS

Security Pacific National Bank
P.O. Box 3546, Terminal Annex, Los Angeles, California 90051

Security Pacific National Bank
63 Wall Street, 13th Floor, New York, New York, 10004

WESCO FINANCIAL CORPORATION
LETTER TO SHAREHOLDERS

To Our Shareholders:

Consolidated "normal" operating income (i.e., before all unusual operating income and all net gains from sales of securities) for the calendar year 1987 increased to $16,612,000 ($2.33 per share) from $11,934,000 ($1.68 per share) in the previous year.

Consolidated net income (i.e., after unusual operating losses and all net gains from sales of securities) decreased to $15,213,000 ($2.14 per share) from $16,524,000 ($2.32 per share) in the previous year.

Wesco has three major subsidiaries, Mutual Savings, in Pasadena, Precision Steel, headquartered in Chicago and engaged in the steel warehousing and specialty metal products businesses, and Wesco-Financial Insurance Company, headquartered in Omaha and currently engaged in the reinsurance business. Consolidated net income for the two years just ended breaks down as follows (in 000s except for per-share amounts)(1):

	Year Ended			
	December 31, 1987		December 31, 1986	
	Amount	Per Wesco Share	Amount	Per Wesco Share
"Normal" net operating income (loss) of:				
Mutual Savings	$ 2,895	$ .41	$ 2,159	$ .30
Precision Steel's businesses	2,450	.34	1,701	.24
Wesco-Financial insurance business —				
Underwriting	(1,394)	(.19)	(1,469)	(.21)
Investment activity	10,853	1.52	8,084	1.14
	9,459	1.33	6,615	.93
All other "normal" net operating income(2)	1,808	.25	1,459	.21
	16,612	2.33	11,934	1.68
Writeoff by Mutual Savings of prepaid FSLIC insurance premiums(3)	(1,935)	(.27)	—	—
Flood loss at Precision Steel	(672)	(.09)	—	—
Net gains on sales of securities	1,208	.17	4,590	.64
Wesco consolidated net income	$15,213	$2.14	$16,524	$2.32

(1) All figures are net of income taxes.
(2) After deduction of interest and other corporate expenses. Income was from ownership of the Mutual Savings headquarters office building, primarily leased to outside tenants, and interest and dividend income from cash equivalents and marketable securities owned outside the savings and loan and insurance subsidiaries.
(3) Necessitated by the Federal Home Loan Bank's elimination of the savings and loan industry's nearly $1-billion secondary insurance reserve, consisting of deposit insurance premiums prepaid to FSLIC, the U.S agency which insures accounts in savings and loan associations.

This supplementary breakdown of earnings differs somewhat from that used in audited financial statements which follow standard accounting convention. The supplementary breakdown is furnished because it is considered useful to shareholders.

Mutual Savings

Mutual Savings' "normal" net operating income of $2,895,000 in 1987 represented an increase of 34% from the $2,159,000 figure the previous year.

However, this "normal" figure of $2,895,000 for Mutual Savings' 1987 earnings is created by ignoring as abnormal an after-tax charge of $1,935,000 from wri'eoff of prepayments of deposit-insurance premiums. The premiums had been prepaid in previous years to FSLIC, the U.S. agency which insures accounts in savings and loan associations. Since FSLIC has been grievously impaired by widespread failure of insured associations and continues to be insolvent, and since its long-term source of support is collection of premiums which the savings and loan industry is *compelled* to pay, it may well be questioned whether FSLIC-related charges far in excess of past experience should on that account now be excluded from the "normal" as we do in this explanatory letter. Mutual Savings' position, relative to FSLIC, is like that of the owner of a concrete pier, mostly underwater, compelled to buy fire insurance on a pooled-rate basis with a group of oily-rag collectors, many of whom have already had but not reported their fires, with the result that no provision for such fires has yet been made in pooled-basis premium rates. Such an owner probably has not yet had his last unpleasant surprise from his insurance costs. Even so, we chose "unusual" classification for the FSLIC special charge in 1987, because it is not certain to be repeated.

Separate balance sheets of Mutual Savings at yearend 1986 and 1987 are set forth at the end of this annual report. They show (1) total savings accounts rising to $287 million from $282 million the year before, (2) a very high ratio of shareholders' equity to savings account liabilities (probably the highest for any mature U.S. savings and loan association), (3) a substantial portion of savings account liabilities offset by cash equivalents and marketable securities, and (4) a loan portfolio (mostly real estate mortgages) of about $139 million at the end of 1987, up 76% from the $79 million at the end of 1986.

The loan portfolio at the end of 1987, although containing almost no risk of loss from defaults, bore an average interest rate of only 8.38%, probably near the lowest among U.S. savings and loan associations, but up sharply from 7.48% at the end of 1986. There is now no significant unrealized depreciation in the loan portfolio, while unrealized appreciation in Mutual Savings' interest-bearing securities and preferred stocks at December 31, 1987 was about $9 million.

As pointed out in Note 10 to the accompanying financial statements, the book value of Wesco's equity in Mutual Savings ($56.6 million at December 31, 1987) overstates the amount realizable, after taxes, from sale or liquidation at book value. If all Mutual Savings' assets, net of liabilities, were to be sold, for the $56.6 million reported as book value, the parent corporation would receive much less than $56.6 million after substantial income taxation imposed because about $47 million of what is designated shareholders' equity for accounting purposes is considered bad debt reserves for most tax purposes.

Mutual Savings has not only a buried plus value in unrealized appreciation of securities, but also a buried plus value in real estate. The foreclosed property on hand (mostly 22 largely oceanfront acres in Santa Barbara) has become worth over a long holding period much more than its $2.0 million balance sheet carrying cost. Reasonable, community-sensitive development of this property has been delayed over 12 years in the course of administration of land-use laws. But, miraculous to report, grading is now actually under way on the property for an authorized development into 31 houses interspersed with large open areas. Mutual Savings plans to make the development first rate in every respect, and unique in the quality of its landscaping.

The buried plus value in real estate is limited by the small number of houses allowed (31) and by the fact that only a minority of such houses (11) will have any significant ocean view. Additional limitation will come from prospective high cost of private streets, sewage and utility improvements and connections, and landscaping. And, most important of all, various charges and burdens, including heavy archaeological obligations imposed by governmental bodies, will drastically reduce our potential recovery from what it would have been had the zoning and development climate of the early 1970s continued into 1988.

Mutual Savings is now a "qualified thrift lender" under the Federal regulatory definition requiring 60% of assets in various housing-related categories. Substantially all loans receivable have either short expected lives or bear interest rates which fluctuate with the market to 25% per annum or more.

While the "spread" between Mutual Savings' average interest rates paid on savings and received on loans remains too low to provide respectable profits, such spread is improving. Moreover, the disadvantage from inadequate spread continues to be offset to a considerable degree by the effect of various forms of tax-advantaged investment, primarily preferred stock. The negative side of this tax-advantaged antidote to inadequate interest rate margin on loans is the risk that preferred stock, with its fixed dividend and long life, will decline in value and not provide enough income to cover Mutual Savings' interest costs, if the general level of interest rates should sharply rise. In view of this risk, Mutual Savings' total commitment to preferred stock is kept conservative, relative to the amount of its net worth.

All in all, Mutual Savings continues to be a mediocre business, albeit one which is both (1) improving slightly and (2) expected to produce an average return of at least 10% per annum on the after-tax proceeds which could be realized from its liquidation. And, of course, we are making needed loans in our community while we try to behave as if there were no federal deposit-insurance system. Such an institution may find a bigger role as the years go by.

Precision Steel

The businesses of Wesco's Precision Steel subsidiary, located in the outskirts of Chicago at Franklin Park, Illinois, contributed $2,450,000 to "normal" net operating income in 1987, up 44% compared with $1,701,000 in 1986. The increase in 1987 profit occurred in spite of only a modest increase in revenues (up 5% to $54,843,000).

The "normal" net operating income figure does not include the adverse effect of an after-tax charge of $672,000 from a flood loss following a severe rainstorm in August, during which nine inches of rain fell in a twenty-four hour period. We consider such a flood a once-in-a-hundred-years type of occurrence, and have no hesitation as we exclude the item from "usual" results in our explanatory letter.

Under the skilled leadership of David Hillstrom, Precision Steel's businesses in 1987 provided an extraordinary return even without taking into account the financial leverage put into Wesco's consolidated picture incident to their acquisition.

The good financial results have an underlying reason. Precision Steel's businesses, despite their mundane nomenclature, are steps advanced on the quality scale from mere commodity-type businesses. Many customers of Precision Steel, needing dependable supply on short notice of specialized grades of high-quality, cold-rolled strip steel, reasonable prices, technical excellence in cutting to order, and remembrance when supplies are short, rightly believe that they have no fully comparable alternative in Precision Steel's market area. Indeed, many customers at locations remote from Chicago and Charlotte (for instance, Los Angeles) seek out Precision Steel's service.

Wesco-Financial Insurance Company

A new business was added to the Wesco group in 1985, in co-venture with Wesco's 80% owner and ultimate parent corporation, Berkshire Hathaway Inc.

With the enthusiastic approval of all Wesco's directors, including substantial Wesco shareholders in the Peters and Caspers families, without whose approval such action would not have been taken, Wesco in 1985 invested $45 million in cash equivalents in a newly organized, wholly owned insurance company, Wesco-Financial Insurance Company ("Wes-FIC"). Another $45 million was invested in 1986 and 1987.

The new subsidiary, Wes-FIC, has reinsured, through another Berkshire Hathaway insurance company subsidiary as intermediary-without-profit, 2% of the entire book of insurance business of the long-established Fireman's Fund Corp. (listed on the NYSE). Wes-FIC thereby assumed the benefits and burdens of Fireman's Fund's prices, costs and losses under a contract covering all insurance premiums earned by Fireman's Fund during a four-year period commencing September 1, 1985. The arrangement puts Wes-FIC in almost exactly the position it would have been in if it, instead of Fireman's Fund, had directly written 2% of the business. Differences in results should occur only from the investment side of insurance, as Wes-FIC, instead of Fireman's Fund, invests funds from "float" generated. Wes-FIC's share of premiums earned in 1987 exceeded $73 million.

Wes-FIC's net income for 1987 was $9,468,000, versus $6,967,000 for 1986. The net income figures included securities gains, net of income taxes, of $9,000 in 1987 and $352,000 in 1986. Wes-FIC's 1987 net income benefitted by about

$1 million because of an unusual adjustment to its income tax provision caused by the Tax Reform Act of 1986.

It is in the nature of even the finest casualty insurance businesses that in keeping their accounts they must estimate and deduct all future costs and losses from premiums already earned. Uncertainties inherent in this undertaking make financial statements more mere "best honest guesses" than is typically the case with accounts of non-insurance-writing corporations. And the reinsurance portion of the casualty insurance business, because it contains one or more extra links in the loss-reporting chain, usually creates more accounting uncertainty than the non-reinsurance portion. Wesco shareholders should remain aware, not only of the inherent imperfections of Wes-FIC's accounting, but also of the inherent cyclicality of its business.

However, Wesco hopes for: (1) a reasonable return on its investment over the four years of the Fireman's Fund reinsurance contract, and (2) possible future reinsurance contracts with other insurers.

All Other "Normal" Net Operating Income

All other "normal" net operating income, net of interest paid and general corporate expenses, increased to $1,808,000 in 1987 from $1,459,000 in 1986. Sources were (1) rents ($2,272,000 gross, excluding rent from Mutual Savings) from Wesco's Pasadena office building block (predominantly leased to outsiders although Mutual Savings is the ground floor tenant) and (2) interest and dividends from cash equivalents and marketable securities held by Precision Steel and its subsidiaries and at the parent company level.

