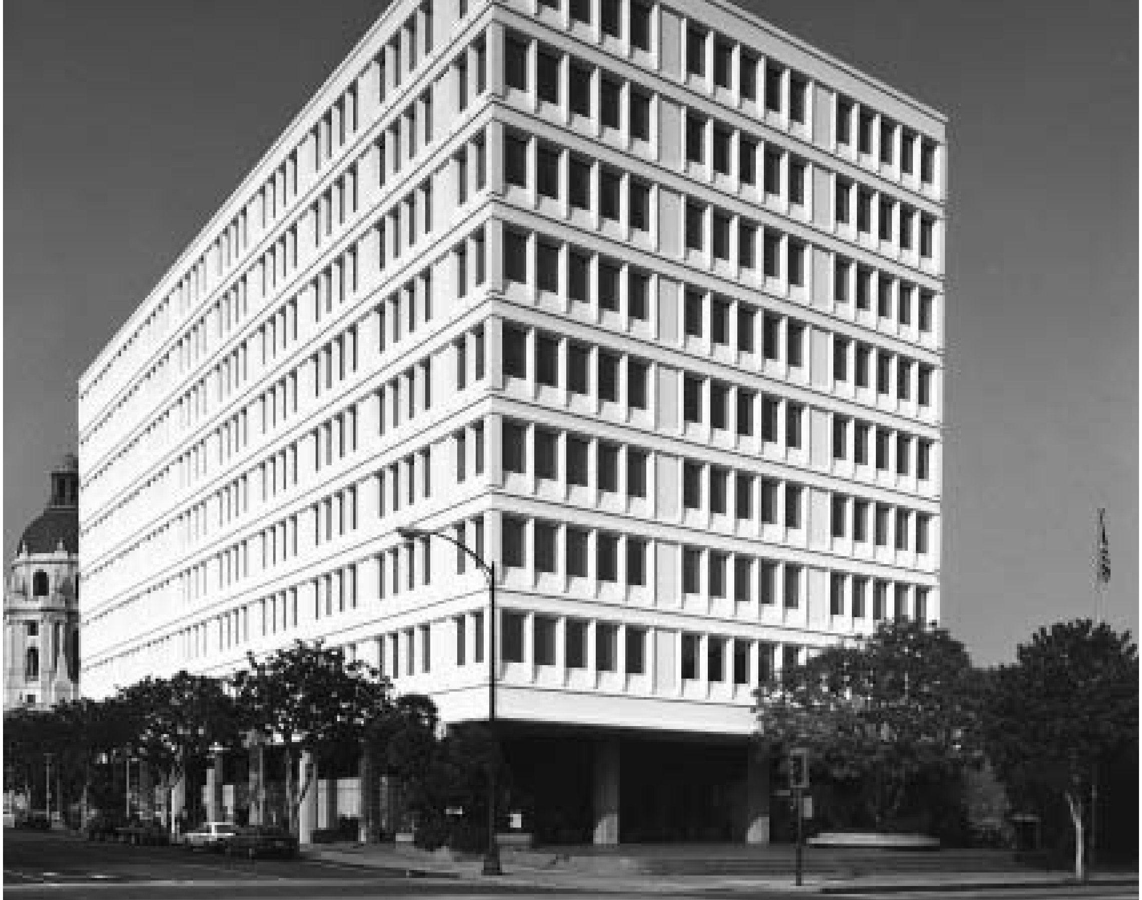
WESCO FINANCIAL CORPORATION

Annual Report 1997

Form 10-K Annual Report 1997



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, Costco Companies, 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*
Executive Director,
Community Housing Services, Inc., Pasadena, California

William T. Caspers*
Personal investments

James N. Gamble*
Gamble, Jones, Morphy & 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
Chaifman 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 1997 increased to $38,262,000 ($5.38 per share) from $30,720,000 ($4.32 per share) in the previous year.

Consolidated net income (i.e., after irregularly occurring items shown in the table below) increased to $101,809,000 ($14.30 per share) from $30,619,000 ($4.30 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, 1997		December 31, 1996	
	Amount	Per Wesco Share[2]	Amount	Per Wesco Share[2]
''Normal'' net operating income of:				
Wes-FIC and KBS insurance businesses	$ 33,507	$ 4.71	$27,249	$3.83
Precision Steel businesses	3,622	.51	3,033	.43
All other ''normal'' net operating income[3]	1,133	.16	438	.06
	38,262	5.38	30,720	4.32
Realized net securities gains (losses)	62,697	8.80	(115)	(.02)
Gain on sales of foreclosed properties	850	.12	14	—
Wesco consolidated net income	$101,809	$14.30	$30,619	$4.30

(1) All figures are net of income taxes.

