WESCO FINANCIAL CORPORATION

Annual Report 1996

Form 10-K Annual Report 1996

Office building owned by Wesco's property subsidiary, with Pasadena city hall in the background.

WESCO FINANCIAL CORPORATION

BOARD OF DIRECTORS

Charles T. Munger
Chairman of the Board, 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, shoes, retailing, manufacturing, newspaper and encyclopedia publishing, flight training, 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); Director, Costco Companies, Inc. (formerly Price/Costco, Inc. — operator of a large chain of membership warehouses)

Robert H. Bird
President, Wesco Financial Corporation; Director and President, Blue Chip Stamps; Vice President, Berkshire Hathaway Inc.

Carolyn H. Carlburg*
Carolyn H. Carlburg & Associates, attorneys at law

William T. Caspers*
Personal investments

James N. Gamble*
Gamble, Jones, Holbrook & Bent, investment counseling and trust administration

Elizabeth Caspers Peters
Personal investments

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

**Audit Committee member*

OFFICERS

Charles T. Munger
Chairman of the Board

Robert H. Bird
President

Jeffrey L. Jacobson
Vice President and Chief Financial Officer

Robert E. Sahm
Vice President

Margery Patrick
Secretary

LEGAL COUNSEL

Hahn & Hahn

LISTED ON

American Stock Exchange
Pacific Stock Exchange

TRANSFER AGENT AND REGISTRAR

ChaseMellon Shareholder Services
400 South Hope Street, 4th Floor, Los Angeles, CA 90071-2899
Shareholder Relations Department: (800) 356-2017

WESCO FINANCIAL CORPORATION
LETTER TO SHAREHOLDERS

To Our Shareholders:

Consolidated "normal" net operating income (i.e., before irregularly occurring items shown in the table below) for the calendar year 1996 increased to $30,734,000 ($4.32 per share) from $30,208,000 ($4.24 per share) in the previous year.

Consolidated net income (i.e., after irregularly occurring items shown in the table below) decreased to $30,619,000 ($4.30 per share) from $34,541,000 ($4.85 per share) in the previous year.

Wesco has three major subsidiaries: (1) Wesco-Financial Insurance Company ("Wes-FIC"), headquartered in Omaha and engaged principally in the reinsurance business, (2) The Kansas Bankers Surety Company ("KBS"), purchased by Wes-FIC in July 1996 and specializing in insurance products tailored to midwestern banks, and (3) Precision Steel, headquartered in Chicago and engaged in the steel warehousing and specialty metal products businesses. 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, 1996		December 31, 1995	
	Amount	Per Wesco Share	Amount	Per Wesco Share
"Normal" net operating income of:				
Wes-FIC and KBS insurance businesses	$27,249	$3.83	$26,496	$3.72
Precision Steel businesses	3,033	.43	2,386	.33
All other "normal" net operating income[2]	452	.06	1,326	.19
	30,734	4.32	30,208	4.24
Net gain (loss) on sales of marketable securities	(115)	(.02)	4,333	.61
Wesco consolidated net income	$30,619	$4.30	$34,541	$4.85

(1) All figures are net of income taxes.

(2) After deduction of interest and other corporate expenses, and costs and expenses associated with delinquent loans and foreclosed real estate previously charged against Wesco's former Mutual Savings and Loan Association subsidiary. Income was from ownership of the Wesco headquarters office building, primarily leased to outside tenants, and interest and dividend income from cash equivalents and marketable securities owned outside the insurance subsidiaries.

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.

Wesco-Financial Insurance Company ("Wes-FIC")

Wes-FIC's normal net income for 1996 was $27,249,000, versus $26,496,000 for 1995. The 1996 figure includes $2,288,000 contributed by The Kansas Bankers Surety Company ("KBS") following its purchase by Wes-FIC early in the third quarter. The purchase of KBS is discussed in the section, "The Kansas Bankers Surety Company," below.

At the end of 1996 Wes-FIC retained about $31 million in invested assets, offset by claims reserves, from its former reinsurance arrangement with Fireman's Fund Group. This arrangement was terminated August 31, 1989. However, it will take a long time before all claims are settled, and, meanwhile, Wes-FIC is being helped over many years by proceeds from investing "float."

We previously informed shareholders that Wes-FIC had entered into the business of super-cat reinsurance through retrocessions from the Insurance Group of Berkshire Hathaway, Wesco's ultimate parent. Wes-FIC's entry into the super-cat reinsurance business early in 1994 followed the large augmentation of its claims-paying capacity caused by its merger with Mutual Savings, the former savings and loan subsidiary of Wesco. In 1994, in recognition of Wes-FIC's sound financial condition, Standard and Poor's Corporation assigned to Wes-FIC the highest possible claims-paying-ability rating: AAA.

The super-cat reinsurance business, in which Wes-FIC is engaged, continues to be a very logical business for Wes-FIC. Wes-FIC has a large net worth in relation to annual premiums being earned. And this is exactly the condition rationally required for any insurance company planning to be a "stand alone" reinsurer covering super-catastrophe risks it can't safely pass on to others sure to remain solvent if a large super-catastrophe comes. Such a "stand alone" reinsurer must be a kind of Fort Knox, prepared occasionally, without calling on any other reinsurers for help, to pay out in a single year many times more than premiums coming in, as it covers losses from some super catastrophe worse than Hurricane Andrew. In short, it needs a balance sheet a lot like Wes-FIC's.

In connection with the retrocessions of super-cat reinsurance to Wes-FIC from the Berkshire Hathaway Insurance Group, the nature of the situation as it has evolved is such that Berkshire Hathaway, owning 100% of its Insurance Group and only 80% of Wesco and Wes-FIC, does not, for some philanthropic reason, ordinarily retrocede to Wes-FIC any reinsurance business that Berkshire Hathaway considers desirable and that is available only in amounts below what Berkshire Hathaway wants for itself on the terms offered. Instead, retrocessions occur only occasionally, under limited conditions and with some compensation to Berkshire Hathaway. Such retrocessions ordinarily happen only (1) when Berkshire Hathaway, for some reason (usually a policy of overall risk limitation), desires lower amounts of business than are available on the terms offered and (2) Wes-FIC has adequate capacity to bear the risk assumed and (3) Wes-FIC pays a fair ceding commission designed to cover part of the cost of getting and managing insurance business.

Generally, Berkshire Hathaway, in dealing with partly owned subsidiaries, tries to lean over a little backward in an attempt to observe what Justice Cardozo called "the punctilio of an honor the most sensitive," but it cannot be expected to make large and plain giveaways of Berkshire Hathaway assets or business to a partially owned subsidiary like Wes-FIC.

Given Berkshire Hathaway's unwillingness to make plain giveaways to Wes-FIC and reductions in opportunities in the super-cat reinsurance market in recent years, prospects are often poor for Wes-FIC's acquisition of retroceded super-cat reinsurance.

Moreover, Wesco shareholders should continue to realize that super-cat reinsurance is not for the faint of heart. A huge variation in annual results, with some very unpleasant future years for Wes-FIC, is inevitable.

But it is precisely what must, in the nature of things, be associated with these bad possibilities, with their huge and embarrassing adverse consequences in occasional years, that makes Wes-FIC like its way of being in the super-cat business. Buyers (particularly wise buyers) of super-cat reinsurance often want to deal with Berkshire Hathaway subsidiaries (possessing as they do the highest possible credit ratings and a reliable corporate personality) instead of other reinsurers less cautious, straightforward and well endowed. And many competing sellers of super-cat reinsurance are looking for a liberal "intermediary's" profit, hard to get because they must find a "layoff" reinsurer both (1) so smart that it is sure to stay strong enough to pay possible losses yet (2) so casual about costs that it is not much bothered by a liberal profit earned by some intermediary entity not willing to retain any major risk. Thus the forces in place can rationally be expected to cause acceptable long-term results for well-financed, disciplined decision makers, despite horrible losses in some years and other years of restricted opportunity to write business. And, again, we wish to repeat that we expect only acceptable long-term results. We see no possibility for bonanza.

It should also be noted that Wes-FIC, in the arrangements with the Insurance Group of Berkshire Hathaway, receives a special business-acquisition advantage from using Berkshire Hathaway's general reputation. Under all the circumstances, the 3% ceding commission now being paid seems more than fair to Wes-FIC. Certainly and obviously, Berkshire Hathaway would not offer terms so good to any other entity outside the Berkshire Hathaway affiliated group.

Finally, we repeat an important disclosure about Wes-FIC's super-cat-reinsurance-acquisition mechanics. It is impractical to have people in California make complex accept-or-reject decisions for Wes-FIC when retrocessions of reinsurance are offered by the Berkshire Hathaway Insurance Group. But, happily, the Berkshire Hathaway Insurance Group executives making original business-acquisition decisions are greatly admired and trusted by the writer and will be "eating their own cooking." Under such circumstances, Wesco's and Wes-FIC's boards of directors, on the writer's recommendation, have simply approved automatic retrocessions of reinsurance to Wes-FIC as offered by one or more wholly owned Berkshire Hathaway subsidiaries. Each retrocession is to be accepted forthwith in writing in Nebraska by agents of Wes-FIC who are at the same time salaried employees of wholly owned subsidiaries of Berkshire Hathaway. Moreover, each retrocession will be made at a 3%-of-premiums ceding commission. Finally, two conditions must be satisfied: (1) Wes-FIC must get 20% or less of the risk (before taking into account effects from the ceding commission) and (2) wholly owned Berkshire Hathaway subsidiaries must retain at least 80% of the identical risk (again, without taking into account effects from the ceding commission).

We will not ordinarily describe individual super-cat reinsurance contracts in full detail to Wesco shareholders. That would be contrary to our competitive interest. Instead, we will try to summarize reasonably any items of very large importance.

Will more reinsurance be later available to Wes-FIC through Berkshire Hathaway subsidiaries on the basis and using the automatic procedure we have above described? Well, we have often proved poor prognosticators. We can only say that we hope so and that more reinsurance should come, albeit irregularly and with long intermissions. However, only three new contracts became available and were taken on by Wes-FIC in 1996, with one of these not being a super-cat contract and another becoming effective starting in January 1997. Moreover, all Wes-FIC's super-cat policies written before 1996 had expired by yearend 1996.

We continue to examine other possible insurance-writing opportunities, and also insurance company acquisitions, like and unlike the purchase of our recently acquired KBS.

Wes-FIC is now a very strong insurance company, with very low costs, and, one way or another, in the future as in the past, we expect to continue to find and seize at least a few sensible insurance opportunities.

On super-cat reinsurance accepted by Wes-FIC to date (March 7, 1997) there has been no loss whatsoever that we know of. Underwriting profit of $3.9 million, before taxes, benefited 1996 earnings, versus $6.3 million in 1995. Our accounting policy requires contract expiration before super-cat underwriting profit is recognized. Needless to say, we would not have similar reluctance to report losses before contract expirations. Our super-cat accounting policy is not irrationally super-conservative, although it may amount to "best-practice" accounting.

The Kansas Bankers Surety Company ("KBS")

KBS, purchased by Wes-FIC early in the third quarter of 1996 for approximately $80 million in cash, contributed $2,288,000 to the normal net operating income of the insurance businesses, after adjustments under consolidated accounting convention. The results of KBS have been combined with those of Wes-FIC, and are included in the foregoing table in the category, "'normal' net operating income of Wes-FIC and KBS insurance businesses."