Net Gains On Sales Of Securities

Wesco's aggregate net gains on sales of securities, combined, after income taxes, decreased to $1,208,000 in 1987 from $4,590,000 in 1986.

Bowery Savings Bank

In 1985 Wesco, in another co-venture with its parent corporation, approved by Wesco's directors in the same manner as the Wes-FIC co-venture, joined a group which invested $100,000,000 cash in a newly organized, New York-chartered savings bank. The new bank then took over the name, assets and liabilities of the insolvent Bowery Savings Bank in the city of New York. The takeover received (1) much needed assistance from FDIC, the federal agency, akin to FSLIC, which insures deposits in banks, and (2) the blessing of New York bank regulators. Wesco invested $9,000,000, other Berkshire Hathaway subsidiaries invested $12,384,000, and other unrelated investors invested the balance of the $100,000,000.

The terms of the FDIC assistance were extremely complex but can be fairly summarized as far from adequate to assure that the investors would make a profit. This is as it should be when $100 million buys a highly-leveraged residual equity position in a $5 billion bank, albeit one with many problems.

The investment continued to be carried at cost in Wesco's accompanying year-end financial statements, but it was sold, as part of a friendly acquisition of Bowery by a large and reputable company, on January 31, 1988, at an after-tax profit for Wesco of about $5 million.

Richard Ravitch was the organizing leader in the group which revitalized Bowery Savings Bank, acted as its CEO and negotiated its sale. We take this opportunity to doff our hat to him for a job well done. We have similar admiration for our other co-investors, particularly the Tisch family and Richard Rosenthal. Mr. Rosenthal was a former Salomon partner (see below) who died in a tragic air crash in the midcourse of our venture.

Salomon Inc

On October 1, 1987 Wesco and certain of its wholly owned subsidiaries purchased 100,000 newly issued shares of Series A Cumulative Convertible Preferred Stock, without par value, of Salomon Inc ("Salomon"), at a cost of $100 million. Salomon's primary business is transacted by its subsidiary, Salomon Brothers, a leading securities firm. Our investment was part of a $700 million transaction in which other subsidiaries of Berkshire Hathaway Inc., Wesco's parent, invested $600 million. Principal terms of the transaction include the following: (1) the new preferred stock will pay dividends at the annual rate of 9%; (2) each preferred share, purchased at a cost of $1,000, will be convertible into 26.31579 shares of Salomon common stock on or after October 31, 1990, or earlier if certain extraordinary events occur; and (3) the preferred stock is subject to mandatory redemption provisions requiring the retirement, at $1,000 per share plus accrued dividends, of 20% of the issue on each October 31, beginning in 1995, so long as any shares of preferred stock remain outstanding.

At the stated conversion price of the preferred stock, a profit (subject to certain procedural requirements) will be realizable whenever, after October 31, 1990, the common stock of Salomon (listed NYSE) trades at over $38 per share. At the time of our commitment to buy the new preferred, the common stock of Salomon was selling in the low 30s. However, shortly after the ink dried on Wesco's new stock certificates, the October 19, 1987 "Black Monday" stock market crash occurred, which caused temporary but substantial operating losses plus a lowered credit rating at Salomon. Although Salomon, among securities firms, suffered only its rough share of the general debacle, its common stock at one time after the crash traded as low as 16⅝.

Fortunately, as the conversion privilege we had bargained for declined in value along with the price of Salomon common stock, interest rates also declined, which made our fixed 9% annual preferred stock dividend more valuable. We believe that, all factors considered, at December 31, 1987 our $100 million investment in preferred stock of Salomon was still worth about $98 million.

We much admire the way Salomon and its leader, John Gutfreund, are adjusting operations to cope with new and adverse conditions. They seem ahead of the game to us, compared with competitors, and they work from the sound base of an honored name, affixed to an organization deep in talent and known for hard work.

Berkshire Hathaway's Chairman, Warren Buffett, and the undersigned joined the board of Salomon on October 28, 1987, and are very pleased with the new association.

Consolidated Balance Sheet and Related Discussion

Wesco's consolidated balance sheet (1) retains a strength befitting a company whose consolidated net worth supports large outstanding promises to others and (2) reflects a continuing slow pace of acquisition of additional businesses because few are found available, despite constant search, at prices deemed rational from the standpoint of Wesco shareholders.

As indicated on the accompanying consolidated balance sheet, the aggregate market value of Wesco's marketable equity securities was higher than their aggregate carrying value at December 31, 1987 by about $6 million, down significantly from about $13 million one year earlier. The consolidated aggregate market value of all marketable securities, including bonds and other fixed-income securities, exceeded aggregate carrying value by about $12 million. As earlier noted, about $9 million of this unrealized appreciation lies within the savings and loan subsidiary.

Wesco's Pasadena real estate, a full block (containing (1) about 125,000 first-class net rentable square feet, including Mutual Savings' space, in a modern office building, plus (2) an additional net rentable 34,000 square feet of economically marginal space in old buildings requiring expensive improvement), has a market value substantially in excess of carrying value, demonstrated by (1) mortgage debt ($4,850,000 at 9.25% fixed) against this real estate now exceeding its depreciated carrying value ($3,164,000) in Wesco's balance sheet at December 31, 1987, and (2) substantial current net cash flow (about $1 million per year) to Wesco after debt service on the mortgage. The modern office building is 99% rented, despite a glut of vacant office space in Pasadena. We charge just-below-standard rents and run the building as a sort of first-class club for tenants we admire. With these practices, a prime location and superior parking facilities, we anticipate future increases in cash flow, but at no better rate than the rate of inflation.

Wesco remains in a prudent position when total debt is compared to total shareholders' equity and total liquid assets. Wesco's practice has been to do a certain amount of long-term borrowing in advance of specific need, in order to have maximum financial flexibility to face both hazards and opportunities.

It is expected that the balance sheet strength of the consolidated enterprise will in due course be used in one or more business extensions. The extension activity, however, requires patience, as suitable opportunities are not always present.

As indicated in Schedule I accompanying Wesco's financial statements, investments, both those in the savings and loan and reinsurance subsidiaries and those held temporarily elsewhere pending sale to fund business extension, tend to be concentrated in very few places. Through this practice of concentration of investments, better understanding is sought with respect to the few decisions made.

The ratio of Wesco's annual reported consolidated net income to reported consolidated shareholders' equity, about 15% in 1985-87, was dependent to a very large extent on securities gains, irregular by nature. This recent ratio is almost certain to continue to decline, probably sharply, as it did in 1987. Neither possible future acquisitions of other businesses nor possible future securities gains appear likely to help much in the short term. The business acquisition game continues to be crowded with optimistic players who usually force prices for low-leverage acquirers like Wesco to levels where return-on-investment prospects are modest. And future securities gains are likely to prove harder to come by for very simple reasons. Because securities generally traded lower several years ago than they do now, relative to the intrinsic values of the businesses represented by the securities, creating more obviously sound investments then than now, and because prospects for above-average returns tend to go down as assets managed go up, it is now, early in 1988, even easier than it was early in 1986, to predict less desirable future results. It is also easy for any sophisticated Wesco shareholder, reviewing either (1) this virtual reprint of last year's letter or (2) Wesco's marketable securities disclosed herein, to diagnose (correctly) that the decision-makers are now even more dry of good ideas than they were two years earlier.

The considerable, and higher than desired, liquidity of Wesco's consolidated financial position as this is written does not result from our forecast that business conditions are about to worsen, or that interest rates are about to rise, or that common stock prices are about to fall. Wesco's condition results, instead, from our simply not finding opportunities for more aggressive use of capital with which we are comfortable.

Wesco continues to try more to profit from always remembering the obvious than from grasping the esoteric (including much modern "strategic planning" and "portfolio theory"). Such an approach, while it has worked fairly well on average in the past and will probably work fairly well over the long-term future, is bound to encounter periods of dullness and disadvantage as it limits action.

Moreover, our approach is being applied to no great base position. Wesco has only a tiny fraction of its total intrinsic value in businesses with enough commercial advantage in place to assure permanent high future returns on capital employed. In contrast, Berkshire Hathaway, Wesco's parent corporation, has a larger proportion of its intrinsic value in durable high-return businesses.

Some historical explanation for the current situation becomes appropriate here. When Wesco's parent corporation acquired control, Wesco's activities were almost entirely limited to holding (1) some surplus cash, plus (2) a multi-branch savings and loan association which had many very long-term, fixed-rate mortgages, offset by interest-bearing demand deposits. The acquisition of this intrinsically disadvantageous position was unwisely made, alternative opportunities considered, because the acquirer was overly influenced by a price considered to be moderately below liquidating value. Under such circumstances, acquisitions have a way of producing, on average, for acquirers who are not quick-turn operators, low to moderate long-term results. This happens because any advantage from a starting "bargain" gets swamped by effects from change-resistant mediocrity in the purchased business. Such normal effects have not been completely avoided at Wesco, despite some successful activities, including recent investment in General Foods.

Over the long term, a corporation like Wesco, with no significant proportion of intrinsic value in great businesses, is like a tortoise in a race of hares. And, as noted above, this particular tortoise faces the race with an unoriginal and conservative approach.

However, there are respectable precedents for our approach. The novelist Hardy, who believed that the natural outcome of ambition was getting clobbered, advocated the logical preventative of aiming low. And people known for outcomes far too good to have been expected by Hardy have mined a branch of the same vein. Consider this statement from Newton: "If I have seen further than other men, it is by standing on the shoulders of giants". And this from Mozart (as approvingly quoted by the distinguished advertising creator, David Ogilvy): "I never tried to compose anything original in my life".

It is occasionally possible for a tortoise, content to assimilate proven insights of his best predecessors, to outrun hares which seek originality or don't wish to be left out of some crowd folly which ignores the best work of the past. This happens as the tortoise stumbles on some particularly effective way to apply the best previous work, or simply avoids standard calamities. Anyway, we hope so. And so should recent purchasers of Wesco stock who have not only bet on a tortoise but also, by paying prices in the mid forties, given odds.

On January 28, 1988, Wesco increased its regular quarterly dividend from 17½ cents per share to 18½ cents per share, payable March 15, 1988, to shareholders of record as of the close of business on February 26, 1988.

This annual report contains Form 10-K, a report filed with the Securities and Exchange Commission, and includes detailed information about Wesco and its subsidiaries as well as audited financial statements bearing extensive footnotes. As usual, your careful attention is sought with respect to these items.

Charles T Munger

Charles T. Munger
Chairman of the Board

February 26, 1988

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 1987 — Commission file number 1-4720

WESCO FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	95-2109453 (I.R.S. Employer Identification No.)
315 East Colorado Boulevard, Pasadena, California (Address of principal executive offices)	91101-1954 (Zip Code)

Registrant's telephone number, including area code: (818) 449-2345

Securities registered pursuant to section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Capital Stock, $1 par value	American Stock Exchange and Pacific Stock Exchange
10⅛% Notes Due 1991	American Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding twelve months and (2) has been subject to such filing requirements for the past 90 days. YES...X ...NO......

The aggregate market value of voting stock of the registrant held by non-affiliates of the registrant as of March 11, 1988 was: $43,806,000.

The number of shares outstanding of the registrant's Capital Stock as of March 11, 1988 was: 7,119,807.

DOCUMENTS INCORPORATED BY REFERENCE

Title of Document	Parts of Form 10-K
Proxy Statement for 1988 Annual Meeting of Stockholders	Part III, Items 10, 11, 12 and 13

PART I

Item 1. Business

GENERAL

Wesco Financial Corporation ("Wesco") was incorporated in Delaware on March 19, 1959. The principal businesses of Wesco, conducted by wholly owned subsidiaries, are the savings and loan business, through Mutual Savings and Loan Association ("Mutual Savings"), which was incorporated in California in 1925, the property and casualty insurance business, through Wesco-Financial Insurance Company ("Wes-FIC"), which was incorporated in 1985, and the steel service center business, through Precision Steel Warehouse, Inc. ("Precision Steel"), which was begun in 1940 and acquired by Wesco in 1979. Wesco also has investments in real estate and marketable securities and owns a small insurance agency.