(2) Per-share data is based on 7,119,807 shares outstanding. Wesco has had no dilutive capital stock equivalents.

(3) 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, interest and dividend income from cash equivalents and marketable securities owned outside the insurance subsidiaries, and, in 1997, the reduction of loss reserves provided in prior years against possible losses on sales of foreclosed real estate.

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 1997 was $33,507,000, versus $27,249,000 for 1996. The figures include $6,044,000 in 1997 and $2,288,000 in 1996 contributed by

The Kansas Bankers Surety Company (''KBS'') following its purchase by Wes-FIC early in the third quarter of 1996. The purchase of KBS is discussed in the section, ''The Kansas Bankers Surety Company,'' below.

At the end of 1997 Wes-FIC retained about $27.5 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 when (1) 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. No new contracts became available to Wes-FIC in 1997, although one super-cat contract of three-years' duration, written in 1996, became effective in January 1997, and another expired during the year. As of 1997 yearend, the one remaining super-cat contract, plus one other contract, not a super-cat contract, and renewed during the year, represented Wes-FIC's active reinsurance business.

We continue to examine other possible insurance-writing opportunities, and also insurance company acquisitions, like and unlike the purchase of 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 9, 1998) there has been no loss whatsoever that we know of, but some ''no-claims'' contingent commissions have been paid to original cessors of business (i.e., cessors not including Berkshire Hathaway). Super-cat underwriting profit of $2.3 million, before taxes, benefited 1997 earnings, versus $3.9 million in 1996. The balance of pre-tax underwriting profit, amounting to $2.8 million for 1997, came mostly from favorable revision of loss reserves on the old Fireman's Fund contract. 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.

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 $6,044,000 to the normal net operating income of the insurance businesses in 1997 and $2,288,000 in 1996, after reductions for goodwill amortization under consolidated accounting convention of $508,000, after taxes, in 1997 and $275,000 in 1996. 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.''

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 25 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 $3,622,000 to normal net operating income in 1996, up 19% compared with $3,033,000 in 1996. The improvement in 1997 earnings was attributable mainly to a 15% increase in pounds of product sold. Revenues were up only 6.3%.

Under the skilled leadership of David Hillstrom, Precision Steel's businesses in 1997 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 of about $13 million. In 1997, MS Property Company shrunk by approximately half after sales of several foreclosed properties and contribution of $12,750,000 in cash to Wesco. MS Property Company's results of operations, immaterial versus Wesco's present size, are included in the foregoing breakdown of earnings within ''all other 'normal' net operating income.''

Of course, the main tag end from Wesco's savings and loan days is 28,800,000 shares of Federal Home Loan Mortgage Corporation (''Freddie Mac''), purchased by Mutual Savings for $72 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 $1.2 billion at yearend 1997, now reposes in Wes-FIC.

All Other ''Normal'' Net Operating Income

All other ''normal'' net operating income, net of interest paid and general corporate expenses, increased to $1,133,000 in 1997 from $438,000 in 1996. Sources were (1) rents ($2,885,000 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, less (3) costs and expenses of liquidating tag-end foreclosed real estate. In 1997, reversals of reserves for possible losses on sales of such tag-end real estate, expensed in prior years, benefited this category of earnings by about $1.1 million, after income tax effect. The 1997 and 1996 ''other 'normal' net operating income'' figures also include intercompany charges for interest expense ($172,000 and $298,000 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 1997 contained securities gains of $62,697,000, after income taxes, versus losses of $115,000, after income taxes, in 1996. Of the 1997 figure, only $93,000 was realized through the sale of securities; the balance, $62,604,000, resulted from the exchange of the preferred and common shares of Salomon Inc (''Salomon'') owned by Wesco for preferred and common shares of Travelers Group Inc. (''Travelers'') late in 1997 in connection with the merger of Salomon with a subsidiary of Travelers. Accounting standards promulgated by the Financial Accounting Standards Board require that the fair (market) value of shares received in such an exchange be recorded as the new cost basis as of the date of the exchange, with the difference, after appropriate reserves for future income tax on the gain, recognized in the financial statements as a realized after-tax gain. For income tax purposes the exchange is recorded at the original cost of the securities exchanged; no gain is reported on the tax return, and no taxes are yet due.