The acquisition of KBS became available to, and was accepted by, Wesco following an agreement entered into with KBS by Berkshire Hathaway, under which Berkshire agreed to acquire the stock of the surety company with the intention of having the transaction completed by Wesco or its insurance subsidiary. If you deduct the $63.9 million of cash, cash-equivalent investments, investments in obligations backed by the Federal government and its agencies, and state and municipal bonds owned by KBS as of the purchase date, this left Wesco with approximately $16 million less in net investable assets after the acquisition. This reduction in investable assets was considered worth accepting, given the likely future underwriting profit of KBS.

KBS was chartered in 1909 to underwrite deposit insurance for Kansas banks. Its offices are in Topeka, Kansas. Over the years its service has continued to adapt to the changing needs of the banking industry. Today its customer base, consisting mostly of small and medium-sized community banks, is spread throughout 22 mainly midwestern states. In addition to bank deposit guaranty bonds which insure deposits in excess of FDIC coverage, KBS also offers directors and officers indemnity policies, bank employment practices policies, bank annuity and mutual funds indemnity policies and bank insurance agents professional errors and omissions indemnity policies.

KBS is run by Donald Towle, President, assisted by 13 dedicated officers and employees.

Precision Steel

The businesses of Wesco's Precision Steel subsidiary, headquartered in the outskirts of Chicago at Franklin Park, Illinois, contributed $3,033,000 to normal net operating income in 1996, up 27% compared with $2,386,000 in 1995. However, the substantial improvement in 1996 earnings was due mainly to LIFO inventory accounting adjustments, which increased after-tax earnings approximately $250,000 in 1996 after reducing such earnings by $460,000 in 1995. We do not regard earnings changes from LIFO accounting adjustments, up or down, as material in predicting future earning power. The increase in 1996 profit occurred as pounds of product sold increased 7%. Revenues were up only 2.2%.

Under the skilled leadership of David Hillstrom, Precision Steel's businesses in 1996 continued to provide an excellent return on resources employed.

Tag Ends from Savings and Loan Days

All that now remains outside Wes-FIC but within Wesco as a consequence of Wesco's former involvement with Mutual Savings, Wesco's long-held savings and loan subsidiary, is a small real estate subsidiary, MS Property Company, that holds tag ends of assets and liabilities with a net book value (after writedowns considered adequate) of about $24 million. Operations (including writedowns, of which there were none in 1996) of MS Property Company caused an after-tax loss to Wesco in 1996 of about $400,000. Sooner or later Wesco is expected to realize at least a little more than $24 million from MS Property Company's net assets, after earning modest returns until that time on the $24 million of book value involved. MS Property Company's 1996 loss, immaterial versus Wesco's present size, is included in the foregoing breakdown of earnings within "all other 'normal' net operating income."

It is anticipated that in 1997 Wesco will be able to make a substantial net withdrawal, in cash, from MS Property Company following sale of various real estate assets.

Of course, the main tag end from Wesco's savings and loan days is 28,800,000 shares (reflecting a 4-for-1 split distributed shortly after yearend 1996) of Federal Home Loan Mortgage Corporation ("Freddie Mac"), purchased by Mutual Savings for $71.7 million at a time when Freddie Mac shares could be lawfully owned only by a savings and loan association. This holding, with a market value of $794.7 million at yearend 1996, now reposes in Wes-FIC. And, in the years following our initial purchase, Freddie Mac and its similar cousin, "Fannie Mae," have made matters pretty miserable for the savings and loan industry by taking over most financing of low-to-moderate-cost homes.

Our experience in shifting from savings and loan operation to ownership of Freddie Mac shares tends to confirm a long-held notion that being prepared, on a few occasions in a lifetime, to act promptly in scale in doing some simple and logical thing will often dramatically improve the financial results of that lifetime. A few major opportunities, clearly recognizable as such, will usually come to one who continuously searches and waits, with a curious mind, loving diagnosis involving multiple variables. And then all that is required is a willingness to bet heavily when the odds are extremely favorable, using resources available as a result of prudence and patience in the past.

All Other "Normal" Net Operating Income

All other "normal" net operating income, net of interest paid and general corporate expenses, decreased to $452,000 in 1996 from $1,326,000 in 1995. Sources were (1) rents ($2,917,000 gross) from Wesco's Pasadena office property (leased almost entirely to outsiders, including CenFed Bank as the ground floor tenant), and (2) interest and dividends from cash equivalents and marketable securities held outside the insurance subsidiaries, mostly offset in both years by costs and expenses of liquidating tag-end delinquent loans and foreclosed real estate. The 1996 and 1995 figures also include intercompany charges for interest expense ($298,000 and $965,000 after taxes, respectively) on borrowings from Wes-FIC principally made late in 1993 to facilitate the transfer of loans and foreclosed properties to MS Property Company. This intercompany interest expense does not affect Wesco's consolidated net income inasmuch as the same amount is included as interest income in Wes-FIC's "normal" net operating income.

Net Securities Gains and Losses

Wesco's earnings for 1996 contained securities losses of $115,000, after income taxes, versus net gains of $4,333,000, after income taxes, in 1995. The latter figure included $4,192,000 realized on the conversion to common stock and sale of Wesco's investment in convertible preferred stock of Champion International Corporation.

Convertible Preferred Stockholdings

At the end of 1996, Wesco and its subsidiaries owned $72 million, at original cost, in convertible preferred stocks of Salomon Inc ("Salomon") and USAir Group, Inc. ("USAir"), both requiring redemption at par value or conversion to common stock within the next few years.

The investments are carried on Wesco's consolidated balance sheet at fair market value, with any difference between historical cost and market value as to Salomon, and between adjusted cost and market value as to USAir, included in shareholders' equity, net of income tax effect, without affecting reported net income, according to accounting convention. The investment in USAir was written down to a fair market value of $3 million effective December 31, 1994, and this $3 million figure is now treated as adjusted cost; the $5.9 million after-tax loss on the writedown to the new adjusted cost was shown as a separate charge on Wesco's 1994 statement of income. Following is a summary of these investments in convertible preferred stocks at yearend 1996:

Security	Preferred Dividend Rate	Par Value of Holding	Conversion Price at Which Par Value May Be Exchanged for Common Stock	Market Price of Common Stock on 12/31/96	12/31/96 Yearend Carrying Value of Holding
Salomon Inc.	9.00%	$60 Million	$38.00	$47.125	$ 66 Million
USAir Group, Inc.	9.25%	12 Million	38.74	23.375	10.8 Million

These convertible preferred stocks were purchased at the same time Wesco's parent corporation, Berkshire Hathaway, purchased additional amounts of the same stocks at the same price per share. On October 31, 1995, in accordance with the terms of its convertible preferred stock, Salomon redeemed $20 million par value of its preferred shares owned by Wesco at cost plus accrued dividends. One year later, on October 31, 1996, Wesco converted $20 million par value of its remaining preferred shares of Salomon to 526,314 shares of common stock of Salomon. Market value of these common shares, carried in the category "marketable equity securities" in Wesco's financial statements, was $24.8 million at yearend 1996.

In previous years we noted that "few, if any, investors have ever prospered mightily from investing in convertible preferred stocks of leading corporations." Our two holdings at yearend 1996 appear to bear this out. We estimate that (1) our $60 million Salomon holding was worth about $6 million more than we paid for it, and (2) our $12 million USAir holding, written down to an adjusted cost of $3 million at yearend 1994, was at yearend 1996 worth about $7.8 million more than such adjusted cost, but $1.2 million less than we paid for it. These figures when combined created $13.8 million in pre-tax appreciation above adjusted cost, and $4.8 million more than actual cost, considering the $9 million pre-tax loss shown in 1994 on the USAir Group writedown. Readers should bear in mind, however, that Wesco's experience to date has been very much better in an investment in convertible preferred stock of The Gillette Company, made in 1989 at cost of $40 million, and converted into Gillette common stock in 1991. This investment is carried at a $248.8 million yearend market value in Wesco's consolidated 1996 balance sheet. This is $200.8 million more than the investment cost. Also, as discussed above, Wesco realized an after-tax gain of $4.2 million in 1995 on sale of its $23 million investment in preferred stock of Champion International Corporation. However, even with all good experience factored in, our overall investment returns from convertible preferred stockholdings have been unexciting, although somewhat better than we predicted.

Consolidated Balance Sheet And Related Discussion

As indicated in the accompanying financial statements, Wesco increased its net worth, as accountants compute it under their conventions, to $1.25 billion ($176 per Wesco share) at yearend 1996 from $957 million ($134 per Wesco share) at yearend 1995.

The $293 million increase in reported net worth in 1996 was the result of two factors: (1) $270 million resulting from continued net appreciation of investments after provision for future taxes on capital gains; and (2) $23 million from retention of 1996 net income after deduction of dividends paid.

The foregoing $176-per-share book value approximates liquidation value assuming that all Wesco's non-security assets would liquidate, after taxes, at book value. Probably, this assumption is too conservative. But our computation of liquidation value is unlikely to be too low by more than a couple of dollars per Wesco share, because (1) the liquidation value of Wesco's consolidated real estate holdings (where interesting potential now lies almost entirely in Wesco's equity in its office property in Pasadena) is now far below its former high, and (2) unrealized appreciation in other assets (primarily Precision Steel) cannot be large enough, in relation to Wesco's overall size, to change very much the overall computation of after-tax liquidating value.

Of course, so long as Wesco does not liquidate, and does not sell any appreciated assets, it has, in effect, an interest-free "loan" from the government equal to its deferred income taxes on unrealized gains, subtracted in determining its net worth. This interest-free "loan" from the government is at this moment working for Wesco shareholders and amounted to about $66 per Wesco share at yearend 1996.

However, some day, perhaps soon, major parts of the interest-free "loan" must be paid as assets are sold. Therefore, Wesco's shareholders have no perpetual advantage creating value for them of $66 per Wesco share. Instead, the present value of Wesco's shareholders' advantage must logically be much lower than $66 per Wesco share. In the writer's judgment, the value of Wesco's advantage from its temporary, interest-free "loan" was probably about $20 per Wesco share at yearend 1996.

After the value of the advantage inhering in the interest-free "loan" is estimated, a reasonable approximation can be made of Wesco's intrinsic value per share. This approximation is made by simply adding (1) the value of the advantage from the interest-free "loan" per Wesco share and (2) liquidating value per Wesco share.

Others may think differently, but the foregoing approach seems reasonable to the writer as a way of estimating intrinsic value per Wesco share.

Thus, if the value of the advantage from the interest-free tax-deferral "loan" present was $20 per Wesco share at yearend 1996, and after-tax liquidating value was then about $176 per share (figures that seem rational to the writer), Wesco's intrinsic value per share would become about $196 per share at yearend 1996, up 32% from intrinsic value as guessed in a similar calculation at the end of 1995. And, finally, this reasonable-to-this-writer, $196-per-share figure for intrinsic per share value of Wesco stock should be compared with the $187 per share price at which Wesco stock was selling on December 31, 1996. This comparison indicates that Wesco stock was then selling about 5% below intrinsic value.

As Wesco's unrealized appreciation has continued to grow, it should be remembered that it is subject to market fluctuation, with no guaranty as to its ultimate full realization. Unrealized after-tax appreciation represents 70% of Wesco's shareholders' equity at 1996 yearend, versus 63% and 51% one and two years earlier.