From 1973 to July 1983, Wesco was controlled by a corporation named Blue Chip Stamps. In July 1983, that company transferred ownership of its 80.1% investment in Wesco to a newly formed, wholly owned company (the present Blue Chip Stamps) and was subsequently merged into Berkshire Hathaway Inc. ("Berkshire"). Thus, Wesco and its subsidiaries are controlled and 80.1%-owned directly by the present Blue Chip Stamps and indirectly by Berkshire.

Wesco's activities fall into three business segments — financial, insurance, and steel service. The financial segment includes (a) the savings and loan business, (b) operation of a business block in Pasadena, California, and (c) investments, principally in marketable preferred and common stocks. The insurance segment comprises the property and casualty insurance business. The steel service segment comprises mainly steel service center operations. The amounts of revenue, operating profit and identifiable assets attributable to each of these three business segments are included in the "Business Segment Data" note to Wesco's consolidated financial statements contained in Item 8, Financial Statements.

FINANCIAL SEGMENT

The earnings of Mutual Savings have been and are dependent on the interest rate spread between the yields earned on its real estate loans and investments, and the costs of savings accounts.

The savings and loan business has been a difficult business since the late 1970s, as institutions with substantial amounts of long-term, low-yielding mortgage loans on their books, funded by short-term borrowings from depositors, have seen their cost of funds increase dramatically. The increase in cost of funds has been due both to prevailing interest rates at levels much higher than were once thought normal, and to fundamental changes that have occurred in the savings and loan industry. As a result of changes in federal regulations affecting savings and loan associations (and other depository institutions such as banks), regulations limiting rate competition for depositors' accounts were largely dismantled by 1985, and completely eliminated in 1986. Other regulations and regulatory attitudes have been modified to enable savings and loan associations and banks to compete more directly with each other and with other financial institutions in providing a wide variety of consumer financial services. In 1981 and 1982, most savings and loans suffered operating losses, and although many have more recently earned profits, principally as a result of the possibly short-term moderation of interest rates, many others are burdening the Federal Savings and Loan Insurance Corporation ("FSLIC"), the Federal agency that insures savings deposits, with their financial difficulties.

Mutual Savings, which has retained its financial strength, prepared for the changes in the savings and loan business by substantially reducing the size and scope of its business and altering the nature of its business activities while pondering a sound operating plan that would provide a socially constructive service while operating with acceptable profits accompanied by an acceptable level of risk. In 1979 Mutual Savings substantially curtailed its real estate loan originations because of the high cost of savings deposits, the reduction in net savings inflow, and uncertainty as to the future direction of loan interest rates.

In December 1980, Mutual Savings, which had operated at seventeen locations in Southern California and had ranked approximately 39th among California savings and loan associations in assets, sold all of its offices, except for its Pasadena headquarters office and a satellite office in a shopping mall across the street, to another association. Under terms of the sale, Mutual Savings transferred to the buyer approximately $307 million of net branch savings accounts together with an equal book value of its highest-yielding mortgage loans and the physical assets of the branch offices, receiving approximately $8 million, in cash. Mutual Savings realized a gain on the sale of branch premises and equipment, after income taxes and expenses of sale, of approximately $2.9 million.

Mutual Savings, in 1986, re-entered real estate lending, offering a fully adjustable-rate mortgage loan. Loans made under this program beginning December 1, 1987 have borne a 25% interest rate cap. These loans yield a spread of about 2% above the rate quoted on one year U.S. Treasury bills, or an average rate of 9.0% as of 1987 yearend. Approximately $34 million was lent during 1986 and 1987.

During 1987 the Federal regulatory authorities adopted regulations making it desirable that Mutual Savings maintain at least 60% of its assets in housing-related categories. Mutual Savings, in December, invested approximately $51 million in mortgage obligations collateralized by pools of Government National Mortgage Association- and Federal Home Loan Mortgage Corporation-backed loans. These fixed-rate mortgage securities yield approximately 9.1% over their expected average lives of 2.5 years. Another $35 million was invested in Federal Home Loan Bank bonds, priced to yield about 8.1%. These bonds are due in December 1989. Management is hopeful that, as Mutual Savings continues its program of direct real estate lending, and as these fixed-rate obligations are repaid, they will be replaced by Mutual Savings' own directly made loans. In any event, at least 60% of Mutual Savings' assets will be in adjustable high-quality housing-related assets.

Mutual Savings is now relatively small, ranking approximately 70th among California's savings and loan associations in assets at the end of 1987. Because it sold its highest-yielding mortgage loans in 1980, and it has begun to lend and invest in mortgage-backed securities only recently, after interest rates had fallen from the higher levels which generally prevailed since 1980, Mutual Savings' entire loan portfolio, including the $51 million invested in mortgage-backed loans, bears what may be one of the lowest average interest rates (8.4% per annum at the end of 1987) of all associations in the United States. The fixed-rate old (pre-1980) portion of the portfolio, which bears an average interest rate of 7.4%, and which is carried on Mutual Savings' books at the end of 1987 at about $56 million, consists of rapidly repaying, seasoned loans, all collateralized by properties in which the borrowers have large equity positions. The whole portfolio of housing-related assets is believed to present almost no risk of loss to Mutual Savings. Based on a comparison with other associations, Mutual Savings is believed to have a higher ratio of shareholders' equity to total interest-bearing liabilities; a higher proportion of assets in short term, interest-bearing cash equivalents; and a much higher proportion of assets in intermediate-term, tax-exempt bonds and preferred stocks. The short-term, interest-bearing cash equivalents currently produce a tax-equivalent yield sharply (about 3 percentage points) below that prevailing on the mortgage portfolio of the typical association, which operated more aggressively than Mutual Savings during former high-interest periods. The tax-exempt bonds and preferred stocks currently produce a tax-equivalent yield sharply (about 5 percentage points) higher than typical mortgage portfolios of such associations.

Savings and loan associations are required to pay Federal insurance premiums to maintain insurance of accounts. From 1962 to 1973 supplemental insurance premiums were required. These built up on the accounts of FSLIC as the industry's "secondary insurance reserve," and were considered assets, "prepaid insurance premiums," on the books of the savings and loan associations. FSLIC has, in recent years, been forced to assist and rescue numerous associations that have either become innocent victims of regional economic collapse or aggressively ventured into high-risk areas on high-risk terms, sometimes involving dishonesty. Following an audit by the Federal General Accounting Office in early 1987, FSLIC was declared insolvent, and as a result, prepayments to the secondary insurance reserve were required to be written off. Mutual Savings, accordingly, wrote off its

$3.6 million share of this reserve during 1987, resulting in an after-tax charge of $1.9 million for the year.

The Federal government directly supports FSLIC's commitment to protect insured deposits. This Federal guarantee was restated when, in August 1987, President Reagan signed into law the Competitive Equality Banking Act of 1987, containing language reaffirming that deposits up to the prescribed coverage limits in Federally insured depository institutions are backed by the full faith and credit of the United States. This new law also enables FSLIC to raise $10.8 billion over a three-year period through the sale of bonds. There is much speculation, however, that additional Federal assistance will be required for FSLIC to remain solvent.

Federal and state regulations provide that a savings and loan association can invest, subject to certain limitations, in any securities deemed prudent by its management. Under this authority Mutual Savings increased its holdings of public utility preferred stocks by approximately $5 million during 1987.

Mutual Savings expects the savings and loan business to continue to be a difficult and competitive business. It intends to preserve its options by retaining financial strength and remaining very flexible with respect to expansion (including possible acquisition), or contraction. It may also consider revision of services designed to create more differentiation in the marketplace from standard financial services provided by others.

Effective in January 1983, the regulations of the California Savings and Loan Commissioner were amended to provide that a service corporation wholly owned by a savings and loan association could engage in any activity approved by the Commissioner. Mutual Savings' service subsidiary, Wes-Fin Service Corp. ("Wes-Fin"), accordingly, obtained approval to purchase common and preferred stocks from time to time provided that, at the time of any purchase, the total amount invested would not exceed 7½% of the then total assets of Mutual Savings. In October 1987 Wes-Fin joined with other Wesco and Berkshire subsidiaries, and invested $26 million in cumulative convertible preferred stock of Salomon Inc (see Note 2 to the accompanying consolidated financial statements for additional information).

During 1987, Mutual Savings, excluding its service subsidiary, sustained a pre-tax operating loss before gains on sales of securities. However, the pre-tax loss was more than offset by income tax benefits available through application of Mutual Savings' pre-tax loss, as computed under income tax law, against pre-tax income of affiliates to be included in the same consolidated federal and state tax returns. In addition, (1) the service subsidiary had a pre-tax operating profit before securities gains, and (2) securities gains increased income. This resulted in total 1987 net income of Mutual Savings of $1,796,000, broken down as follows: (1) Mutual Savings' after-tax income of $2,895,000 before writeoff of premiums prepaid to FSLIC and before capital gains, minus (2) $1,935,000 effect of writeoff of premiums prepaid to FSLIC, plus (3) $836,000, effect of Mutual Savings' 1987 capital gains.

Wesco, as a savings and loan holding company, and Mutual Savings, as a savings and loan association, are subject to regulation by the Federal Savings and Loan Insurance Corporation ("FSLIC"), the Federal Home Loan Bank Board and the California Department of Savings and Loan. This regulatory framework encompasses reserve requirements, reporting requirements, periodic regulatory examinations, limitations on the types of loans and other investments that can be made, and regulations affecting the acquisition or disposition of certain types of businesses.

Issues currently of particular concern to the regulators and the industry are summarized below.

- The management of interest rate risk through the matching of interest-sensitive assets with liabilities of similar maturities.

- An increase in the level of net worth required of the industry, in steps, from 3% of liabilities at 1986 yearend (a level that many associations have not yet attained) to approximately 3.5% at 1987 yearend, and, ultimately, to 6% in several years. Mutual Savings' net worth amounted to 19.4% of liabilities at 1987 yearend.

• The possible need for new assistance to FSLIC, now considered financially impaired as a result of its having rescued numerous associations in the past several years.

Wesco, while it seeks suitable businesses to acquire and expansion of its existing operations, invests in marketable securities, including common stocks of unaffiliated companies. (See Note 2 to the accompanying consolidated financial statements for a summary of these investments and Schedule I accompanying such statements for further information.) Wesco owns a business block in Pasadena, California, which includes the nine-story office building in which its headquarters and the main offices of Mutual Savings, Wes-Fin and WSC Insurance Agency (a small insurance agency wholly owned by Wesco) are located, and a multistory garage structure. These properties are nearly fully leased under agreements expiring at various dates to 1994.

Approximately 60 full-time employees are engaged in the savings and loan business and other financial segment activities.

INSURANCE SEGMENT

Wes-FIC was incorporated in 1985 to engage in the property and casualty insurance and reinsurance business. Wesco contributed, as initial capital, $45 million in cash and cash-equivalents to Wes-FIC in September 1985, $36.2 million in cash in January 1986 and an additional $9 million in March 1987.

Wes-FIC, as its sole insurance transaction to date, reinsured, through a Berkshire Hathaway insurance company subsidiary, National Indemnity Company ("NICO"), as intermediary-without-profit, 2% of the entire book of insurance business of the long-established Fireman's Fund Insurance Companies. Wes-FIC thus assumed the benefits and burdens of Fireman's Fund's prices, costs and losses under a contract covering all insurance premiums earned by Fireman's Fund during a four-year period commencing September 1, 1985. The arrangement put Wes-FIC in virtually the same position it would have been in if it, instead of Fireman's Fund, had directly written the business reinsured. Differences in results occur only from the investment side of insurance, as Wes-FIC, instead of Fireman's Fund, invests funds from "float" generated. Wes-FIC's share of premiums earned in 1987 exceeded $73 million.