Although the realized gain had a material impact on Wesco's reported earnings, *it had a very minor impact on Wesco's shareholders' equity*. Inasmuch as $48,504,000 of the after-tax gain had previously been reflected in the unrealized gain component of Wesco's shareholders' equity as of September 30, 1997, that amount was merely switched from unrealized gains to retained earnings, another component of shareholders' equity.

Convertible Preferred Stockholdings

At the end of 1997, Wesco and its subsidiaries owned $52 million, at original cost, in convertible preferred stocks of Travelers Group Inc. (''Travelers'') and US Airways Group, Inc. (''US Air''). The Travelers preferred stock was received in late 1997 (see the preceding section) in exchange for the Wesco group's remaining shares of Salomon Inc preferred stock, which originally cost $40 million, and whose cost was adjusted upwards to $90 million as of the date of the exchange. The US Air preferred stock originally cost $12 million; that figure was adjusted down to $3 million when we decided in 1994 that an other-than-temporary decline in the value of its stock had occurred. Both issues require redemption at par value or conversion to common stock within the next two years.

The investments are carried on Wesco's consolidated balance sheet at fair value, with any difference between *adjusted* cost and market value included in shareholders' equity, net of income tax effect, without affecting reported net income, according to accounting convention. Following is a summary of these investments in convertible preferred stocks at yearend 1997:

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 12/31/97	12/31/97 Yearend Carrying Value of Holding
Travelers Group Inc. . . .	9.00%	$40 Million	$22.42	$53.875	$ 96 Million
US Airways Group, Inc.	9.25%	12 Million	38.74	62.50	19.2 Million

These convertible preferred stocks were obtained at the same time Wesco's parent corporation, Berkshire Hathaway, obtained additional amounts of the same stocks at the same price per share. The preferred stock of Travelers was obtained in exchange for the remaining shares of preferred stock of Salomon Inc which Wesco and its subsidiaries had acquired in 1987. 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. On October 31, 1996 and October 31, 1997, Wesco converted an aggregate of $40 million par value of its remaining preferred shares of Salomon to 1,052,628 shares of Salomon common stock, with Wesco continuing to hold par value of $40 million of Salomon preferred stock. On November 28, 1997, Wesco and its subsidiaries received $40 million par value of Travelers 9% preferred stock plus 1,784,204 shares of Travelers common stock, in exchange for the Salomon holdings, in connection with a merger of Salomon into Travelers. Fair value of the Travelers preferred and common shares, carried on Wesco's consolidated balance sheet in the categories ''securities with fixed maturities'' and ''marketable equity securities,'' were $96.0 million and $96.1 million, respectively, at yearend 1997, versus the adjusted costs of $90.0 and $90.8 million, respectively, at which they were carried.

US Air has called its convertible preferred stock for redemption on March 15, 1998. On March 13, 1998, Wesco converted its shares, acquired for $12 million in 1989 and written down to an adjusted cost of $3 million in 1994, to 309,718 shares of US Air common.

In previous years we noted that ''few, if any, investors have ever prospered mightily from investing in convertible preferred stocks of leading corporations.'' Our experience proves, yet again, what poor prognosticators we are. We estimate that (1) our investment in preferred and common stock of Travelers, acquired in 1997 through its merger with Salomon, in which we originally invested $80 million, net, was worth about $112.1 million more than we paid, and (2) our $12 million US Air holding was at yearend 1997 worth about $7.2 million more than we paid. These figures when combined created $119.3 million more than actual cost. In addition, Wesco's 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 is carried at a $321.4 million yearend market value in Wesco's consolidated 1997 balance sheet. This is $281.4 million more than the investment cost. Also, in 1995, Wesco realized a gain of $6.9 million, before taxes ($4.2 million after taxes), on sale of its $23 million investment in preferred stock of Champion International Corporation.

Consolidated Balance Sheet And Related Discussion

As indicated in the accompanying financial statements, Wesco's net worth increased, as accountants compute it under their conventions, to $1.76 billion ($248 per Wesco share) at yearend 1997 from $1.25 billion ($176 per Wesco share) at yearend 1996.