Business and human quality in place at Wesco continues to be not nearly as good, all factors considered, as that in place at Berkshire Hathaway. Wesco is not an equally-good-but-smaller version of Berkshire Hathaway, better because its small size makes growth easier. Instead, each dollar of book value at Wesco continues plainly to provide much less intrinsic value than a similar dollar of book value at Berkshire Hathaway.

All that said, we make no attempt to appraise relative attractiveness for investment of Wesco versus Berkshire Hathaway stock at present stock-market quotations.

We are not now pessimists, on a long-term basis, about business expansion. Despite present ebullient markets for entire businesses, making it hard for Wesco to find attractive opportunities, we do not believe that such opportunities will never come.

On January 15, 1997 Wesco increased its regular dividend from 26½ cents per share to 27½ cents per share, payable March 5, 1997, to shareholders of record as of the close of business on February 5, 1997.

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

March 7, 1997

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

(Mark One)
[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 1996 or

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

For the Transition period from ____________ to ____________

Commission file number 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.)
301 East Colorado Boulevard, Suite 300, Pasadena, California (Address of Principal Executive Offices)	91101-1901 (Zip Code)

(818) 585-6700
(Registrant's Telephone Number, Including Area Code)

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

Securities registered pursuant to Section 12(g) of the Act:

None
(Title of Class)

(Title of Class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No __

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

The aggregate market value of voting stock of the registrant held by non-affiliates of the registrant as of March 19, 1997 was: $263,855,000

The number of shares outstanding of the registrant's Capital Stock as of March 19, 1997 was: 7,119,807.

DOCUMENTS INCORPORATED BY REFERENCE

Title of Document	Parts of Form 10-K
Proxy Statement for 1997 Annual Meeting of Shareholders	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. Wesco, through wholly owned subsidiaries, engages in two principal businesses: (1) the insurance business, through Wesco-Financial Insurance Company ("Wes-FIC"), which was incorporated in 1985 and engages in the property and casualty insurance business, and The Kansas Bankers Surety Company ("KBS"), which was incorporated in 1909, was purchased by Wes-FIC in mid-1996 and provides specialized insurance coverages for banks; and (2) the steel service center business, through Precision Steel Warehouse, Inc. ("Precision Steel"), which was begun in 1940 and acquired by Wesco in 1979. Through late 1993, Wesco also engaged in the savings and loan business, through another wholly owned subsidiary, Mutual Savings and Loan Association ("Mutual Savings"), which was incorporated in California in 1925, gave up its status as a regulated thrift institution after disposing of its savings accounts and most of its real estate loans in October 1993, and, in a statutory merger effective January 1, 1994, merged into Wes-FIC.

Wesco's operations also include, through MS Property Company ("MS Property"), the ownership and management of commercial real estate transferred to MS Property by Wesco, and the development and liquidation of foreclosed real estate and delinquent real estate loans transferred to MS Property by Mutual Savings, all in December 1993, when MS Property, a wholly owned subsidiary of Wesco, began its operations. Wesco's operations, through mid-1993, also included the manufacture of electrical equipment through New America Electrical Corporation ("New America Electric"), which was organized in 1982 and was approximately 80%-owned by Wesco from December 1988 through mid-1993.

Since 1973, Wesco has been 80.1% owned by Blue Chip Stamps or its predecessor by the same name (collectively, "Blue Chip"), a wholly owned subsidiary of Berkshire Hathaway Inc. ("Berkshire"). Wesco and its subsidiaries are thus controlled by Blue Chip and Berkshire. All of these companies may also be deemed to be controlled by Warren E. Buffett, who is Berkshire's chairman and chief executive officer and owner of approximately 40% of its stock. Charles T. Munger, the chairman of Wesco, is also vice chairman of Berkshire, and consults with Mr. Buffett with respect to Wesco's investment decisions and major capital allocations, but Mr. Buffett has no active participation in Wesco's management other than as a director of Wes-FIC.

Prior to 1994, Wesco's activities fell into three business segments — financial, insurance, and industrial. The financial segment included the savings and loan business operated by Mutual Savings as well as other activities more closely associated with the savings and loan business than either of Wesco's other principal businesses, namely, investment activity other than Wes-FIC's and parent company operations. The insurance segment consisted of Wes-FIC's insurance business. The industrial segment comprised Precision Steel's steel service center operations and, from late 1988 until mid-1993, the manufacture of electrical products by 80%-owned New America Electric.

Effective with the beginning of 1994, following Mutual Savings' discontinuation as a regulated savings and loan association late in 1993 and its subsequent statutory merger into Wes-FIC, the financial segment classification no longer served a useful purpose and was discontinued. The insurance segment was expanded to reflect Wes-FIC's absorption of the portion of Mutual Savings' business that in recent years had employed the majority of its assets in terms of market value: the indirect real estate lending business engaged in through ownership of 7.2 million shares of common stock of Federal Home Loan Mortgage Corporation ("Freddie Mac"), whose market value was $359 million at yearend 1993 (and had increased to $795 million at yearend 1996), and mortgage-backed securities. Other, relatively insignificant operations were removed from the financial segment and are no longer identified with any specific business segment; these include (1) investment activity other than Wes-FIC's, (2) management of owned commercial real estate, (3) development and liquidation of foreclosed real estate and delinquent loans formerly owned by Mutual Savings, and (4) parent company operations.

The amounts of revenues, operating profit and identifiable assets attributable to Wesco's business segments are included in Note 8 to the accompanying consolidated financial statements.

INSURANCE SEGMENT

Wes-FIC was incorporated in 1985 to engage in the property and casualty insurance and reinsurance business. It is headquartered in Omaha, Nebraska.

On January 1, 1994, Wes-FIC's net worth increased from $329 million to $569 million as a result of the absorption of Mutual Savings' remaining net assets (essentially, the market value of Freddie Mac common stock and mortgage-backed securities, less the taxes that would be due if sold) through merger. Primarily due to appreciation of investments, Wes-FIC's shareholder's equity has increased to $1.2 billion as of 1996 yearend. (The foregoing figures have been computed under generally accepted accounting principles. Wes-FIC's regulatory net worth as of yearend 1996 was $1.7 billion. The difference represents mainly the absence in the regulatory figure of income taxes associated with appreciated investments.)

In 1985, Wes-FIC entered into an arrangement whereby it effectively reinsured — through a Berkshire insurance 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 ("Fireman's Fund"). Wes-FIC thus assumed the benefits and burdens of Fireman's Fund's underwriting results under a contract covering virtually all of the property and casualty insurance business of Fireman's Fund during a four-year coverage period that expired on August 31, 1989. The arrangement put Wes-FIC in essentially the same position it would have been in if it, instead of Fireman's Fund, had directly written the business reinsured. Differences in results under this arrangement have occurred principally from the investment of premiums, as Wes-FIC, instead of Fireman's Fund, has invested funds from "float" (funds set aside and invested pending payment of claims). Wes-FIC will remain liable for its share of remaining unpaid losses and loss expenses, an estimate of which is reflected as a liability on Wesco's consolidated balance sheet, and will continue to invest the related float until all liabilities are settled, perhaps many years hence.

In 1990 and 1991, Wes-FIC reinsured 50% of the workers' compensation insurance business written by Cypress Insurance Company ("Cypress"), a wholly owned subsidiary of Berkshire, under a contract patterned generally after that with Fireman's Fund. As with the Fireman's Fund contract, Wes-FIC remains liable for its share of unpaid losses and loss adjustment expenses.

During 1992, Wes-FIC entered into another arrangement with NICO whereby NICO retroceded to it 50% of certain personal lines reinsurance business assumed by NICO. The arrangement terminated in mid-1993 and all claims have been settled and paid.

Wes-FIC's traditional financial strength, made even greater by the absorption of Mutual Savings, enabled it to enter into the business of "super-catastrophe reinsurance," through several subcontracts retroceded by NICO in 1994; most of these were renewed in 1995 but none were renewed in 1996. In 1996, however, Wes-FIC accepted 3% participations in two super-catastrophe reinsurance policies covering hurricane risk in Florida: (1) a 12-month policy effective June 1, 1996 retroceded by Berkshire's National Fire & Marine Insurance Company subsidiary ("National Fire") with maximum potential exposure of $9 million; and (2) a three-year policy effective January 1, 1997 retroceded by NICO with maximum exposure of $24 million.

Throughout this report, "catastrophe reinsurance" refers to the insurance purchased by insurance and reinsurance companies to protect themselves against the accumulation of property losses arising from a single major event or a series of major events. "Super-catastrophe reinsurance" refers to a catastrophe contract which subjects the reinsurer to especially large amounts of losses from a mega-catastrophe such as a hurricane or earthquake. The super-catastrophe policies in which Wes-FIC has participated have indemnified the ceding companies for all or part of covered losses in excess of large, specified retentions; reinsurance of this type is referred to as "excess of loss" reinsurance (as contrasted with "quota share" reinsurance, under which a ceding company is indemnified for a portion of its own loss). Management believes that an insurer in this business must maintain large net worth in relation to annual premiums in order to remain solvent when called upon to pay claims when a super catastrophe occurs. In this regard, Berkshire and Wes-FIC operate differently from other reinsurers in that risks written by them are kept in house, while other reinsurers may retrocede portions of the risks to other reinsurers, thereby assuming contingent risks that such reinsurers will not remain adequately solvent if called upon to pay off on risks reinsured.

Berkshire has indicated that its insurance subsidiaries may from time to time be offered super-catastrophe reinsurance business that is somewhat larger than it wishes to retain and may make a portion of the business available to Wes-FIC, as NICO and National Fire have done. Wesco's and Wes-FIC's boards of directors have authorized automatic acceptance of retrocessions of reinsurance offered by wholly owned subsidiaries of Berkshire provided the following guidelines and limitations are complied with: (1) in order not to delay the acceptance process, the retrocession is to be accepted without delay in writing in Nebraska by agents of Wes-FIC who are salaried employees of Berkshire subsidiaries; (2) the Berkshire subsidiary is to receive a ceding commission of 3% of premiums, probably less than the Berkshire subsidiary could get in the marketplace; (3) Wes-FIC is to assume 20% or less of the risk (before taking into account effects of the ceding commission); (4) wholly owned Berkshire subsidiaries must retain at least 80% of the identical risk (again, before taking into account effects of the ceding commission); and (5) the aggregate premiums from this type of business in any twelve-month period cannot exceed 10% of Wes-FIC's net worth.

Wes-FIC, in Nebraska, Utah and Iowa, is also licensed to write "direct" insurance business (as distinguished from reinsurance), but the volume written to date has been very small.

In July 1996, Wes-FIC purchased KBS for approximately $80 million in cash. The acquisition became available after Berkshire Hathaway agreed to the purchase of KBS by itself or one of its subsidiaries and then provided Wes-FIC the opportunity to be the acquiring party. Wes-FIC's acceptance was approved by the boards of Wes-FIC and Wesco.

KBS provides specialized insurance coverage to more than 20% of the banks in the United States, mostly small and medium-size banks in the Midwest. It is regulated by insurance departments in 22 states and by the Department of the Treasury. Its product line includes financial institution bonds (crime insurance), check kiting fraud indemnification policies, directors and officers liability policies, bank employment practices policies, bank insurance agents professional errors and omissions indemnity policies and bank deposit guaranty bonds, which insure deposits in excess of federal deposit insurance limits. In 1996, KBS ceded about 44% of its gross insurance business to third party reinsurers.