Insurance companies are subject to regulation by the departments of insurance of the various states in which they operate. Regulations relate to, among other things, capital requirements, loss reserve requirements, reporting requirements, periodic regulatory examinations, and limitations on the types of investments that can be made.

In recent years, financial failures in the insurance industry have received considerable attention from news media, regulatory authorities and rating agencies. As one result, industry participants and the public have been made more aware of the benefits derived from dealing with insurers whose financial resources supported, with significant margins of safety against adversity, their promises. In this respect Wes-FIC is competitively well positioned, inasmuch as it possesses above-average financial strength.

Wes-FIC is operated by personnel employed by Berkshire and NICO; it has no employees of its own.

STEEL SERVICE SEGMENT

Precision Steel, acquired in 1979 for approximately $15 million, operates a well- established steel service center business in two service center locations: one in Franklin Park, Illinois, near Chicago; the other, operated by a wholly owned subsidiary, in Charlotte, North Carolina. The service centers buy low carbon sheet and strip steel, coated metals, spring steels, stainless steel, brass, phosphor bronze, aluminum and other metals, cut these metals to order, and sell them to a wide variety of customers.

The service center business is highly competitive. For example, Precision Steel's annual sales volume of about $55 million compares with the steel service industry's annual volume of over $20 billion. Precision Steel competes not only with other service centers but also with mills which supply metal to the service centers. Competition exists in the areas of price, quality, availability of products and speed of delivery. Because it is willing to sell in relatively small quantities, Precision Steel has been able to compete in geographic areas distant from its service center facilities. Competitive pressure is intensified by imports and by a tendency of domestic manufacturers to substitute less costly components for parts traditionally made of steel.

Precision Brand Products, Inc. ("Precision Brand"), a wholly owned subsidiary of Precision Steel, manufactures shim stock and other tool room specialty items, as well as hose and muffler clamps, and distributes them under its own brand names nationwide, using both salesmen and manufacturers' representatives. This business is highly competitive.

Steel service raw materials are obtained principally from major domestic steel mills, and their availability is considered good. Precision Steel's service centers maintain extensive inventories in order to meet customer demand for prompt deliveries. Typically, an order is filled and the processed metals delivered to the customer within one week. Precision Brand normally maintains inventories adequate to allow for off-the-shelf service to customers.

The steel service businesses are subject to economic cycles. These businesses are not dependent on a few large customers. Steel service backlog orders increased to approximately $5.4 million as of December 31, 1987, from the $4.3 million level as of December 31, 1986.

Approximately 265 full-time employees are engaged in the steel service business, almost half of whom are members of unions. Management considers labor relations to be good.

Item 2. Properties

Wesco owns a business block in downtown Pasadena, California, which is improved with a nine-story office building that was constructed in 1964 and has approximately 125,000 square feet of net rentable area, as well as three commercial store buildings and a multistory garage with space for 425 automobiles. Approximately 22,000 square feet of the office building are used by Wesco as its headquarters or leased to Mutual Savings for use as its main office, while the balance is leased to outside parties under agreements expiring at various dates to 1994. Mutual Savings leases its 1,700-square-foot satellite office in the Plaza Pasadena shopping center located across the street from its main office; this lease expires in 1990 and may be extended under two five-year options.

Wes-FIC uses the headquarters office of NICO, a subsidiary of Berkshire Hathaway Inc., its ultimate parent, in Omaha, Nebraska, as its place of business.

Mutual Savings holds real estate which has been acquired by foreclosure. The most valuable parcel consists of 22 acres of vacant, largely oceanfront land near Santa Barbara, California, where residential development is presently intended. Such development is subject to various difficult-to-obtain regulatory approvals, but work in the field on subdivision improvement has commenced. The property is expected eventually to provide a yield greatly in excess of its book cost. Other properties include several buildings in a small shopping center in Upland, California, which are leased to various small businesses.

Precision Steel and its subsidiaries own three buildings housing their plant and office facilities having usable area approximately as follows: 138,000 square feet in Franklin Park, Illinois; 42,000 square feet in Charlotte, North Carolina; and 59,000 square feet in Downers Grove, Illinois.

Item 3. Legal Proceedings

Wesco and its subsidiaries are not involved in any legal proceedings which are expected to result in material loss.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of Wesco's shareholders subsequent to the annual meeting held in April 1987.

PART II

Item 5. Market for the Registrant's Common Stock and Related Stockholder Matters

Wesco's common stock is traded on the American Stock Exchange and the Pacific Stock Exchange.

The following table sets forth the ranges of stock prices reported in the Wall Street Journal for Wesco's shares trading on the American Stock Exchange by quarter for 1987 and 1986, as well as cash dividends paid by Wesco on each outstanding share.

	1987		
	Sales Price		Dividends
Quarter Ended	High	Low	Paid
March 31	$43¾	$38	$0.175
June 30	42¾	36⅞	0.175
September 30	43	36	0.175
December 31	43⅝	32⅜	0.175
			$0.70

	1986		
	Sales Price		Dividends
Quarter Ended	High	Low	Paid
March 31	$50	$36	$0.165
June 30	51¾	40⅝	0.165
September 30	43½	39⅛	0.165
December 31	40½	37⅞	0.165
			$0.66

There were approximately 1,050 shareholders of record of Wesco's common stock as of the close of business on February 26, 1988.

Item 6. Selected Financial Data

Set forth below and on the following pages are selected consolidated financial data for Wesco and its subsidiaries. For additional financial information, attention is directed to Wesco's audited 1987 consolidated financial statements appearing elsewhere in this report. (Dollar amounts are in thousands except for amounts per share.)

	Year Ended December 31,				
	1987	1986	1985	1984	1983
Income items:					
Interest on loans	$ 6,528	$ 5,982	$ 6,794	$ 7,711	$ 8,567
Insurance premiums earned	73,384	67,515	20,412	—	—
Steel service revenues	54,843	52,304	51,124	55,098	46,074
Interest and dividends on investments	35,399	32,227	31,595	24,935	18,319
Gain on sales of marketable securities	2,194	8,282	62,895	19,360	3,025
Other	1,628	2,154	5,017	3,097	1,978
	173,976	168,464	177,837	110,201	77,963
Cost and expense items:					
Interest on savings accounts	20,903	22,275	25,191	20,940	16,870
Insurance losses and expenses	77,641	70,234	23,346	—	—
Cost of steel products sold	45,333	42,836	40,914	44,830	37,220
Selling, general and administrative	10,715	10,082	10,293	9,848	9,388
Interest on notes payable	3,078	3,114	3,035	3,103	4,673
Writeoff of prepaid FSLIC insurance premiums	3,618	—	—	—	—
	161,288	148,541	102,779	78,721	68,151
Income before income taxes	12,688	19,923	75,058	31,480	9,812
Income tax (provision) benefit	2,525	(3,399)	(23,517)	(7,824)	741
Net income	$ 15,213	$ 16,524	$ 51,541	$ 23,656	$ 10,553
Amounts per share:					
Net income	$2.14	$2.32	$7.24	$3.32	$1.48
Cash dividends	$ .70	$ .66	$ .62	$ .58	$ .54

	December 31,				
	1987	1986	1985	1984	1983
Assets:					
Cash, temporary cash investments, investments with fixed maturities and marketable equity securities	$444,294	$466,715	$425,727	$289,540	$211,702
Loans receivable	139,468	78,657	83,472	95,172	106,886
Total assets	647,396	611,199	561,957	417,003	355,031
Liabilities:					
Savings accounts	$286,211	$282,358	$269,047	$227,087	$188,195
Insurance losses and loss adjustment expenses	79,578	49,202	16,111	—	—
Notes payable	31,017	31,273	31,523	31,882	33,487
Total liabilities	434,576	408,608	371,156	273,364	230,919
Shareholders' equity	$212,820	$202,591	$190,801	$143,639	$124,112
Per share	$29.89	$28.45	$26.80	$20.17	$17.43

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

FINANCIAL CONDITION

Financial strength has grown in recent years as Wesco's several business operations have provided a positive cash flow. Wesco and its subsidiaries generally maintain, as a matter of practice, liquidity beyond norms for the industries in which they operate.

Wesco and certain of its subsidiaries, in October 1987, invested $100,000,000 in 9% cumulative convertible preferred stock of Salomon Inc, financing the purchase through the sale of temporary cash investments (see Note 2 to the accompanying consolidated financial statements for further information). Although this investment has utilized the excess liquidity at Wesco's parent company level, Wesco has various other sources of funds available if needed, such as dividends from its subsidiaries or borrowings from banks or others.

The key component of a savings and loan association's earnings is net interest income. Its dependable generation not only requires the management of yields, costs and maturities of assets and liabilities, but also a limitation, consistent with the ratio of net worth to total interest-bearing liabilities, on the margin, or "gap," between interest-sensitive liabilities and interest-sensitive assets. Federal Home Loan Bank Board policies require that savings and loan associations monitor this gap and restructure maturities of assets and liabilities towards a reduction of interest rate risk. The table below sets forth the major balance sheet categories and dollar amounts of items for Mutual Savings and its consolidated subsidiary as of 1987 yearend which are rate sensitive, and the resulting net gaps as of the last three yearends (amounts are in thousands of dollars):

Gap Analysis

	Amounts (in Thousands) Subject to Repricing(*)					
Balance Sheet Category	**Within 6 months**	**Within 1 year**	**Within 3 years**	**Within 5 years**	**Within 10 years**	**Total**
Rate-sensitive assets:						
Cash and temporary cash investments	$ 35,019	$ 35,019	$ 85,519	$ 85,519	$ 85,519	$ 85,519
State and municipal and FHLB bonds	—	—	35,626	41,501	46,626	52,692
Common and preferred stocks	—	—	—	—	—	61,185
Loans receivable**	40,000	50,000	100,000	125,000	133,000	139,427
Total	75,019	85,019	221,145	252,020	265,145	338,823
Rate sensitive liabilities:						
Savings accounts	199,817	241,597	285,386	287,120	287,126	287,126
Net gap at —						
December 31, 1987	$(124,798)	$(156,578)	$(64,241)	$(35,100)	$(21,981)	$ 51,697
December 31, 1986	$ 39,479	$ 4,217	$(32,210)	$(26,053)	$ 12,668	$ 50,000
December 31, 1985	$ (18,315)	$ (56,357)	$(73,196)	$(63,973)	$(21,887)	$ 50,081

* Amounts are *cumulative;* for example, loans that can be repriced in one year include loans which can be repriced in six months.

** Amounts subject to repricing in each period have been estimated inasmuch as they include prepayments as well as normal principal amortization.

The foregoing figures demonstrate the effect that Mutual Savings' recent investment in housing-related securities (see Item 1, Business) has had on its gap. The investment was funded principally through the liquidation of temporary cash investments. Although as presently structured Mutual Savings, and thus Wesco's financial segment, have more short- and intermediate-term exposure to detrimental effects should interest rates sharply increase, such exposure is not expected to result in significant detriment to Wesco in terms of its future net income or net worth. As indicated in Item 1, Business, Mutual Savings re-entered the real estate lending market in 1986, offering adjustable-rate first mortgage loans with low "spread" over cost of funds and a reasonably high cap (currently 25%) on future interest rate changes, on owner-occupied residential property. The volume of these loans approximated $34 million during 1986 and 1987. Management is hopeful that, as the recently purchased, housing-related securities are repaid, and as Mutual Savings continues its program of adjustable-rate lending, housing-related securities eventually will be replaced by Mutual Savings' adjustable-rate loans, directly made, with aggregate interest rate risk at an endurable level.

Mutual Savings is believed to have had one of the lowest loan delinquency rates of any savings and loan association for the past several years. At 1987 yearend, monthly payments were past due over 60 days on $98,000 principal balance of its loans. Management attributes Mutual Savings' favorable loan loss experience (no loan losses have been recorded or required during the past five years) principally to three factors. First, the seasoned fixed-rate loans are secured by properties in which the borrowers have large equity interests. Second, Mutual Savings' adjustable-rate first mortgage loans have been carefully made and are collateralized by conservatively appraised owner-occupied properties. Third, the balance of Mutual Savings' loan portfolio not in the foregoing categories is backed by government guaranteed loans or other extremely high-quality loans.

Wesco and its subsidiaries are believed to have adequate capital resources for all anticipated operational needs.

As presently structured, Wesco's financial segment and insurance operations are not suffering significant detrimental effects from inflation. The gap figures contained in the foregoing table indicate, however, that Mutual Savings and the financial segment are exposed, to a somewhat greater extent than in prior years, to detrimental effects should interest rates rapidly rise in the near future. And very large unanticipated changes in the rate of inflation could adversely impact the insurance business, wherein premium rates are established well in advance of incurrence of the related costs.

The effects of inflation in the steel service businesses are discussed in the section entitled Steel Service Segment below. The inflationary pressures currently affecting the steel service businesses are not considered material to the consolidated operations of Wesco.

RESULTS OF OPERATIONS

The last several years have seen dramatic, sometimes adverse, changes in the savings and loan industry. In response, Wesco's savings and loan business has declined, both in size and its relative importance to Wesco's consolidated operations. At the same time, as funds have become available pending their use in expansion or acquisition, the portfolio of marketable securities has grown, and dividend and interest income and gains on securities transactions have increased in importance to Wesco's consolidated net income. Steel service operations were added in 1979, and property and casualty insurance operations were added in September 1985. (See Item 1, Business, for further discussion of the changes in the savings and loan industry and of Wesco's other operations.)

The following summary indicates the contribution to consolidated net income of each of Wesco's three business segments, and demonstrates the prevalence and effect on consolidated net income of large, unusual items in recent years (amounts are in thousands of dollars, all after income tax effect):

	1987	1986	1985	1984	1983
Financial segment:					
"Normal" net operating income (loss) of					
Mutual Savings	$ 2,895	$ 2,159	$ 3,342	$ 3,476	$ 3,046
Other operations*	1,808	1,459	3,354	4,550	3,839
	4,703	3,618	6,696	8,026	6,885
Unusual items:					
Gain on sales of marketable securities	1,199	4,238	41,523	13,138	2,046
Fluctuation in market value of GNMA futures contract	—	—	1,671	458	—
Writeoff of prepaid FSLIC insurance premiums	(1,935)	—	—	—	—
	(736)	4,238	43,194	13,596	2,046
Net income — financial	3,967	7,856	49,890	21,622	8,931
Insurance segment:					
"Normal" net operating income (loss)	9,459	6,615	(359)	—	—
Gain on sales of marketable securities	9	352	—	—	—
Net income — insurance	9,468	6,967	(359)	—	—
Steel service segment:					
"Normal" net operating income	2,450	1,701	2,010	2,034	1,622
Flood loss	(672)	—	—	—	—
Net income — steel service	1,778	1,701	2,010	2,034	1,622
Net income — consolidated	$15,213	$16,524	$51,541	$23,656	$10,553

* Comprises net commercial real estate rental income, plus interest and dividend income from cash equivalents and marketable securities held outside Mutual Savings and Wes-FIC, less interest and other corporate expenses.

The foregoing summary contains consolidated *after-tax* earnings data. Reference is made to the following: Wesco's consolidated financial statements beginning on page 28, including in particular Note 11 on page 36, for information as to operating profit *before taxes* for each of Wesco's business segments for the past three years; and the condensed consolidated balance sheet of Mutual Savings as of 1987 and 1986 yearends, on page 40. The following discussion, by business segment, should be read in conjunction with all these data.

Financial Segment

The stability of Mutual Savings' consolidated "normal" net operating income for each of the past five years resulted mainly from income tax benefits available principally because of the presence of interest income on state and municipal bonds and dividend income on preferred and common stocks, taxed at very favorable corporate rates. Following is a summary of the components of Mutual Savings' consolidated "normal" net operating income (in thousands of dollars):

	1987	1986	1985	1984	1983
Revenues:					
Interest on loans and temporary cash investments and miscellaneous other revenues ...	$20,391	$18,554	$20,172	$17,572	$14,225
Dividends on preferred and common stocks ..	4,163	4,238	5,455	4,735	4,872
Interest on state and municipal bonds	2,022	2,348	3,220	3,643	3,643
	26,576	25,140	28,847	25,950	22,740
Expenses:					
Interest on savings accounts	20,944	22,396	25,265	22,012	20,025
Operating expenses	4,241	3,902	3,763	3,419	3,514
	25,185	26,298	29,028	25,431	23,539
Income (loss) before income tax benefit	1,391*	(1,158)	(181)	519	(799)
Income tax benefit relating thereto.............	1,504	3,317	3,523	2,957	3,845
Normal net operating income	$ 2,895*	$ 2,159	$ 3,342	$ 3,476	$ 3,046

* These figures are before writeoff of premiums prepaid to FSLIC amounting to $3,618 before taxes and $1,935 after taxes. (See Item 1, Business.)

Mutual Savings' interest expense on savings accounts varies from year to year. The decreases in such costs for 1987 and 1986 resulted from declines in overall interest rates; savings balances increased each year. On an incremental-effects basis, growth in savings accounts has been unprofitable, because Mutual Savings has incurred more in interest and other expenses than it has received from employing proceeds in short-term interest-bearing investments to an extent far above regulatory requirements for liquidity. Only interest on state and municipal bonds and dividends on preferred and common stocks, taxed at favorable rates, have, between 1980 and 1986, enabled Mutual Savings to report a positive rate spread; and, although a positive rate spread was earned by Mutual Savings in 1987 on its real estate loan portfolio, the investment income components continued to be the principal factors responsible for its positive rate spread. Details are set forth in the following table:

	1987	1986	1985
Yield on loans...	7.66%	7.47%	7.60%
Yield on investments*	9.02	9.76	12.26
Combined yield on loans and investments	8.68	9.19	10.94
Cost of savings	(7.25)	(8.24)	(9.81)
Rate spread**	1.43	0.95	1.13

* Interest on short-term investments, interest on state and municipal bonds and dividends on common and preferred stocks, all stated on a so-called tax-equivalent basis, i.e., on a pre-tax basis as if fully subject to income taxes at maximum corporate rates.

** The difference between the combined yield on loans and investments and the cost of savings.

The figures presented in the foregoing table indicate that Mutual Savings, in 1987, experienced a favorable increase in the margin of comfort between its yields and costs. Further improvement in the rate spread is expected in 1988; however, the future of interest rates remains uncertain.

"Normal" net operating income for financial operations other than Mutual Savings', as summarized in the table on page 20, increased to $1,808,000 in 1987 from $1,459,000 in 1986 following a decline from $3,354,000 in 1985. This category of net operating income contains interest and dividend income on investments held outside the savings and loan and insurance businesses. The increase in 1987 resulted principally from a change in mix of Wesco's investment portfolio. The decrease in 1986 resulted mainly from Wesco's contribution of funds to Wes-FIC in September 1985 and January 1986; interest and dividend income earned on these funds is classified as income of the insurance segment.

Insurance Segment

Wesco entered into the property and casualty insurance business in September 1985. Its sole insurance business to date has been an arrangement under which it reinsures 2% of the property and casualty insurance business of Firemen's Fund Insurance Companies ("FFC"). (See Item 1, Business, for further information on Wesco-Financial Insurance Company — "Wes-FIC.")

The "normal" net operating income or loss of Wes-FIC (i.e., income or loss before securities gains) represents the combination of its underwriting results with the interest and dividend income from its investment activities. Following is a summary of such data, in thousands of dollars:

	Year Ended December 31,		Four Months Ended December 31,
	1987	1986	1985
Premiums written	$71,032	$70,506	$46,738
Premiums earned	$73,384	$67,515	$20,412
Losses and loss expenses	53,970	48,454	16,606
Underwriting expenses	23,671	21,780	6,740
Total losses and expenses	77,641	70,234	23,346
Pre-tax underwriting loss	(4,257)	(2,719)	(2,934)
Interest and dividend income	11,618	9,685	2,219
Income (loss) before income taxes	7,361	6,966	(715)
Income tax (provision) benefit	2,098	(351)	356
Normal net operating income (loss)	$ 9,459	$ 6,615	$ (359)

Wes-FIC's underwriting results are based on estimates and actuarial assumptions. Underwriting results in the property and casualty insurance business have historically tended to be cyclical. Results were disastrous to many insurers for several years prior to 1986, as price competition, inflation and new judicial notions tended to extend insurance coverages beyond limits contemplated when policies were issued. Many large losses and several financial failures occurred in the industry. The result was a decrease in the industry's insuring capacity (basically a multiple of its capital). This decreased capacity enabled insurers beginning in 1985 to increase prices (premium rates) significantly, as well as to become more selective in their underwriting. FFC attributed the improvement in its property and casualty underwriting results for 1986 mainly to higher premium rates and use of tighter underwriting standards. The 1987 pre-tax underwriting figures, however, indicate that the cycle has begun to turn against underwriters, resulting principally from increased price competition in the industry.

Insurance losses and loss expenses, and the related liabilities reflected on Wesco's consolidated balance sheet, because they are based in large part upon estimates, are subject to estimation error. Revisions of such estimates in future periods could significantly affect the results of operations reported for such future periods.

Interest and dividend income has been earned by Wes-FIC from its investment of net reinsurance premium proceeds, or "float," and on capital contributed to the insurance business by Wesco — $45 million in September 1985, $36.2 million in January 1986 and $9 million in March 1987.

The provision or benefit for income taxes of Wes-FIC has been dependent largely on the amounts of and proportion that the various components of its pre-tax income, some of which are taxed at favorable rates, have borne to total pre-tax income. The income tax provision or benefit of Wes-FIC has fluctuated as a percentage of pre-tax income or loss in each of the periods presented in the foregoing table. A change in mix of Wes-FIC's investment portfolio beginning late in 1986, combined with an increase in the amount invested, provided approximately $4 million more interest on state and municipal bonds, and about $2.6 million less in interest on short-term cash equivalents, in 1987 than in 1986. Because interest on state and municipal bonds is taxed at a very low effective tax rate, while interest on short-term cash equivalents is fully taxable at the maximum statutory rate, the change in mix of the investment portfolio resulted in a reduction in 1987 income tax expense by approximately

$1 million. Another $1 million of income tax benefit for 1987 is attributed to changes in computations of Federal taxable income and reductions in tax rates as a result of the Tax Reform Act of 1986.

Wes-FIC's arrangement for the reinsurance of 2% of FFC's property and casualty insurance business continues to August 31, 1989. Wes-FIC maintains a strong capital position which provides it the opportunity to accept other insurance contracts, if obtainable at acceptable terms.

Steel Service Segment

Sales revenues increased approximately 5% in 1987 in spite of steady competitive pressures in the marketplace. Two main factors were involved. First, there was an increase in sales volume of approximately 3.5%. Second, Precision Steel held its pricing at levels that management believed to be endurable. Steel service revenues generally have followed economic cycles, with the increase in 1984 attributable mainly to continuation of the economic resurgence experienced after the 1981-1982 recession.