KBS markets its products in some states by exclusive, commissioned agents, and in others by salaried employees who travel. Inasmuch as the number of small midwestern banks is declining as banks are merging, KBS relies for growth on an extraordinary level of service provided by its dedicated employees and agents, and on new products such as bank deposit guaranty bonds, which were introduced in 1993 and currently account for approximately 8% of its business.

In recent years, financial failures in the insurance industry have received considerable attention from news media, regulatory authorities, rating agencies and Congress. As one result, industry participants and the public have been made more aware of the benefits derived from dealing with insurers whose financial resources support their promises with significant margins of safety against adversity. In this respect Wes-FIC and KBS are competitively well positioned, inasmuch as their net premiums written for calendar 1996 amounted to only approximately 1% of their combined statutory surplus compared to an industry average of about 113% based on figures reported for 1995.

Standard & Poor's Corporation, in 1994, recognized Wes-FIC's strong competitive position as a part of the Berkshire Hathaway insurance group and its unusual capital strength, and assigned its highest rating, AAA, to Wes-FIC's claims-paying ability. This rating recognized the commitment of Wes-FIC's management to a disciplined approach to underwriting and reserving, as well as Wes-FIC's extremely strong capital base.

Wesco's and Wes-FIC's boards are hopeful, but have no assurance, that the businesses of Wes-FIC and KBS will grow. They welcome the opportunity to participate in additional attractive catastrophe reinsurance retrocessions, and other insurance arrangements such as the one with Fireman's Fund, as well as acquisitions of other insurance companies.

Insurance companies are subject to regulation by the departments of insurance of the various states in which they write policies as well as the states in which they are domiciled, and, if applicable, by the Department of the Treasury. Regulations relate to, among other things, capital requirements, shareholder and policyholder dividend restrictions, reporting requirements, annual audits by independent accountants, periodic regulatory examinations, and limitations on the size and types of investments that can be made.

Wes-FIC is operated by employees of NICO; it has no employees of its own. KBS has 14 employees.

INDUSTRIAL SEGMENT

Precision Steel, acquired in 1979 for approximately $15 million, operates a well-established steel service center business at two 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. Precision Steel's annual sales volume of approximately 30 thousand tons compares with the steel service industry's annual volume of over 20 million tons. 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 sells them under its own brand names nationwide, generally through industrial distributors. This business is highly competitive. Precision Brand's share of the toolroom specialty products market is believed to approximate 0.5%; statistics are not available with respect to its share of the market for hose and muffler clamps.

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 two weeks. Precision Brand normally maintains inventories adequate to allow for off-the-shelf service to customers within 24 hours.

The steel service businesses are subject to economic cycles. These businesses are not dependent on a few large customers. The backlog of steel service orders increased to approximately $6.0 million as of December 31, 1996 from $5.4 million as of December 31, 1995.

Approximately 250 full-time employees are engaged in the steel service businesses, about 40% of whom are members of unions. Management considers labor relations to be good.

WESCO'S ACTIVITIES NOT IDENTIFIED WITH A BUSINESS SEGMENT

Through 1993, Wesco's business activities included a financial segment, whose principal activities consisted mainly of savings and loan operations. In late 1993, several events occurred that resulted in a major restructuring of the consolidated enterprise. Mutual Savings transferred its savings accounts and certain other liabilities (totaling about $220 million), offset by substantially all of its real estate loans and certain other non-cash assets (about $86 million, combined) and cash (about $134 million), to CenFed Bank, A Federal Savings Bank ("CenFed"). Mutual Savings and Wesco jointly agreed to indemnify CenFed to the extent of at least 90% with respect to any losses that might be sustained on the loans transferred. Wesco loaned $4 million to CenFed's parent corporation for a three-year period. Mutual Savings transferred to MS Property all real estate it was in process of developing and liquidating as well as the few real estate loans that were not sold to CenFed and the indemnification obligation with respect to the loans that were transferred to CenFed. Wesco transferred its commercial real estate property in Pasadena, California to MS Property. Finally, Mutual Savings merged into Wes-FIC by statutory merger, effective January 1, 1994.

After completion of the restructuring, the financial segment no longer served a useful purpose. The activities that remained had previously been included in the financial segment only because they were indirectly related to operation of the savings and loan association and were relatively insignificant. Accordingly, effective with the beginning of 1994, these activities were removed from the financial segment and are no longer identified with any segment as they do not in any way relate to the two remaining segments. These extraneous, relatively insignificant operations include (1) investment activity other than Wes-FIC's, (2) management of commercial real estate property in Pasadena, (3) development and liquidation of foreclosed real estate and the remaining real estate loans, and (4) parent company operations.

Wesco, while it seeks suitable businesses to acquire and explores ways to expand its existing operations, invests in marketable securities of unaffiliated companies. (See Note 2 to the accompanying consolidated financial statements for summaries of investments.)

Seven full-time employees are engaged in the activities of Wesco and MS Property.

Item 2. Properties

MS Property 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, and a multistory garage with space for 425 automobiles, as well as three commercial store buildings, one of which is scheduled for demolition in 1997. Of the 125,000 square feet of space in the office building, approximately 5,000 square feet are used by MS Property or leased to Blue Chip or Wesco. Most of the remainder is leased to outside parties, including CenFed, law firms and others, under agreements expiring at various dates to 2008. MS Property also owns a parking lot with space for approximately 100 automobiles across the street from the garage structure.

Wes-FIC's place of business is the Omaha, Nebraska headquarters office of NICO.

KBS leases 6,250 square feet of office space in a multi-story office building in Topeka, Kansas. The ten-year lease expires in mid-1997, at which time KBS plans to relocate to 5,815 square feet of office space which it has leased for five years, with an option to renew for an additional five-year term, in another multi-story office building nearby.

MS Property holds real estate acquired by Mutual Savings or itself through foreclosure. The most valuable parcel, acquired in 1966, consists of 22 acres of largely oceanfront land near Santa Barbara, California, where a luxury development consisting of 20 town houses and 12 residential lots has been in process of construction and sale for a number of years; as of December 31, 1996, 16 of the town houses and five of the lots had been sold. Other properties include several buildings in a small shopping center in Upland, California, which are leased to various small businesses, and several single-family residences in Southern California, of which one is undergoing extensive remodeling to enhance its marketability.

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; 63,000 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 May 1996.

PART II

Item 5.

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

The following table sets forth quarterly ranges of composite prices for Wesco shares for 1996 and 1995, based on those reported daily in The Wall Street Journal, as well as cash dividends paid by Wesco on each outstanding share:

	1996				1995		
	Sales Price		Dividends		Sales Price		Dividends
Quarter Ended	High	Low	Paid	Quarter Ended	High	Low	Paid
March 31	$189	$164¾	$0.265	March 31	$128	$113½	$0.255
June 30	183	155	0.265	June 30	133⅞	116⅛	0.255
September 30	182	158⅛	0.265	September 30	150	124	0.255
December 31	193	171¾	0.265	December 31	192	144	0.255
			$1.060				$1.020

There were approximately 750 shareholders of record of Wesco's capital stock as of the close of business on March 19, 1997. It is estimated that approximately 3,000 additional Wesco shareholders held shares of Wesco's capital stock in street name at that date.

Item 6. Selected Financial Data

Set forth below and on the following page are selected consolidated financial data for Wesco and its subsidiaries. For additional financial information, attention is directed to Wesco's audited 1996 consolidated financial statements appearing elsewhere in this report. (Amounts are in thousands except for amounts per share.)

	Year Ended December 31,				
	1996	1995	1994	1993	1992
Revenues:					
Sales and service revenues	$ 63,654	$ 62,271	$62,143	$ 63,627	$ 65,438
Insurance premiums earned	10,060	9,294	1,133	12,158	19,587
Dividends and interest on investments other than mortgage-backed securities	31,815	27,774	26,207	28,152	28,186
Interest on loans and mortgage-backed securities	1,498	2,499	2,810	7,952	16,688
Gains (losses), net, on sales of securities and foreclosed property	(177)	7,428	323	1,783	105
Gain on disposition of Mutual Savings' loans and deposits	—	—	—	1,577	—
Other	1,169	1,791	2,842	2,109	1,811
	108,019	111,057	95,458	117,358	131,815
Costs and expenses:					
Cost of products and services sold	50,054	50,019	49,459	51,570	52,491
Insurance losses and expenses	4,264	1,501	(571)	12,894	20,779
Interest on savings accounts	—	—	—	5,792	11,986
Selling, general and administrative	10,849	11,142	13,411	16,051	15,813
Interest on notes payable	3,352	3,371	3,394	4,610	4,872
Decline in value of investment	—	—	9,000	—	—
Loss on sale of New America Electric	—	—	—	2,700	—
	68,519	66,033	74,693	93,617	105,941
Income before income taxes and cumulative effect of change in accounting for income taxes	39,500	45,024	20,765	23,741	25,874
Provision for income taxes	(8,881)	(10,483)	(1,793)	(5,046)	(20,873)*
Income before cumulative effect of change in accounting for income taxes	30,619	34,541	18,972	18,695	5,001*
Cumulative effect of change in accounting for income taxes	—	—	—	1,023	—
Net income	$ 30,619	$ 34,541	$18,972	$ 19,718	$ 5,001*
Amounts per share:					
Income before cumulative effect of change in accounting for income taxes	$ 4.30	$ 4.85	$ 2.66	$ 2.63	$ .70*
Net income	4.30	4.85	2.66	2.77	.70*
Cash dividends	$ 1.06	$ 1.02	$ .98	$ .94	$ .90

* Reflects tax provision of $17,500, or $2.46 per share, related to recapture of special bad debt tax deductions, which was required to be recorded when Mutual Savings decided to give up its status as a regulated savings and loan association.

	December 31,				
	1996	1995	1994	1993	1992
Assets:					
Cash and cash equivalents	$ 23,039	$ 87,981	$ 15,800	$ 5,230	$123,705
Investments* —					
Securities with fixed maturities	176,885	119,575	183,089	202,126	236,513
Marketable equity securities	1,533,009	1,102,221	696,261	639,958	331,770
Excess of cost of KBS over net assets acquired	30,903	—	—	—	—
Real estate loans receivable	2,650	1,352	5,884	1,848	101,891
Other assets	51,919	54,598	60,727	65,993	71,080
Total assets	$1,818,405	$1,365,727	$961,761	$915,155	$864,959
Liabilities:					
Insurance losses and expenses	$ 45,491	$ 34,195	$ 39,785	$ 53,818	$ 61,526
Savings accounts	—	—	—	—	250,612
Income taxes payable, principally deferred*	468,370	324,341	191,858	180,722	72,928
Notes payable	37,162	37,369	37,557	37,896	55,119
Other liabilities	16,367	12,193	14,414	16,632	13,060
Total liabilities	$ 567,390	$ 408,098	$283,614	$289,068	$453,245
Shareholders' equity:					
Capital stock and surplus	$ 30,439	$ 30,439	$ 30,439	$ 30,439	$ 30,439
Unrealized appreciation of investments, net of taxes*	871,640	601,326	349,122	309,057	107,709
Retained earnings	348,936	325,864	298,586	286,591	273,566
Total shareholders' equity	$1,251,015	$ 957,629	$678,147	$626,087	$411,714
Per share	$ 175.71	$ 134.50	$ 95.25	$ 87.94	$ 57.83

* Wesco adopted SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," effective at 1993 yearend, with the result that all marketable equity securities owned by Wesco and its subsidiaries beginning December 31, 1993 are stated above at quoted market value or, in the absence of such a quotation, at estimated fair value, with the aggregate net unrealized gain added to shareholders' equity net of deemed applicable income taxes. (Previously only marketable equity securities owned by Wes-FIC had been valued in this manner.) Due to a change in classification in 1994, the reporting of securities with fixed maturities was changed to conform it to that of marketable equity securities; the balances beginning at yearend 1994 reflect that change. If the foregoing changes could have been implemented starting with 1992 yearend, unrealized appreciation of investments, net of taxes, included in shareholders' equity, would have increased approximately $15 million and $169 million at 1993 and 1992 yearends.