Cost of products sold, as a percentage of sales, amounted to 82.7%, 81.9% and 80.0% for 1987, 1986 and 1985. The increase in the cost percentage in 1987 resulted from the inclusion of an uninsured flood loss of $1,340,000 in cost of steel products sold. The loss followed an unusually severe rainstorm in the Chicago area in August, during which nine inches of rain fell in a twenty-four hour period. The area was subsequently declared a Federal disaster area, a small consolation being that the Company was therefore able to amend its 1986 Federal income tax return to claim the 1987 flood loss against 1986 taxable income, thus effecting an immediate refund at the prior year's 46% Federal rate, rather than the 40% rate available on the 1987 Federal return. Were it not for the flood loss, cost of products sold in 1987 would have amounted to 80.2% of steel service revenues. The cost percentage typically fluctuates slightly from year to year as a result of changes in product mix, the effect of competition for sales volume based on selling prices, and the availability of favorable quantity order prices on materials purchased.

Steel service net income increased approximately 5% in 1987 following a decrease of approximately 15% in 1986. Were it not for the $672,000 detrimental effect on 1987 after-tax earnings of the flood loss discussed in the preceding paragraph, 1987 steel service net income would have increased approximately 44% in 1987. The steel service business operates on a low gross margin. Any slight change in its cost of products sold as a percentage of revenues has a large effect on its net income.

* * * * * *

Realized securities gains amounted to $1,208,000, $4,590,000 and $41,523,000 after income taxes in 1987, 1986 and 1985. The 1985 figure included an unusually large amount, $34,363,000 after income taxes, realized by Wesco and its subsidiaries from sale of General Foods stock to Philip Morris Company in connection with the latter's tender offer at a large premium over the then-prevailing market price of General Foods' stock.

Wesco's consolidated revenues include significant amounts of fully tax-exempt interest on state and municipal bonds, substantially exempt dividend income from preferred and common stocks, and gains and losses on sales of stocks which, through 1987, have been subject to favorable income tax rates. Fluctuations in the amounts of and proportion that these investment income components have borne to total consolidated pre-tax income have resulted in tax provisions and benefits expressed as percentages of pre-tax income, as follows: tax benefits of 19.9% in 1987 and 7.6% in 1983; tax provisions of 17.1% in 1986, 31.3% in 1985 and 24.9% in 1984. (See note 6 to the accompanying consolidated financial statements for further information on income taxes.)

In December 1987 the Financial Accounting Standards Board issued Statement No. 96 ("FASB 96") which requires a change in accounting for income taxes. This statement must be implemented no later than 1989. Uncertainties exist with respect to the most appropriate means of implementing the changes, and Wesco management has not determined precisely when or how it will accomplish the newly prescribed methods. Management believes that if changes expected under FASB 96 had been made as of 1987 yearend, the resulting 1987 consolidated earnings and shareholders' equity data of Wesco would not have significantly differed from such information contained in Item 6, Selected Financial Data, and in the consolidated financial statements beginning on page 28.

Consolidated revenues, expenses and earnings set forth in Item 6, Selected Financial Data, and in Wesco's consolidated statement of income, are not necessarily indicative of future revenues, expenses and earnings, in that they are subject to significant variations in amount and timing of securities gains and losses and the possible occurrence of other unusual items and significant changes in the interest rate spread. In particular, management does not expect Wesco's annual gains in the foreseeable future to approach their unprecedented 1985 level.

In October 1987 an agreement was reached, subject to regulatory approval, for the sale of Wesco's 9% equity interest in the Bowery Savings Bank ("Bowery"). Wesco's investment in Bowery is carried on the 1987 yearend consolidated balance sheet at cost of $9,020,000. Regulatory approval for the sale was granted, and the sale transaction completed, in January 1988, and Wesco's after-tax gain of approximately $5 million will be included in earnings for the quarter ending March 31, 1988.

Item 8. Financial Statements

Following is an index to financial statements and related schedules appearing in this report:

The data appearing on the financial statement schedules listed below should be read in conjunction with the consolidated financial statements and notes of Wesco Financial Corporation and the report of independent accountants referred to above. Schedules not included with these financial statement schedules have been omitted because they are not applicable or the required information is shown in the financial statements or notes thereto.

Item 9. Disagreements on Accounting and Financial Disclosure

Not applicable.

PART III

Item 10. Directors and Executive Officers of the Registrant

The information set forth in the section entitled "Election of Directors" appearing in the definitive combined notice of annual meeting and proxy statement of Wesco Financial Corporation for its 1988 annual meeting of shareholders is incorporated herein by reference.

Item 11. Management Remuneration and Transactions

The information set forth in the section "Compensation of Directors and Executive Officers" in the definitive combined notice of annual meeting and proxy statement of Wesco Financial Corporation for its 1988 annual meeting of shareholders is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management

The information set forth in the section "Voting Securities and Principal Holders Thereof" in the definitive combined notice of annual meeting and proxy statement of Wesco Financial Corporation for its 1988 annual meeting of shareholders is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions

The information set forth in the section "Transactions With Management and Others" in the definitive combined notice of annual meeting and proxy statement of Wesco Financial Corporation for its 1988 annual meeting of shareholders is incorporated herein by reference.

Item 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K

The following exhibits (listed by numbers corresponding to Table 1 of Item 601 of Regulation S-K) are filed as part of this Annual Report on Form 10-K or are incorporated herein by reference:

3a. Articles of Incorporation and By-Laws of Wesco Financial Corporation.

4. Form of Indenture (incorporated by reference to Exhibit 2 to Amendment No. 1 of Form S-7 Registration Statement of Wesco Financial Corporation filed June 20, 1979. File No. 2-64616).

22. Subsidiaries.

The index to financial statements and related schedules set forth in Item 8 of this report is incorporated herein by reference.

The following report on Form 8-K was filed during the quarter ended December 31, 1987:

Report dated October 12, 1987. Item reported: 5.

SIGNATURES

Pursuant to the requirements of Section 13 of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

WESCO FINANCIAL CORPORATION

By:

Charles T. Munger — March 24, 1988
Chairman of the Board and President
(principal executive officer)

By:

Jeffrey L. Jacobson — March 24, 1988
Vice President and Chief Financial Officer
(principal financial officer)

By:

Jeanne Leach — March 24, 1988
Treasurer
(principal accounting officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Charles T. Munger — March 24, 1988
Director

H. R. Dettmann — March 24, 1988
Director

David K. Robinson — March 24, 1988
Director

James N. Gamble — March 24, 1988
Director

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Shareholders of
Wesco Financial Corporation

We have examined the consolidated balance sheets of Wesco Financial Corporation and subsidiaries as of December 31, 1987 and 1986, and the related statements of income and retained earnings, and changes in financial position for each of the three years in the period ended December 31, 1987. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above present fairly the financial position of Wesco Financial Corporation and subsidiaries as of December 31, 1987 and 1986, and the results of their operations and the changes in their financial position for each of the three years in the period ended December 31, 1987, in conformity with generally accepted accounting principles applied on a consistent basis.

Our examinations also comprehended the schedules listed in the index at Item 8. In our opinion, such schedules, when considered in relation to the basic financial statements, present fairly, in all material respects, the information presented therein.

Touche Ross & Co.

Los Angeles, California
February 26, 1988

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

ASSETS

	December 31, 1987	December 31, 1986
Cash and temporary cash investments	$112,132	$270,591
Investments:		
Obligations with fixed maturities, at cost (market $301,112 and $177,043)	295,646	166,683
Marketable equity securities, at cost (market $42,930 and $42,370)	36,516	29,441
Investment in Bowery Savings Bank	9,020	9,020
Loans receivable	139,468	78,657
Accounts receivable from customers, agents and others	15,162	15,962
Property, premises and equipment	8,024	8,054
Other assets	31,428	32,791
	$647,396	$611,199

LIABILITIES AND SHAREHOLDERS' EQUITY

	1987	1986
Savings accounts	$286,211	$282,358
Insurance losses and loss adjustment expenses	79,578	49,202
Unearned insurance premiums	26,964	29,317
Income taxes payable	5,324	11,520
Notes payable	31,017	31,273
Other liabilities	5,482	4,938
Total liabilities	434,576	408,608
Shareholders' equity:		
Capital stock, $1 par value — authorized 7,500,000 shares; issued 7,119,807 shares	7,120	7,120
Capital surplus arising from stock dividends	23,319	23,319
Retained earnings — partially restricted	182,381	172,152
Total shareholders' equity	212,820	202,591
	$647,396	$611,199

See accompanying notes to consolidated financial statements.

WESCO FINANCIAL CORPORATION
CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

(Dollar amounts in thousands except for amounts per share)

	Year Ended December 31,		
	1987	1986	1985
Income items:			
Interest on loans	$ 6,528	$ 5,982	$ 6,794
Insurance premiums earned	73,384	67,515	20,412
Steel service revenues	54,843	52,304	51,124
Interest and dividend income on investments	35,399	32,227	31,595
Gain on sales of marketable securities	2,194	8,282	62,895
Rental income of $2,272, $2,229 and $2,219, less expense of $1,167, $1,138 and $1,123	1,105	1,091	1,096
Other income	523	1,063	3,921
	173,976	168,464	177,837
Cost and expense items:			
Interest expense on savings accounts	20,903	22,275	25,191
Insurance losses and loss adjustment expenses	53,970	48,454	16,606
Insurance underwriting expenses	23,671	21,780	6,740
Cost of steel products sold	45,333	42,836	40,914
Selling, general and administrative expenses	10,715	10,082	10,293
Interest expense on notes payable	3,078	3,114	3,035
Writeoff of prepaid FSLIC insurance premiums	3,618	—	—
	161,288	148,541	102,779
Income before income taxes	12,688	19,923	75,058
Income tax (provision) benefit	2,525	(3,399)	(23,517)
Net income	15,213	16,524	51,541
Retained earnings — beginning of year	172,152	160,327	113,200
Cash dividends declared and paid	(4,984)	(4,699)	(4,414)
Retained earnings — end of year	$182,381	$172,152	$160,327
Amounts per share based on 7,119,807 shares:			
Net income	$2.14	$2.32	$7.24
Cash dividends	$ .70	$ .66	$ .62

See accompanying notes to consolidated financial statements.

WESCO FINANCIAL CORPORATION
CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION
(Dollar amounts in thousands)

	Year Ended December 31,		
	1987	1986	1985
Sources (uses) of cash, including temporary cash investments, from operations—			
Net income	$ 15,213	$ 16,524	$ 51,541
Add (deduct):			
Depreciation and amortization, including amortization of bond premiums of $2,629, $1,509, and $300	3,582	2,504	1,289
Interest expense credited to savings accounts	17,359	18,705	20,845
Net increase in losses and loss adjustment expenses of insurance business	28,023	36,082	42,437
Increase (decrease) in income taxes payable	(6,196)	(11,610)	16,041
Other, net	3,015	(3,430)	(18,851)
Cash provided from operations	60,996	58,775	113,302
Other sources (uses) of cash—			
Real estate loans originated	(25,425)	(8,992)	—
Purchase of mortgage-backed securities	(51,224)	—	—
Principal collections on real estate loans	15,600	13,758	11,772
(Increase) decrease in obligations with fixed maturities and marketable equity securities	(138,667)	(106,030)	37,894
Increase (decrease) in savings accounts, net	(13,506)	(5,394)	21,115
Payment of cash dividends	(4,984)	(4,699)	(4,414)
Other, net	(1,249)	(4,949)	(14,908)
	(219,455)	(116,306)	51,459
Increase (decrease) in cash, including temporary cash investments	$(158,459)	$(57,531)	$164,761

See accompanying notes to consolidated financial statements.

WESCO FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands except for amounts per share)

Note 1. Presentation and Consolidation

Wesco Financial Corporation ("Wesco") is 80.1%-owned by Blue Chip Stamps ("Blue Chip"), which in turn is wholly owned by Berkshire Hathaway Inc. ("Berkshire").