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

FINANCIAL CONDITION

Wesco's shareholders' equity at December 31, 1996 was $1.25 billion or $175.71 per share, up $293.4 million or $41.21 per share for the year. This increase was due principally to appreciation in market value of investments, which under accounting convention is credited directly to shareholders' equity, net of taxes, without being reflected in earnings. Because unrealized appreciation is recorded using current market quotations, which are subject to fluctuation, or estimated fair values, the net gains ultimately realized could differ substantially from recorded unrealized appreciation, which constituted 70% of shareholders' equity at December 31, 1996, compared to 63% at December 31, 1995 and 51% at December 31, 1994.

Even if unrealized appreciation is ignored, the financial condition of Wesco and its subsidiaries continues to be sound and liquid.

Borrowings from banks and others have been available to Wesco and its subsidiaries under attractive terms for a number of years. In recognition of the sound financial condition of Wesco and of its Wes-FIC insurance subsidiary, Wesco's $30 million of Notes due November 1999 and Wes-FIC's claims-paying ability have since 1994 been assigned Standard & Poor Corporation's highest rating, AAA.

MS Property is in process of liquidating foreclosed real estate and real estate loans acquired from Mutual Savings in December 1993. In addition, MS Property and Wesco are contingently liable for at least 90% of any losses that may be sustained by CenFed on collection of real estate loans sold by Mutual Savings to CenFed in October 1993. The managements of MS Property and Wesco believe any net overall loss on disposition of these items would not be material.

Wesco is not now suffering from inflation, but its insurance and industrial segments have potential exposure. Very large unanticipated changes in the rate of inflation could adversely impact the insurance business, because premium rates are often established well in advance of expenditures. Also, Wesco's consolidated balance sheet contains substantial unrealized appreciation of investments; investment values, in particular that of Freddie Mac, are considered sensitive to general interest rate changes. Precision Steel's steel service businesses are competitive and operate on tight gross profit margins, and thus its earnings are susceptible to bad effects from inflationary cost increases.

RESULTS OF OPERATIONS

See Item 1, Business, for a discussion of Wesco's operations and events that resulted in a restructuring of the consolidated enterprise, reflected in the consolidated financial statements as of the beginning of 1994.

The following summary sets forth the contribution to consolidated net income of each of Wesco's business segments, insurance and industrial, and of Wesco's nonsegment activities. In each case unusual items (i.e., securities gains, losses and writedowns) are shown separately from "normal" net operating income. (Amounts are in thousands, all after income tax effect.)

	Year Ended December 31,		
	1996	1995	1994
Insurance segment:			
"Normal" net operating income	$27,249	$26,496	$21,582
Securities gains (losses)	(115)	2,424	163
Decline in value of investment*	—	—	(5,850)
Segment net income	27,134	28,920	15,895
Industrial segment net income (all "normal" net operating income)	3,033	2,386	2,900
Other than identified business segments:			
"Normal" net operating income	452	1,326	177
Securities gains	—	1,909	—
Nonsegment net income	452	3,235	177
Consolidated net income	$30,619	$34,541	$18,972

* Represents writedown of investment in preferred stock of USAir Group, Inc., explained in Note 2 to the accompanying consolidated financial statements.

In the following sections the "normal" net operating income data set forth in the foregoing summary on an *after-tax* basis are broken down and discussed. Attention is directed to Note 8 to the accompanying consolidated financial statements for information as to operating profit *before* taxes.

Insurance Segment

The "normal" net operating income of the insurance segment (i.e., Wes-FIC and, since July 1996, KBS) represents the combination of underwriting results with dividend and interest income. Following is a summary of such data (in thousands):

	Year Ended December 31,		
	1996	1995	1994
Premiums written	$ 5,353	$ 5,808	$ 8,825
Premiums earned	$10,060	$ 9,294	$ 1,133
Underwriting gain	$ 5,795	$ 7,794	$ 1,579
Dividend and interest income	29,353	26,107	24,969
Income before income taxes	35,148	33,901	26,548
Income tax provision	(7,899)	(7,405)	(4,966)
"Normal" net operating income	$27,249	$26,496	$21,582

Premiums written by the insurance group for 1996 were comprised of (1) $4.2 million attributable to KBS and (2) $1.2 million attributable to Wes-FIC, mainly relating to its participation in a super-catastrophe policy covering hurricane risk in Florida for a twelve-month period beginning June 1, 1996, retroceded by National Fire. Premiums written in 1995 and 1994 consisted almost entirely of premiums from super-catastrophe policies retroceded by NICO. The decline in super-catastrophe retrocessions from Berkshire subsidiaries from 1994 to 1996 resulted principally from increased competition: Berkshire's management has stated repeatedly that it will not knowingly write business at inadequate rates. (As explained in Item 1, Business, Wes-FIC accepted a participation in another, larger, Florida-hurricane super-catastrophe policy in 1996, but the three-year coverage period did not begin until January 1997.)

Earned premiums for 1996 included $4.6 million attributable to KBS; the remainder were attributable to Wes-FIC and related principally to super-catastrophe business. Premiums on super-catastrophe reinsurance are not recognized as earned until the earlier of a loss occurrence or policy expiration. Insurance premiums on all other forms of insurance are recognized as earned revenues by Wes-FIC and KBS pro rata over the term of the contract.

The underwriting gain for 1996 included $1.7 million contributed by KBS, after deduction of six months' goodwill amortization amounting to $.4 million. (Wes-FIC paid about $31 million more to purchase KBS than the fair value of the identified net assets acquired. This excess, or "goodwill," is being amortized over 40 years; the annual charge to underwriting gain or loss will be $.8 million.) The remainder of the 1996 underwriting gain was earned by Wes-FIC on expiration of several super-catastrophe policies written in 1995. The underwriting gain reported in 1995 was earned by Wes-FIC principally upon expiration of several one-year super-catastrophe reinsurance contracts. The underwriting gain reported for 1994 resulted mainly from a reduction of liabilities for losses and loss expenses with respect to certain quota share insurance business written in earlier years. Liabilities for losses and loss expenses are typically based on estimates and thus are subject to estimation error; revisions of such estimates are reflected in underwriting results of the current accounting period. The 1994 adjustment, while not insignificant in terms of its effect on Wesco's net income for the year, was not material in relation to the cumulative insurance business previously written by Wes-FIC or in terms of its effect on Wesco's net worth.

Although no super-catastrophe losses have been incurred to date, the managements of Berkshire, Wes-FIC and Wesco believe that large super-catastrophe losses will inevitably occur from time to time. In accepting super-catastrophe retrocessions, they accept the prospect of relatively volatile underwriting results for Wes-FIC in order to obtain what they believe to be better long-term results than Wes-FIC might otherwise obtain.

One area of particular concern to the insurance industry is its exposure to claims for environmental contamination. Management of Wes-FIC has reported that it believes Wes-FIC has virtually no such liability.

Wes-FIC and KBS remain liable for runoff of the losses and loss expenses under the insurance arrangements summarized in Item 1, Business. As claims are paid over many future years, the liability for insurance business to date (estimated to be $45.5 million as of December 31, 1996 — see Note 4 to the accompanying consolidated financial statements) will decline, as will the float.

Dividend and interest income has been earned by the insurance group principally (1) on the assets (approximately $400 million at market value) added to Wes-FIC by the merger of Mutual Savings on January 1, 1994, (2) on capital contributed by Wesco, (3) on earnings retained and reinvested, and (4) on float.

The income tax provision of the insurance segment has fluctuated as a percentage of its pre-tax income in each of the periods presented in the foregoing table. These fluctuations have been caused by fluctuations in the relationship of substantially tax-exempt components of income to total pre-tax income.

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 future periods. However, the insurance group has maintained a capital position strong enough not only to absorb adverse estimation corrections but also to enable it to accept other insurance contracts. Although additional reinsurance retrocessions from Berkshire subsidiaries, or acquisitions of insurance businesses like or unlike that of KBS, or other attractive reinsurance or insurance arrangements, would be welcome, the timing and extent of any increase in insurance underwriting activity cannot presently be predicted.

Industrial Segment

Following is a summary of the "normal" net operating results of the industrial segment, consisting of the businesses of Precision Steel and its subsidiaries (in thousands):

	Year Ended December 31,		
	1996	1995	1994
Revenues, principally sales and services	$63,762	$62,382	$62,492
Income before income taxes	$ 5,076	$ 4,005	$ 4,811
Income tax provision	(2,043)	(1,619)	(1,911)
"Normal" net operating income	$ 3,033	$ 2,386	$ 2,900

Revenues of Precision Steel's businesses have been relatively stable over the past three years, although volume, in terms of pounds of steel products sold, has fluctuated somewhat. Management of Precision Steel attributes the fluctuations in sales volume to both changing economic conditions and competitive pressures in the industrial sector of the economy.

Income before income taxes and normal net operating income of the industrial segment are dependent not only on revenues, but also on operating expenses and the cost of products sold. The latter, as a percentage of revenues, amounted to 78.6%, 80.3% and 79.6% for 1996, 1995 and 1994. The cost percentage typically fluctuates slightly from year to year as a result of changes in product mix and price competition at the wholesale and retail levels. The improvement in the 1996 figure, however, was caused mainly by a decline in the cost of materials purchased in 1996 compared to 1995, which had increased from that of 1994. Precision Steel's cost of products sold percentage is very sensitive to current changes in the cost of purchasing raw materials, because it carries its inventories at the lower of last-in, first-out cost or market; under this method, the most recent costs are reflected in cost of goods sold.

Other Than Identified Business Segments

Set forth below is a summary of "normal" net operating income for items not identified with either business segment, insurance or industrial (in thousands):

	Year Ended December 31,		
	1996	1995	1994
Dividend and interest income	$3,988	$5,709	$6,308
Rental income, net, from commercial real estate	1,035	1,249	1,453
Interest expense	(3,858)	(5,007)	(4,571)
General and administrative expenses	(1,229)	(1,379)	(1,544)
Provision for losses on foreclosed real estate	—	(1,000)	(3,000)
Other items, net	(484)	599	(492)
Income (loss) before income tax provision or benefit	(548)	171	(1,846)
Income tax benefit	1,000	1,155	2,023
"Normal" net operating income	$ 452	$1,326	$ 177

"Normal" net operating income other than from identified business segments includes mainly (1) dividend and interest income from marketable securities and cash equivalents owned outside the insurance subsidiaries and (2) rental income from owned commercial real estate, reduced by (1) the costs associated with the development and liquidation of foreclosed real estate and delinquent loans formerly owned by Mutual Savings and (2) interest and other corporate expenses — plus or minus income taxes other than those associated with activities of the identified segments.

"Normal" net operating income other than from identified business segments typically fluctuates from period to period. The decrease in the figure for 1996 from the corresponding figure for 1995 was due primarily to a reduction in tax-favored dividend income following the conversion to common stock and sale in the second quarter of 1995 of the Wesco group's investment in preferred stock of

Champion International Corporation and the redemption in the fourth quarter of that year of $20 million of the Wesco group's investment in preferred stock of Salomon Inc. The reduction in dividend income was partially offset by the absence in 1996 of provisions for losses on foreclosed real estate; there had been a sharp decline in such provisions in 1995 from 1994, accounting for most of 1995's improvement in normal net income. As of March 7, 1997, all 20 of the town houses and all but one of the lots in MS Property's development near Santa Barbara, California, have been sold or are in escrow, and the outlook for satisfactory disposition of MS Property's other foreclosed real estate has improved. Thus, it now appears likely that valuation allowances provided in past years, when the real estate market was much weaker, will no longer be required.

Nonsegment interest expense was much lower in 1996 than in 1995 and 1994, mainly due to the parent company's partial repayment of borrowings from Wes-FIC beginning in mid-1995 using proceeds from sale of its Champion International Corporation investment in mid-1995 and partial redemption of its Salomon Inc preferred stock holding late in 1995. The reduction in Wesco's interest payments to Wes-FIC reduced insurance segment revenues accordingly (although Wesco's consolidated net income was not affected).

Wesco's nonsegment activities have been credited with an income tax benefit in recent years because of the high proportion of tax-favored dividend income to total pre-tax income or loss from such activities. The decline in the tax benefit from 1994 to 1995 followed the decline in such tax-favored income.

* * * * *

Management's long-term goal is to maximize gain in Wesco's intrinsic business value per share, with little regard to earnings recorded in any given year. There is no particular strategy as to the timing of sales of investments or the realization of securities gains. Securities may be sold for a variety of reasons, including (1) the belief that prospects for future appreciation of a particular investment are less attractive than the prospects for reinvestment of the after-tax proceeds from its sale, or (2) the desire for funds for an acquisition or repayment of debt.

Realized gains and losses on investments have been an element of Wesco's net income for a number of years. The amounts of these gains or losses, recorded when securities are sold or when a decline in market value of an investment is considered to be other than temporary, tend to fluctuate significantly from year to year. The varying effect upon Wesco's pre-tax income is evident on the face of the consolidated statement of income. The amount of realized gain or loss has no predictive value, and variations in amount from period to period have no practical analytical value, particularly in view of the existence of substantial net unrealized price appreciation in Wesco's consolidated investment portfolio. (Wesco's shareholders' equity at December 31, 1996 contained $871.6 million, or $122.42 per share, of unrealized appreciation of investments, net of taxes — about 70% of shareholders' equity, compared to 63% at December 31, 1995 and 51% at December 31, 1994.)

Consolidated 1996 earnings included realized securities losses of $0.1 million, after income taxes. In 1995 Wesco and its subsidiaries realized securities gains of $4.3 million, after taxes, including an after-tax gain of $4.2 million on conversion to common stock and sale of their investment in convertible preferred stock of Champion International Corporation. In 1994, the Wesco group realized net after-tax gains on sales of securities of $0.2 million; they also wrote down their carrying value of an investment in preferred stock of USAir Group, Inc. ("USAir"), believed to have declined in market value other than temporarily by $5.9 million, after income tax effect. (See Note 2 to Wesco's consolidated financial statements for further information as to investments of the Wesco group.)

Wesco's consolidated revenues include significant amounts of tax-favored dividend income from preferred and common stocks as well as substantially tax-exempt interest on state and municipal bonds. Fluctuations in the proportion of these components to total consolidated pre-tax income have resulted in tax provisions as percentages of pre-tax income of 22.5%, 23.3% and 8.6% in 1996, 1995 and 1994. The exceptionally low effective rate in 1994 was caused essentially by the $9.0 million writedown of the Wesco group's investment in USAir preferred stock; the writedown significantly reduced the proportion of pre-tax income taxed at ordinary rates. (See Note 5 to the accompanying consolidated financial statements for further information on income taxes.)

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. For example, the merger of Mutual Savings into Wes-FIC at the beginning of 1994 increased Wes-FIC's insurance and reinsurance capacity and asset-deployment options, enabling it to enter into the business of super-catastrophe reinsurance in 1994, as explained above. Another example of a significant unusual item was Wesco's expansion of its insurance segment operations through acquisition of KBS in mid-1996. In addition to exposure to large fluctuations due to realization of securities gains and losses or the occurrence of other unusual items, Wesco's consolidated revenues, expenses and earnings *from operations* are expected to be much more volatile than they were prior to Wes-FIC's entry into the super-catastrophe reinsurance business.

Shareholders' equity is impacted not only to the extent the foregoing types of unusual items affect earnings, but also to reflect changes in unrealized appreciation of investments, which are not reflected in earnings.

Item 8. Financial Statements

Following is an index to financial statements and related schedules of Wesco 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 and the independent auditors' report 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 consolidated financial statements or notes thereto.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable, as there were no such changes or disagreements.

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 1997 annual meeting of shareholders (the "1997 Proxy Statement") is incorporated herein by reference.

Item 11. Executive Compensation

The information set forth in the section "Compensation of Directors and Executive Officers" in the 1997 Proxy Statement 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 Holders Thereof" in the 1997 Proxy Statement is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions

Certain information set forth in the sections "Election of Directors," "Compensation of Directors and Executive Officers" and "Board of Director Interlocks and Insider Participation" in the 1997 Proxy Statement is incorporated herein by reference.

PART IV

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 (incorporated by reference to Exhibit 3a to Wesco's Annual Report on Form 10-K for the year ended December 31, 1994).
- 4.1 Form of Indenture dated October 2, 1989 (incorporated by reference to Exhibit 4.1 to report on Form 8-K of Wesco Financial Corporation dated October 31, 1989, File No. 33-31290).
- 4.2 Form of Supplemental Indenture dated October 15, 1989 (incorporated by reference to Exhibit 4.1 to report on Form 8-K of Wesco Financial Corporation dated October 31, 1989, File No. 33-31290).
- 22. List of Subsidiaries.
- 27. Financial Data Schedule.

Instruments defining the rights of holders of long-term debt of registrant and its subsidiaries are not being filed since the total amount of securities authorized by all such instruments does not exceed 10% of the total assets of the Registrant and its subsidiaries on a consolidated basis as of December 31, 1996. The Registrant hereby agrees to furnish to the Commission upon request a copy of any such debt instrument to which it is a party.

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

No reports on Form 8-K were filed during the quarter ended December 31, 1996.

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 Chairman of the Board (principal executive officer)	March 19, 1997
By:	Robert H. Bird President (principal operating officer)	March 19, 1997
By:	Jeffrey L. Jacobson Vice President and Chief Financial Officer (principal financial and accounting officer)	March 19, 1997

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.

Robert H. Bird Director	March 19, 1997
Carolyn H. Carlburg Director	March 19, 1997
James N. Gamble Director	March 19, 1997
Charles T. Munger Director	March 19, 1997
David K. Robinson Director	March 19, 1997

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders of
Wesco Financial Corporation

We have audited the accompanying consolidated balance sheets of Wesco Financial Corporation and subsidiaries as of December 31, 1996 and 1995, and the related consolidated statements of income and retained earnings and cash flows for each of the three years in the period ended December 31, 1996. Our audits also included the financial statement schedule listed in the index at Item 8. These financial statements and the financial statement schedule are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Wesco Financial Corporation and subsidiaries as of December 31, 1996 and 1995, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1996, in conformity with generally accepted accounting principles. Also, in our opinion, the financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

Deloitte & Touche LLP

Omaha, Nebraska
March 7, 1997

WESCO FINANCIAL CORPORATION
CONSOLIDATED BALANCE SHEET

(Dollar amounts in thousands)

	December 31, 1996	December 31, 1995
ASSETS		
Cash and cash equivalents	$ 23,039	$ 87,981
Investments:		
Securities with fixed maturities	176,885	119,575
Marketable equity securities	1,533,009	1,102,221
Accounts receivable	7,940	6,680
Real estate held for sale	15,831	19,021
Property and equipment	13,297	13,967
Excess of cost over net assets of acquired business	30,903	—
Other assets	17,501	16,282
	$1,818,405	$1,365,727
LIABILITIES AND SHAREHOLDERS' EQUITY		
Insurance losses and loss adjustment expenses	$ 45,491	$ 34,195
Income taxes payable, principally deferred	468,370	324,341
Notes payable	37,162	37,369
Other liabilities	16,367	12,193
	567,390	408,098
Shareholders' equity:		
Capital stock, $1 par value — authorized, 7,500,000 shares; issued and outstanding, 7,119,807 shares	7,120	7,120
Capital in excess of par value	23,319	23,319
Unrealized appreciation of investments, net of taxes	871,640	601,326
Retained earnings	348,936	325,864
Total shareholders' equity	1,251,015	957,629
	$1,818,405	$1,365,727

See accompany 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, 1996	1995	1994
Revenues:			
Sales and service revenues	$ 63,654	$ 62,271	$ 62,143
Insurance premiums earned	10,060	9,294	1,133
Dividend and interest income	33,313	30,273	29,017
Gains (losses), net, on sales of securities and foreclosed property	(152)	7,428	323
Other	1,144	1,791	2,842
	108,019	111,057	95,458
Costs and expenses:			
Cost of products and services sold	50,054	50,019	49,459
Insurance losses, loss adjustment and underwriting expenses	4,264	1,501	(571)
Selling, general and administrative expenses	10,849	11,142	13,411
Interest on notes payable	3,352	3,371	3,394
Decline in value of investment	—	—	9,000
	68,519	66,033	74,693
Income before income taxes	39,500	45,024	20,765
Provision for income taxes	(8,881)	(10,483)	(1,793)
Net income	30,619	34,541	18,972
Retained earnings — beginning of year	325,864	298,586	286,591
Cash dividends declared and paid	(7,547)	(7,263)	(6,977)
Retained earnings — end of year	$348,936	$325,864	$298,586
Amounts per share based on 7,119,807 shares outstanding throughout each year:			
Net income	$4.30	$4.85	$2.66
Cash dividends	$1.06	$1.02	$ .98

See accompany notes to consolidated financial statements.