The consolidated financial statements of Wesco include the accounts of Wesco and its subsidiaries, all either directly or indirectly wholly owned. Wesco and its subsidiaries are engaged in several diverse businesses, notably Mutual Savings and Loan Association ("Mutual Savings"), Wesco-Financial Insurance Company ("Wes-FIC") and Precision Steel Warehouse, Inc. ("Precision Steel"). See Note 11 for financial information classified by Wesco's business segments.

All material intercompany balances and transactions have been eliminated in the preparation of the accompanying consolidated financial statements.

Note 2. Investments

Investments in obligations with fixed dates of maturity — bonds and redeemable preferred stocks — are carried on the consolidated balance sheet at cost, adjusted for accretion of discount or amortization of premium. Marketable equity securities are carried at the lower of aggregate cost or market, except for those held in the insurance business, which, when held, are carried at market value, with any resulting unrealized gain or loss added to or deducted from shareholders' equity, net of deemed applicable income taxes, without effect on net income.

Wesco, in October 1987, invested $100,000 in 100,000 newly issued shares of Cumulative Convertible Preferred Stock of Salomon Inc ("Salomon"). This investment was part of a $700,000 transaction in which other subsidiaries of Berkshire participated, and it was subject to an agreement, principal terms of which include the following: (1) the new preferred stock will pay dividends at the annual rate of 9%; (2) each preferred share will be convertible into 26.31579 shares of Salomon common stock on or after October 31, 1990, or earlier if certain extraordinary events occur, such as a tender offer for Salomon's common stock; and (3) the preferred stock is subject to mandatory redemption provisions requiring the retirement, at Wesco's cost plus accrued dividends, of 20% of the issue on each October 31, beginning in 1995, so long as any shares of preferred stock remain outstanding. This investment is carried in obligations with fixed maturities on the accompanying consolidated balance sheet.

The December 31, 1987 consolidated financial statements also reflect an equity investment in approximately 9% of the Bowery Savings Bank ("Bowery") at a cost of $9,020. In October 1987 an agreement was reached for the sale of Bowery, subject to regulatory approval. The sale was completed early in 1988, and Wesco's after-tax gain of approximately $5,000 will be included in earnings for the quarter ending March 31, 1988.

At December 31, 1987, the consolidated portfolio of marketable equity securities contained aggregate unrealized gains of $6,597 and losses of $183.

Note 3. Loans Receivable

Following is a summary of loans receivable by type of collateral at yearend:

	1987	1986
Residential property of one to four units	$ 78,439	$66,208
Residential property of more than four units	6,689	7,815
Mortgage-backed securities (residential)	52,080	1,764
Commercial property and vacant land	1,983	2,384
Savings accounts	278	516
	139,469	78,687
Less unearned loan fees and unrealized profit on sales of real estate	(1)	(30)
	$139,468	$78,657
Average interest rate	8.38%	7.48%

Interest income on loans is recognized under the accrual method of accounting. Such accrued interest amounted to $539 and $279 at 1987 and 1986 yearends.

Note 4. Property, Premises and Equipment

Following is a summary of property, premises and equipment, stated at cost at yearend:

	1987	1986
Land	$ 2,065	$ 2,026
Buildings and leasehold improvements	10,069	9,731
Machinery and equipment	5,789	5,385
Furniture and fixtures	1,063	1,092
	18,986	18,234
Less accumulated depreciation and amortization	10,962	10,180
	$ 8,024	$ 8,054

Land and buildings collateralize certain debt. See Note 7.

Property, premises and equipment are depreciated under the straight-line method over the estimated useful lives of the assets.

Note 5. Savings Accounts

Following is a summary of accounts by type of account and interest rate at yearend:

Type of Account	Interest Rate(a)	1987	1986
Interest-bearing checking accounts(b)	5.25%	$ 3,762	$ 3,154
Passbook accounts(b)	5.5	16,183	14,308
Money market rate accounts(b)	5.95	72,867	71,935
Certificate accounts:			
32 days-6 months	7.06	30,370	30,867
7 months-1 year	6.94	30,715	25,328
13 months-2 years	6.94	32,389	38,030
25 months-4 years	9.11	48,655	52,661
Over 4 years	8.89	12,839	8,811
IRA/Keogh accounts, 18 months(c)	7.75	30,914	30,405
IRA/Keogh accounts, 4 years	9.78	4,072	2,956
Jumbo certificates of deposit	7.37	2,907	2,240
Other accounts	7.75	538	1,663
		$286,211	$282,358

(a), (b) and (c) — see following page

Dollar amounts in thousands except for amounts per share

(a) Weighted average interest rate at 1987 yearend.

(b) No stated maturity.

(c) Other IRA/Keogh accounts included in the various certificate accounts amounted to $1,599 and $2,394 at 1987 and 1986 yearends.

The weighted average interest rates on all accounts at 1987 and 1986 yearends were 7.18% and 7.46%. These rates are based upon stated interest rates without giving consideration to daily compounding of interest or forfeiture of interest due to premature withdrawals.

At yearend in 1987, certificate accounts mature as follows: 1988, $147,870; 1989, $31,851; 1990, $11,938; 1991, $1,734; 1992, $0; thereafter, $6.

Note 6. Taxes on Income

Certain items of income and expense are recognized in the financial statements in periods that differ from the periods in which these items are recognized on the income tax returns, giving rise to the recognition in the financial statements of deferred and prepaid income taxes. The liability for deferred income taxes is included on the accompanying consolidated balance sheet, net of prepaid income taxes, in income taxes payable. Following is a breakdown of the liability for income taxes reflected on the accompanying consolidated balance sheet:

	1987	1986
Payable currently	$ 1,768	$ 3,386
Deferred	3,556	8,134
	$ 5,324	$11,520

The consolidated statement of income contains income tax charges (benefits) as follows:

	1987	1986	1985
Payable currently—			
Federal	$ 2,391	$ 807	$15,097
State	591	895	6,133
	2,982	1,702	21,230
Payable (recoverable) in the future—			
Federal	(5,141)	1,747	2,273
State	(366)	(50)	14
	(5,507)	1,697	2,287
Total income tax provision (benefit)	$(2,525)	$3,399	$23,517

Following is a summary of the tax effects of timing differences:

	1987	1986	1985
Deferred insurance premium acquisition costs	$ (204)	$ 357	$ 3,797
Discounting of losses and loss adjustment expense reserves of insurance business	(3,041)	—	—
Reversal of accrual of interest credited by FSLIC to secondary reserve (Note 8)	(1,076)	—	—
Loan fees recognized under different methods	(342)	(403)	(339)
State income taxes deducted on cash basis for tax return purposes vs. accrual basis for financial reporting purposes	(91)	1,903	(1,234)
Other, net	(753)	(160)	63
Income taxes payable (recoverable) in the future	$(5,507)	$1,697	$ 2,287

Dollar amounts in thousands except for amounts per share

A reconciliation of the statutory Federal income tax rate with the effective income tax rate resulting in the income tax provision (benefit) appearing on the accompanying consolidated statement of income follows:

	1987	1986	1985
Statutory Federal income tax rate	40.0 %	46.0 %	46.0 %
Increase (decrease) resulting from:			
Tax-exempt interest income	(39.7)	(19.2)	(1.8)
Exclusion from taxable income of a significant portion of dividend income	(14.7)	(8.9)	(5.2)
Fresh-start adjustment relating to discounting losses and loss adjustment expense reserves	(3.9)	—	—
Rate differentials relating to realized investment gains	(0.2)	(1.9)	(13.2)
State income taxes, less Federal tax benefit	1.1	2.2	4.4
Other differences, net	(2.5)	(1.1)	1.1
Effective income tax provision (benefit) rate	(19.9)%	17.1 %	31.3 %

Wesco and its subsidiaries join with other Berkshire subsidiaries in the filing of consolidated Federal income tax returns for the Berkshire group. The consolidated Federal tax liability is apportioned among group members pursuant to methods that result in each member of the group paying or receiving an amount that approximates the increased or decreased taxes attributable to each member.

Federal income tax returns through 1983 have been examined by and settled with the Internal Revenue Service.

Note 7. Notes Payable

Following is a list of notes payable at yearend:

	1987	1986
Notes due June 1991, currently redeemable at 102% of face value, declining to 100% by 1989, bearing interest at 10⅛%, payable in semiannual installments	$25,000	$25,000
Notes payable, collateralized by land, buildings and assignment of leases, due in monthly installments through February 2007 of $45 including interest at 9¼%	4,850	4,940
Industrial revenue bonds, due in quarterly installments through December 1994 of $42 plus interest at 6½%	1,167	1,333
	$31,017	$31,273

Notes payable at yearend in 1987 mature as follows:

Year	
1988	$ 259
1989	260
1990	278
1991	25,288
1992	300
Thereafter	4,632
	$31,017

Agreements relating to the 10⅛% notes and the industrial revenue bonds contain covenants, among others, restricting funded debt, dividends and liens on property, premises and equipment. The obligors are in compliance with all of the covenants.

Dollar amounts in thousands except for amounts per share

Note 8. Writeoff of Prepaid FSLIC Insurance Premiums

The 1987 consolidated results of operations of Wesco include a charge of $1,935 ($.27 per share), representing the after-tax effect of a writeoff of prepaid Federal Savings and Loan Insurance Corporation ("FSLIC") insurance premiums. Wesco's subsidiary, Mutual Savings, took this charge in May 1987 following a notice from the Federal Home Loan Bank Board that FSLIC had eliminated the savings and loan industry's secondary reserve because FSLIC had been required to recognize a contingent liability of $10,500,000 as of December 31, 1986, to cover future losses associated with troubled financial institutions, and, thus, FSLIC's liabilities exceeded all of its available reserves by at least $6,500,000 as of 1986 yearend.

The secondary reserve represented $800,000 in prepayments of insurance premiums required from FSLIC-insured institutions during the years 1962 through 1973, plus interest credited by FSLIC through 1986.

Note 9. Quarterly Financial Information

Unaudited quarterly financial information for 1987 and 1986 follows:

	Quarter Ended			
	December 31, 1987	September 30, 1987	June 30, 1987	March 31, 1987
Total revenues	$42,729	$44,687	$43,642	$42,918
Net income	5,207	4,559	2,292	3,155
Per share	.74	.64	.32	.44
Gain on sales of marketable securities, net of income taxes, included in net income above	60	959	189	—
Per share	.01	.14	.02	—

	Quarter Ended			
	December 31, 1986	September 30, 1986	June 30, 1986	March 31, 1986
Total revenues	$46,040	$39,880	$42,480	$40,064
Net income	5,628	3,497	4,561	2,838
Per share	.79	.49	.64	.40
Gain on sales of marketable securities, net of income taxes, included in net income above	2,140	558	1,442	450
Per share	.29	.08	.21	.06

Note 10. Retained Earnings

Retained earnings of Wesco include $47,314 of undistributed retained earnings of Mutual Savings, which were taken as special bad debt deductions for income tax purposes through 1968, after which such deductions were no longer available to Mutual Savings due to its having reached certain limitations. These deductions are not related to amounts of losses actually anticipated and have not been charged against income for financial reporting purposes. If, in the future, any portion of such retained earnings is used for any purpose other than to absorb loan losses, including payment of dividends to Wesco or distribution in liquidation, such withdrawal will necessitate accrual and payment of income taxes.

Because of the special bad debt deductions, and other differences in methods of reporting results of operations for tax return and financial statement purposes, Mutual Savings' ability to pay dividends to Wesco without being subject to tax is limited to approximately $5,000, plus future earnings on a tax-return basis. (Dividends of $7,500 and $14,000 were paid in 1986 and 1985; none were paid in 1987.)

Dollar amounts in thousands except for amounts per share

Note 11. Business Segment Data

Financial information for each of the three most recent years is presented below, broken down as to Wesco's business segments.