WESCO FINANCIAL CORPORATION
CONSOLIDATED STATEMENT OF CASH FLOWS

(Dollar amounts in thousands)

	Year Ended December 31,		
	1996	1995	1994
Cash flows from operating activities:			
Net income	$ 30,619	$ 34,541	$ 18,972
Adjustments to reconcile net income with cash flows from operating activities —			
(Gains) losses, net, on sales of securities and foreclosed property, before taxes	152	(7,428)	(323)
Other-than-temporary decline in value of investment	—	—	9,000
Provision for depreciation and amortization	1,672	1,395	1,704
Provision for losses on real estate held for sale	—	1,000	3,000
Decrease in liabilities for losses and loss adjustment expenses of insurance businesses	(2,816)	(5,590)	(14,033)
Increase (decrease) in income taxes payable currently	1,325	(1,114)	(7,198)
Other, net	(6,228)	(3,140)	4,099
Net cash flows from operating activities	24,724	19,664	15,221
Cash flows from investing activities:			
Acquisition of business, net of cash and cash equivalents acquired	(77,320)	—	—
Principal collections on loans	5,102	3,154	66
Purchases of securities with fixed maturities	(65,918)	—	(20,637)
Proceeds from maturities and redemptions of securities with fixed maturities	10,521	38,181	35,889
Proceeds from sales of securities with fixed maturities	45,389	35,046	—
Purchases of marketable equity securities	—	(20,687)	—
Other, net	314	4,274	(2,553)
Net cash flows from investing activities	(81,912)	59,968	12,765
Cash flows from financing activities:			
Repayments of notes and short-term borrowings	(207)	(188)	(10,439)
Payment of cash dividends	(7,547)	(7,263)	(6,977)
Net cash flows from financing activities	(7,754)	(7,451)	(17,416)
Increase (decrease) in cash and cash equivalents	(64,942)	72,181	10,570
Cash and cash equivalents — beginning of year	87,981	15,800	5,230
Cash and cash equivalents — end of year	$ 23,039	$ 87,981	$ 15,800
Supplementary disclosures:			
Interest paid during year	$ 3,352	$ 3,371	$ 3,109
Income taxes paid, net, during year	10,794	13,939	11,038

See accompany 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

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").

Wesco's consolidated financial statements include the accounts of Wesco and its subsidiaries, which are all either directly or indirectly wholly owned. The principal subsidiaries are Wesco-Financial Insurance Company ("Wes-FIC"); The Kansas Bankers Surety Company ("KBS"), purchased by Wes-FIC in July 1996; Precision Steel Warehouse, Inc. ("Precision Steel"); and MS Property Company ("MS Property"). Prior to 1994, Wesco's consolidated financial statements also included the accounts of another wholly owned subsidiary, Mutual Savings and Loan Association ("Mutual Savings"). See Note 8 for Wesco's consolidated financial information classified by business segment beginning with the year 1994.

In connection with Mutual Savings' sale of approximately $81,000 principal amount of first mortgage real estate loans in 1993 (paid down to about $32,000 as of yearend 1996), Wesco agreed to indemnify the buyer with respect to at least 90% of any losses that might be sustained on the loans sold. There have been no losses to date.

The outstanding stock of KBS was purchased for approximately $80,000. The excess of purchase cost over the fair value of the net assets acquired, approximately $31,300, is being amortized on a straight-line basis over 40 years. The net unamortized balance is carried as an asset on the consolidated balance sheet.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. The estimates and assumptions are based on management's evaluation of the relevant facts and circumstances using information available at the time such estimates and assumptions are made. Although the amounts of such assets, liabilities, revenues and expenses included in the consolidated financial statements may differ from those that might result from use of estimates and assumptions based on facts and circumstances not yet available, Wesco's management does not believe such differences, if any, would have a material adverse effect on reported shareholders' equity.

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

Note 2. Investments

Cash equivalents consist of funds invested in money-market accounts and in other investments maturing in less than three months from date acquired.

Management determines the appropriate classifications of investments in securities with fixed maturities and marketable equity securities at the time of purchase and reevaluates such designations as of each balance sheet date. There are three permissible classifications: held-to-maturity; available-for-sale; and trading (of which there have been none). Securities are deemed to be held-to-maturity securities when both the ability and the positive intent to hold them to maturity are present; they are carried on the consolidated balance sheet at amortized cost and adjusted for any accretion of discount or amortization of premium using a method that produces approximately level yield. Available-for-sale securities are carried at quoted market value or, if market quotations are not available, at estimated fair value, with unrealized gains and losses, net of deemed applicable income taxes, reported as a separate component of shareholders' equity; there is no effect on net income, except to reflect changes in income tax rates relating to such unrealized gains and losses.

Realized gains and losses on sales of investments, determined on a specific identification basis, are included in the consolidated statement of income, as are provisions for other-than-temporary declines in market or estimated fair value. Once the carrying value of an investment has been written down to reflect an other-than-temporary decline, any subsequent increase in market or fair value is credited, net of taxes, to shareholders' equity, without affecting net income.

Investments in marketable equity securities and securities with fixed maturities at December 31, 1996 and 1995 were deemed to be available-for-sale and, accordingly, carried at quoted market or estimated fair value, with the net unrealized gain shown as a separate component of shareholders' equity. Because market quotations are subject to fluctuation, gains or losses ultimately realized upon sale of the investments, less taxes, could differ substantially from recorded unrealized appreciation, which constituted 70% and 63% of Wesco's shareholders' equity at December 31, 1996 and 1995.

Following is a summary of securities with fixed maturities:

	December 31, 1996		December 31, 1995	
	Amortized cost	Estimated Fair (Carrying) Value	Amortized cost	Estimated Fair (Carrying) Value
Mortgage-backed securities	$ 13,236	$ 13,308	$ 23,658	$ 23,780
Preferred stocks —				
Salomon Inc, 9%	60,000	66,000	80,000	84,000
USAir Group, Inc., 9.25%	3,000*	10,800	3,000*	7,200
State and municipal bonds	21,114	21,172	4,411	4,595
Obligations of U.S. Government and its agencies	65,421	65,605	—	—
	$162,771	$176,885	$111,069	$119,575

* Net of writedown (see below).

At 1996 yearend, the estimated fair values of securities with fixed maturities contained $14,375 of unrealized gains and $261 of unrealized losses, compared with $8,533 of unrealized gains and $27 of unrealized losses at 1995 yearend.

The preferred stocks shown in the foregoing summary were acquired in conjunction with purchases made by other subsidiaries of Berkshire, and are convertible into common stock and subject to various other contractual terms and conditions. They are similar to an investment in preferred stock of Champion International Corporation, which Wesco and its subsidiaries converted to common stock and sold in 1995; the after-tax gain of $4.2 million ($.59 per share) is reflected in Wesco's 1995 earnings.

The Salomon Inc preferred stock was purchased in 1987. Of the Wesco group's original investment at par of $100,000, $20,000 was redeemed by the issuer on October 31, 1995; $20,000 was converted to common stock by Wesco on October 31, 1996; and $20,000 each must be redeemed by the issuer on October 31, 1997, 1998 and 1999, to the extent the installment is still outstanding.

The investment in preferred stock of USAir Group, Inc. ("USAir") was made in 1989 at par. The Wesco group's share was $12,000, while that of other Berkshire subsidiaries was $346,000. If not called or converted prior to August 7, 1999, the stock is redeemable by USAir at par plus accrued dividends. At yearend 1994, because USAir had incurred significant losses for several years and had suspended payment of dividends, Berkshire and Wesco managements concluded that an other-than-

Dollar amounts in thousands except for amounts per share

temporary decline in the value of the stock had occurred. Accordingly, Wesco's 1994 consolidated statement of income included a charge of $9,000, or $5,850 after income taxes, reducing Wesco's carrying value of its investment to estimated fair value of $3,000. At yearend 1995, after USAir had returned to profitability, Berkshire and Wesco managements estimated the fair value of Wesco's investment to be $7,200. During the second half of 1996, USAir began paying dividend arrearages on the preferred shares. The Wesco group's share, included in dividend and interest income on the consolidated statement of income, was $1,170, leaving approximately $1,500 in arrears (of which $1,000 was received in January 1997). Consequently, at yearend 1996, Berkshire and Wesco managements estimated the fair value of Wesco's investment to be $10,800. The increases in estimated fair value of Wesco's investment over the $3,000 adjusted cost ($4,200 at yearend 1995 and an additional $3,600 at yearend 1996) have been added back to the carrying value of the investment and are included, net of taxes, in unrealized appreciation of investments, a separate component of shareholders' equity, on the consolidated balance sheet as of those dates, without effect on the consolidated statement of income.

Investments in state and municipal bonds and in obligations of the U.S. Government and its agencies as of 1996 yearend are expected to mature as follows:

	Amortized Cost	Market Value
In one year or less	$54,753	$54,809
After one year through five years	28,920	29,177
After five years through ten years	2,862	2,791
	$86,535	$86,777

Following is a summary of marketable equity securities (all common stocks):

		December 31, 1996		December 31, 1995	
	Number of Shares	Cost	Quoted Market (Carrying) Value	Cost	Quoted Market (Carrying) Value
Freddie Mac	28,800,000	$ 71,729	$ 794,700	$ 71,729	$ 601,200
The Coca-Cola Company	7,205,600	40,761	379,195	40,761	267,508
The Gillette Company	3,200,000	40,000	248,800	40,000	166,800
Wells Fargo & Company	169,340	11,351	45,679	11,351	36,577
American Express Company	647,700	20,687	36,595	20,687	26,799
Salomon Inc	526,314	20,000	24,803	—	—
Other		2,914	3,237	2,914	3,337
		$207,442	$1,533,009	$187,442	$1,102,221

The market values of marketable equity securities contained no unrealized losses at 1996 or 1995 yearends.

Note 3. Real Estate Held for Sale

Real estate held for sale ("REO") represents property owned by MS Property and acquired through foreclosure by Mutual Savings or itself. It is stated on the accompanying consolidated balance sheet at cost, less valuation allowances. The principal property is a 22-acre parcel of largely oceanfront land near Santa Barbara, California, where a luxury development consisting of 20 town houses and 12 residential lots has been in process of construction and sale for a number of years. During 1996, six town houses were sold, leaving four town houses and seven lots unsold at 1996 yearend. The net book value of the project decreased to $9,708 at 1996 yearend from $13,831 one year earlier; these

Dollar amounts in thousands except for amounts per share

carrying values reflect allowances for possible losses of approximately $2,000 and $3,400 as of those dates, resulting from writedowns to estimated net realizable values taken prior to 1996.

Note 4. Insurance

Wes-FIC's insurance business through mid-1996 consisted mainly of participations in property and casualty reinsurance contracts of Berkshire's principal insurance subsidiary. Wes-FIC's purchase of KBS in July 1996 added to its operations the sale of various insurance products geared towards small and medium-sized banks located primarily in the midwestern United States. These products include bank deposit insurance in excess of FDIC coverage, directors and officers liability insurance, employment practice insurance and fidelity bond coverage.

Insurance premiums are recognized as earned revenues pro rata over the term of each contract on all forms of insurance except for catastrophic excess of loss reinsurance contracts. Premiums on this type of reinsurance contract are not recognized as earned until the earlier of a loss occurrence or contract expiration. Unearned insurance premiums of $8,505 and $5,420 at December 31, 1996 and 1995 are included in other liabilities on the consolidated balance sheet.

Liabilities for unpaid losses and loss adjustment expenses are established at the aggregate of estimated ultimate payment amounts, which are determined from (1) individual case amounts, (2) incurred but not reported losses, based on past experience, and (3) reports from ceding insurers.

Provisions for losses and loss adjustment expenses are reported in the consolidated statement of income after deducting estimates of amounts that will be recoverable under reinsurance contracts. Reinsurance contracts do not relieve the ceding companies of their obligations to indemnify policyholders with respect to the underlying insurance contracts. Losses and loss adjustment expenses recoverable at yearend 1996 under reinsurance contracts are included in accounts receivable on the consolidated balance sheet.

Following is a summary of liabilities for unpaid losses and loss adjustment expenses for each of the past three years:

	1996	1995	1994
Balance at beginning of year	$34,195	$39,785	$53,818
Liabilities of KBS at date of acquisition	12,639	—	—
Incurred losses recorded during year —			
For current year	984	1	1,982
For all prior years*	(194)	(1,014)	(3,967)
Total incurred losses	790	(1,013)	(1,985)
Payments made during year —			
For current year	1,224	—	1,465
For all prior years	1,749	4,577	10,583
Total payments	2,973	4,577	12,048
Plus ceded liabilities at end of year	840	—	—
Balance at end of year	$45,491	$34,195	$39,785

* Includes adjustments of estimated losses provided for in prior years.

Dollar amounts in thousands except for amounts per share

Note 5. Income Taxes

Following is a breakdown of income taxes payable at 1996 and 1995 yearends:

	1996	1995
Deferred tax liabilities, relating to —		
Unrealized appreciation of investments	$467,902	$321,959
Recapture of Mutual Savings' special bad debt tax deductions	3,859	6,620
Other items	5,391	4,322
	477,152	332,901
Deferred tax assets	(8,037)	(7,582)
Net deferred tax liabilities	469,115	325,319
Taxes currently recoverable	(745)	(978)
Income taxes payable	$468,370	$324,341

Income taxes are accounted for using the asset and liability method. Under this method, temporary differences between financial statement and tax-return bases of assets and liabilities at each balance sheet date are multiplied by the tax rates in effect at that date, with the results reported on the financial statements as net deferred tax liabilities or assets. The effect of a change in tax rate on such deferred items is required, under generally accepted accounting principles, to be reflected when enacted in the consolidated statement of income even though the original charge or credit for income taxes was not reflected in that statement; see Note 2 for explanation of the accounting for unrealized appreciation of investments, the taxes on which are subject to this rate-change rule. As the temporary differences reverse in future periods, the taxes become currently payable or recoverable.

The consolidated statement of income contains a provision for income taxes, as follows:

	1996	1995	1994
Federal	$ 8,578	$ 9,917	$ 1,681
State	303	566	112
Provision for income taxes	$ 8,881	$10,483	$ 1,793
Current	$11,028	$13,046	$ 4,465
Deferred benefit	(2,147)	(2,563)	(2,672)
Provision for income taxes	$ 8,881	$10,483	$ 1,793

Following is a reconciliation of the statutory federal income tax rate with the effective income tax rate resulting in the provision for income taxes appearing on the consolidated statement of income:

	1996	1995	1994
Statutory federal income tax rate	35.0%	35.0%	35.0%
Increase (decrease) resulting from:			
Exclusion from taxable income of a significant portion of dividend income	(14.4)	(13.7)	(25.8)
Exclusion from taxable income of a significant portion of interest income on state and municipal bonds	(0.6)	(0.6)	(2.3)
State income taxes, less federal tax benefit	0.5	0.8	0.9
Other differences, net	2.0	1.8	0.8
Effective income tax provision rate	22.5%	23.3%	8.6%

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

Dollar amounts in thousands except for amounts per share

receiving an amount that approximates the increase or decrease in consolidated taxes attributable to that member.

Federal income tax returns through 1988 have been examined by and settled with the Internal Revenue Service. California franchise tax returns through 1990 have been examined by and settled with the California Franchise Tax Board.

Note 6. Notes Payable

Following is a list of notes payable, at year end:

	December 31, 1996	December 31, 1995
Notes due November 1999, bearing interest at 8⅞% payable semiannually	$30,000	$30,000
Note payable, collateralized by land, buildings and assignment of leases, due in monthly installments through February 2007 of $45 including interest at 9¼%	3,527	3,734
Industrial revenue bonds due December 2014, bearing interest at 7¾% payable semiannually	2,600	2,600
Note payable, due December 1998, bearing interest at 10% payable monthly	1,035	1,035
	$37,162	$37,369

Notes payable at 1996 yearend mature as follows: 1997, $225; 1998, $1,282; 1999, $30,270; 2000, $297; 2001, $325; thereafter, $4,763.

Agreements relating to the 8⅞% notes contain covenants, among others, enabling the lenders to require Wesco to redeem the notes at par in the event Wesco ceases to be controlled by Berkshire. Wesco is in compliance with all of the covenants.

Estimated fair market values of the foregoing notes payable at December 31, 1996 and December 31, 1995 were approximately $39,100 and $40,400. These figures were computed using discounted cash flow computations based upon estimates as to interest rates prevailing on those dates for comparable borrowings.

Dollar amounts in thousands except for amounts per share

Note 7. Quarterly Financial Information

Unaudited quarterly financial information for 1996 and 1995 follows:

	Quarter Ended			
	December 31, 1996	September 30, 1996	June 30, 1996	March 31, 1996
Total revenues	$26,836	$26,999	$24,734	$29,450
Net income excluding securities gains	$ 7,673	$ 7,918	$ 6,573	$ 8,570
Per share	1.08	1.12	.92	1.20
Securities gains (losses), net of applicable income tax effect	—	(115)	—	—
Per share	—	(.02)	—	—
Net income	$ 7,673	$ 7,803	$ 6,573	$ 8,570
Per share	1.08	1.10	.92	1.20

	December 31, 1995	September 30, 1995	June 30, 1995	March 31, 1995
Total revenues	$21,551	$23,816	$31,448	$34,242
Net income excluding securities gains	$ 5,852	$ 6,120	$ 7,856	$10,380
Per share	.82	.86	1.10	1.46
Securities gains (losses), net of applicable income tax effect	—	155	4,192	(14)
Per share	—	.02	.59	—
Net income	$ 5,852	$ 6,275	$12,048	$10,366
Per share	.82	.88	1.69	1.46

Dollar amounts in thousands except for amounts per share

Note 8. Business Segment Data

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

The insurance segment includes the accounts of Wes-FIC and, since July 1996, its subsidiary, KBS.

The industrial segment includes the operating accounts of Precision Steel and its subsidiaries.

Items not identified with either business segment include principally (1) investments other than those of Wes-FIC and KBS, together with related dividend and interest income and securities gains and losses, (2) commercial real estate properties, together with related revenues and expenses, (3) foreclosed real estate and delinquent loans formerly owned by Mutual Savings, together with associated costs and expenses of development and liquidation, and (4) the assets, revenues and expenses of the parent company.

	1996	1995	1994
Revenues:			
Insurance	$ 39,714	$ 39,241	$ 26,354
Industrial	63,762	62,382	62,492
Not identified with a business segment	4,543	9,434	6,612
	$ 108,019	$ 111,057	$ 95,458
Operating profit before taxes:			
Insurance	$ 34,972	$ 37,632	$ 17,800
Industrial	5,278	4,005	4,811
Interest expense on notes payable	(3,352)	(3,371)	(3,394)
Not identified with a business segment	2,602	6,758	1,548
	$ 39,500	$ 45,024	$ 20,765

The above revenue and pre-tax operating profit data include net gains (losses) on sales or writedowns of securities and foreclosed property — notably, the $9,000 writedown in 1994 of USAir preferred stock explained in Note 2 — as summarized below:

	1996	1995	1994
Insurance	$ (177)	$ 3,730	$ (8,749)
Not identified with a business segment	25	3,698	72
	$ (152)	$ 7,428	$ (8,677)

Additional business segment data follow:

	1996	1995	1994
Capital expenditures:			
Insurance	$ 19	—	—
Industrial	452	$ 275	$ 459
Not identified with a business segment	—	697	1,426
	$ 471	$ 972	$ 1,885
Depreciation and amortization of tangible assets other than investments:			
Insurance	$ 15	—	—
Industrial	879	$ 929	$ 890
Not identified with a business segment	353	360	349
	$ 1,247	$ 1,289	$ 1,239
Identifiable assets at yearend:			
Insurance	$1,710,475	$1,259,279	$826,390
Industrial	22,001	20,062	22,254
Not identified with a business segment	85,929	86,386	113,117
	$1,818,405	$1,365,727	$961,761

Dollar amounts in thousands except for amounts per share

WESCO FINANCIAL CORPORATION
SCHEDULE I — CONDENSED FINANCIAL INFORMATION OF REGISTRANT

BALANCE SHEET
(Dollar amounts in thousands)

	December 31, 1996	December 31, 1995
ASSETS		
Cash and cash equivalents	$ 17	$ 68
Marketable equity securities	12,401	—
Convertible preferred stocks	33,000	42,000
Investment in subsidiaries, at cost plus equity in subsidiaries' undistributed earnings and unrealized appreciation:		
Wes-FIC and KBS	1,201,182	907,034
Precision Steel	41,203	36,635
MS Property	24,248	24,675
Other assets	852	5,066
	$1,312,903	$1,015,478
LIABILITIES AND SHAREHOLDERS' EQUITY		
Intercompany advances	$ 28,657	$ 24,774
Income taxes payable, principally deferred	1,727	1,559
Notes payable	31,035	31,035
Other liabilities	469	481
Total liabilities	61,888	57,849
Shareholders' equity (see consolidated balance sheet)	1,251,015	957,629
	$1,312,903	$1,015,478

STATEMENT OF INCOME AND RETAINED EARNINGS
(Dollar amounts in thousands)

	Year Ended December 31, 1996	1995	1994
Revenues:			
Dividend income	$ 3,375	$ 4,704	$ 5,240
Gains on sales of securities	—	2,339	—
Other	197	768	511
	3,572	7,811	5,751
Expenses:			
Interest on notes payable	3,320	4,165	3,911
General and administrative	366	348	390
	3,686	4,513	4,301
Income (loss) before items shown below	(114)	3,298	1,450
Income tax (provision) benefit	760	(222)	542
Equity in undistributed earnings of subsidiaries	29,973	31,465	16,980
Net income	30,619	34,541	18,972
Retained earnings — beginning of year	325,864	298,586	286,591
Cash dividends declared and paid	(7,547)	(7,263)	(6,977)
Retained earnings — end of year	$348,936	$325,864	$298,586

See notes to consolidated financial statements

WESCO FINANCIAL CORPORATION
SCHEDULE I — CONDENSED FINANCIAL INFORMATION OF REGISTRANT

STATEMENT OF CASH FLOWS
(Dollar amounts in thousands)

	Year Ended December 31,		
	1996	1995	1994
Cash flows from operating activities:			
Net income	$ 30,619	$ 34,541	$ 18,972
Adjustments to reconcile net income with cash flows from operating activities —			
Gains on sales of securities	—	(2,339)	—
Decrease (increase) in income taxes recoverable currently	(1,196)	(19)	1,492
Equity in undistributed earnings of subsidiaries	(29,973)	(31,465)	(16,980)
Other, net	163	(373)	39
Net cash flows from operating activities	(387)	345	3,523
Cash flows from investing activities:			
Proceeds from sales and redemptions of securities with fixed maturities	—	20,339	—
Principal collections on loans	4,000	—	—
Other, net	—	411	289
Net cash flows from investing activities	4,000	20,750	289
Cash flows from financing activities:			
Advances from (repayments to) subsidiaries, net	3,883	(13,861)	3,054
Payment of cash dividends	(7,547)	(7,263)	(6,977)
Other, net	—	75	100
Net cash flows from financing activities	(3,664)	(21,049)	(3,823)
Increase (decrease) in cash and cash equivalents	(51)	46	(11)
Cash and cash equivalents — beginning of year	68	22	33
Cash and cash equivalents — end of year	$ 17	$ 68	$ 22

See notes to consolidated financial statements

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