The financial segment includes the accounts of Wesco, Mutual Savings and Wes-Fin Service Corporation, as well as temporary cash investments and other investments of Precision Steel and its subsidiaries, together with related interest and dividend income and gain or loss on related sales. The insurance segment includes the accounts of Wes-FIC. The steel service segment includes the operating accounts of Precision Steel and its subsidiaries.

	1987	1986	1985
Revenues:			
Financial	$ 33,909	$ 38,109	$103,901
Insurance	85,013	77,853	22,631
Steel service	55,054	52,502	51,305
	$173,976	$168,464	$177,837
Operating profit (loss) before taxes:			
Financial	$ 5,490	$ 12,264	$ 75,235
Insurance	7,365	7,619	(715)
Steel service	3,139	3,372	3,802
Corporate expenses	(228)	(218)	(229)
Interest expense on notes payable	(3,078)	(3,114)	(3,035)
	$ 12,688	$ 19,923	$ 75,058

The above revenue and operating profit (loss) data include securities gains before taxes, as follows:

	1987	1986	1985
Financial	$ 2,190	$ 7,629	$ 62,895
Insurance	4	653	—
	$ 2,194	$ 8,282	$ 62,895

Additional business segment data follows:

	1987	1986	1985
Capital expenditures:			
Financial	$ 332	$ 379	$ 486
Insurance	—	—	—
Steel service	591	343	457
	$ 923	$ 722	$ 943

Depreciation and amortization of tangible assets:

	1987	1986	1985
Financial	$ 340	$ 297	$ 267
Insurance	—	—	—
Steel service	612	670	673
	$ 952	$ 967	$ 940

Identifiable assets at yearend:

	1987	1986	1985
Financial	$412,887	$420,877	$452,272
Insurance	215,293	172,020	91,077
Steel service	19,216	18,302	18,608
	$647,396	$611,199	$561,957

Dollar amounts in thousands except for amounts per share

WESCO FINANCIAL CORPORATION
SCHEDULE I—MARKETABLE SECURITIES — OTHER INVESTMENTS
DECEMBER 31, 1987
(Dollar amounts in thousands)

Name of Issuer and Title of Each Issue	Number of Shares of Stock or Principal Amount of Notes	Cost	Market Value	Balance Sheet Carrying Value
Marketable Securities held by the Consolidated group were as follows:				
Temporary cash investments —				
Securities of U.S. Government and obligations of the Federal Home Loan Bank and other U.S. Government agencies	$ 82,761	$ 81,984	$ 82,029	$ 81,984
Ford Motor Credit Corp., 7.9%, due 1-5-88	$ 19,500	19,436	20,528	19,436
Other	$ 7,160	7,160	7,161	7,160
Total temporary cash investments		$108,580	$109,718	$108,580
Fixed maturities —				
State and municipal bonds	$148,150	$159,014	$166,697	$159,014
Cumulative convertible preferred stock of Salomon Inc ("Salomon")	100,000 shares	100,000	98,000*	100,000
Federal Home Loan Bank bonds, 8¼%, due 12-26-89	$ 35,000	35,126	35,123	35,126
Other	61,500 shares	1,506	1,292	1,506
		$295,646	$301,112	$295,646
Marketable equity securities —				
Preferred stocks consisting principally of various issues of public utilities	906,008 shares	$ 33,679	$ 40,034	$ 33,679
Common stocks — various	40,500 shares	2,837	2,896	2,837
		$ 36,516	$ 42,930	$ 36,516
GNMA and FHLMC mortgage-backed securities —				
Shearson Lehman CMO, Series L-3, 7.0%, 10-25-99, expected maturity 4-25-93	$ 23,000	$ 21,731	$ 21,850	$ 21,731
Firemans Fund Mortgage Corp., Pass-Through Ctf. Ser. 1987 Class B, 6.0%, 6-25-04, expected maturity 9-25-91	$ 13,491	12,766	12,800	12,766
Various others	$ 18,942	17,583	18,000	17,583
		$ 52,080	$ 52,650	$ 52,080
All of the securities listed above were held by Mutual Savings except as indicated below:				
Held by Wesco (registrant) —				
Other temporary cash investments	$ 6	$ 6	$ 6	$ 6
Cumulative convertible preferred stock of Salomon	50,000 shares	50,000	49,000*	50,000
		$ 50,006	$ 49,006	$ 50,006
Held by Precision Steel (wholly owned subsidiary of Wesco) —				
Common stocks	40,500 shares	$ 2,837	$ 2,896	$ 2,837
Other temporary cash investments	$ 5,364	5,364	5,364	5,364
State and municipal bonds	$ 3,000	3,257	3,201	3,257
		$ 11,458	$ 11,461	$ 11,458
Held by Wesco-Financial Insurance Company (wholly owned subsidiary of Wesco) —				
Ford Motor Credit Corp., 7.9%, due 1-5-88	$ 19,500	$ 19,436	$ 20,528	$ 19,436
Other temporary cash investments	$ 1,637	1,637	1,637	1,637
State and municipal bonds	$127,775	138,191	142,968	138,191
Cumulative convertible preferred stock of Salomon	24,000 shares	24,000	23,520*	24,000
		$183,264	$188,653	$183,264
Held by Wes-Fin Service Corporation (wholly owned subsidiary of Mutual Savings) —				
U.S. Government securities	$ 7,500	$ 7,488	$ 7,488	$ 7,488
Cumulative convertible preferred stock of Salomon	26,000 shares	26,000	25,480*	26,000
		$ 33,488	$ 32,968	$ 33,488

* Estimated by Wesco management.

WESCO FINANCIAL CORPORATION
SCHEDULE III — CONDENSED FINANCIAL INFORMATION OF REGISTRANT
BALANCE SHEET
(Dollar amounts in thousands)

	December 31, 1987	December 31, 1986
ASSETS		
Cash and temporary cash investments (including savings accounts at Mutual Savings of $892 and $13)	$ 934	$ 55,451
Investment in Salomon Inc	50,000	—
Investment in subsidiaries, at equity:		
Mutual Savings	56,558	54,763
Precision Steel	26,107	23,846
Wesco-Financial Insurance Company	106,297	87,808
Other	119	137
	189,081	166,554
Premises and equipment, net	3,189	3,119
Other assets	429	9,589
	$243,633	$234,713
LIABILITIES AND SHAREHOLDERS' EQUITY		
Notes payable	$ 29,850	$ 29,940
Accounts payable and accrued expenses	222	426
Income taxes payable	741	1,756
Total liabilities	30,813	32,122
Shareholders' equity (see consolidated balance sheet)	212,820	202,591
	$243,633	$234,713

See notes to consolidated financial statements.

WESCO FINANCIAL CORPORATION
SCHEDULE III—CONDENSED FINANCIAL INFORMATION OF REGISTRANT
STATEMENT OF INCOME AND RETAINED EARNINGS
(Dollar amounts in thousands)

	Year Ended December 31, 1987	1986	1985
Revenues —			
Dividends on preferred and common stocks	$ 1,125	$ 179	$ 874
Interest on temporary cash investments	2,237	3,077	4,908
Interest on savings accounts at Mutual Savings	37	117	66
Rental of office, store and garage premises, net	1,820	1,791	1,771
Dividends from subsidiaries	60	7,500	14,075
Gain on sales of marketable securities	702	3,165	35,995
Other	36	44	38
	6,017	15,873	57,727
Expenses —			
Interest	2,995	3,200	3,034
General and administrative	591	574	605
	3,586	3,774	3,639
Income before items shown below	2,431	12,099	54,088
Income tax provision	(726)	(2,267)	(14,086)
Equity in undistributed earnings of subsidiaries	13,508	6,692	11,539
Net income	15,213	16,524	51,541
Retained earnings — beginning of year	172,152	160,327	113,200
Cash dividends	(4,984)	(4,699)	(4,414)
Retained earnings — end of year	$182,381	$172,152	$160,327

See notes to consolidated financial statements.

WESCO FINANCIAL CORPORATION
SCHEDULE III — CONDENSED FINANCIAL INFORMATION OF REGISTRANT
STATEMENT OF CHANGES IN FINANCIAL POSITION
(Dollar amounts in thousands)

	Year Ended December 31, 1987	1986	1985
Sources (uses) of cash, including temporary cash investments, from operations —			
Net income	$ 15,213	$ 16,524	$ 51,541
Add (deduct):			
Depreciation and amortization	282	277	253
Increase (decrease) in income taxes payable	(1,015)	(9,063)	10,363
Equity in undistributed earnings of subsidiaries	(13,507)	(6,692)	(11,539)
Other, net	(64)	(75)	175
Cash provided from operations	909	971	50,793
Other sources (uses) —			
Decrease in marketable equity securities	—	—	12,613
Investment in subsidiaries, net	(9,020)	—	(45,100)
Investment in Salomon Inc	(50,000)	—	—
Payment of cash dividends	(4,984)	(4,699)	(4,414)
Other, net	8,578	(286)	(9,561)
	(55,426)	(4,985)	(46,462)
Increase (decrease) in cash, including temporary cash investments	$(54,517)	$ (4,014)	$ 4,331

See notes to consolidated financial statements.

WESCO FINANCIAL CORPORATION
SUPPLEMENTARY INSURANCE INFORMATION
(Dollar amounts in thousands)

SCHEDULE V

Segment	Deferred Policy Acquisition Costs	Future Claim and Loss Expenses	Unearned Premiums	Earned Premiums	Net Investment Income	Loss and Loss Adjustment Expenses Incurred	Amortized Deferred Policy Acquisition Costs	Other Underwriting Expenses	Written Premiums
Property and casualty reinsurance —									
1987	$8,521	$79,578	$26,964	$73,384	$11,618	$53,970	$22,947	$ —	$71,032
1986	9,030	49,202	29,317	67,515	9,685	48,454	20,939	—	70,506
1985	8,254	16,111	26,326	20,412	2,219	16,606	6,402	—	46,738

MUTUAL SAVINGS AND LOAN ASSOCIATION
(A Wholly Owned Subsidiary of Wesco Financial Corporation)
CONDENSED CONSOLIDATED BALANCE SHEET
(Dollar amounts in thousands)

	December 31, 1987	December 31, 1986
ASSETS		
Cash and temporary cash investments	$ 85,519	$204,234
FHLB bond, 8¼%, due December 26, 1989	35,126	—
State and municipal bonds, at cost (market $20,528 and $22,575)	17,566	18,647
Marketable equity securities, consisting principally of public utility preferred stocks, owned by Mutual Savings (market $40,034 and $42,370)	33,679	29,441
Other marketable securities, at cost (market $1,292 and $1,499)	1,506	1,506
Investment in preferred stock of Salomon Inc, by service subsidiary	26,000	—
Loans receivable, principally real estate, yielding 8.38% and 7.48%	139,427	78,613
Real estate held for sale	2,441	2,133
Investment in stock of Federal Home Loan Bank	794	881
Prepayments to FSLIC secondary reserve	—	3,617
Other assets	5,498	3,128
	$347,556	$342,200
LIABILITIES AND SHAREHOLDER'S EQUITY		
Savings accounts	$287,126	$282,441
Accounts payable and accrued expenses	1,037	323
Income taxes payable, principally deferred	2,834	4,673
	290,997	287,437
Shareholder's equity:		
Guarantee stock and additional paid-in capital	100	100
Retained earnings — substantially restricted	56,459	54,663
Total shareholder's equity	56,559	54,763
	$347,556	$342,200
Cash dividends declared and paid	$ —	$ 7,500

See notes to consolidated financial statements of Wesco Financial Corporation.

Main entrance to Mutual Savings head office

MUTUAL SAVINGS
AND LOAN ASSOCIATION

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Plaza Pasadena Office: 255 Plaza Pasadena
Pasadena, California 91101-2311

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