The $513 million increase in reported net worth in 1997 was the result of three factors: (1) $419 million resulting from continued net appreciation of investments after provision for future taxes on capital gains; plus (2) $94 million from retention of 1997 net income, including $63 million realized on the exchange of Salomon stock for Travelers stock, discussed above; less (3) dividends paid.

The foregoing $248-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 two or three 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) containing only 125,000 net rentable square feet, 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 both the unrealized gains and gains deferred from the merger of Salomon into Travelers in 1997, 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 $102 per Wesco share at yearend 1997.

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 $102 per Wesco share. Instead, the present value of Wesco's shareholders' advantage must logically be much lower than $102 per Wesco share. In the writer's judgment, the value of Wesco's advantage from its temporary, interest-free ''loan'' was probably about $25 per Wesco share at yearend 1997.

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 $25 per Wesco share at yearend 1997, and after-tax liquidating value was then about $248 per share (figures that seem rational to the writer), Wesco's intrinsic value per share would become about $273 per share at yearend 1997, up 39% from intrinsic value as guessed in a similar calculation at the end of 1996. And, finally, this reasonable-to-this-writer, $273-per-share figure for intrinsic per share value of Wesco stock should be compared with the $300 per share price at which Wesco stock was selling on December 31, 1997. This comparison indicates that Wesco stock was then selling about 10% above intrinsic value.

As Wesco's unrealized appreciation has continued to grow in frothy markets for securities, it should be remembered that it is subject to market fluctuation, possibly dramatic on the downside, with no guaranty as to its ultimate full realization. Unrealized after-tax appreciation represents 73% of Wesco's shareholders' equity at 1997 yearend), versus 70% and 63% 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. Moreover, the quality disparity in book value's intrinsic merits has, in recent years, been widening in favor of 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 super-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 28, 1998 Wesco increased its regular dividend from 27½ cents per share to 28½ cents per share, payable March 11, 1998, to shareholders of record as of the close of business on February 11, 1998.

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 13, 1998

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, 1997 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)

(626) 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, 1998 was: $486,959,000

The number of shares outstanding of the registrant's Capital Stock as of March 19, 1998 was: 7,119,807.

DOCUMENTS INCORPORATED BY REFERENCE

Title of Document	Parts of Form 10-K
Proxy Statement for 1998 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, 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.

Wesco's activities fall into two business segments — insurance and industrial. The insurance segment consists of the operations of Wes-FIC and KBS. The industrial segment comprises Precision Steel's steel service center operations. Wesco is also engaged in several relatively insignificant activities not identified with either business segment; these include (1) investment activity unrelated to the insurance segment, (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, as well as nonsegment activities, 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. Its insurance operations are managed by National Indemnity Company (''NICO''), headquartered in Omaha, Nebraska. To simplify discussion, the term ''Berkshire Insurance Group,'' as used in this report, refers to NICO and all other wholly owned insurance subsidiaries of Berkshire, individually or collectively, although in practice Berkshire also includes in its group the insurance subsidiaries 80.1%-owned through its ownership of Wesco.

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 due if sold) through merger. Primarily due to appreciation of investments, Wes-FIC's shareholder's equity has increased to $1.7 billion as of 1997 yearend. (The foregoing figures have been computed under generally accepted accounting principles. Wes-FIC's regulatory net worth as of yearend 1997 was $2.4 billion. The difference represents mainly the absence in the regulatory figure of income taxes associated with unrealized appreciation of investments.)

In 1985, Wes-FIC entered into an arrangement whereby it effectively reinsured — through the Berkshire Insurance Group, 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 a member of the Berkshire Insurance Group. As with the similar Fireman's Fund contract, Wes-FIC remains liable for its share of unpaid losses and loss adjustment expenses.

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 subcontracts retroceded by the Berkshire Insurance Group. Several were entered into in 1994; most of these were renewed in 1995 but none were renewed in 1996. In 1996, 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, not renewed upon policy expiration in mid-1997; and (2) a three-year policy effective January 1, 1997 with exposure not significant to Wes-FIC's capital base. There has been no other super-catastrophe reinsurance business to date.

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, the Berkshire Insurance Group and Wes-FIC are believed to operate differently from other reinsurers in that risks they write 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 it may from time to time be offered super-catastrophe reinsurance business that is somewhat larger than it wishes to have a wholly owned subsidiary retain and may make a portion of the business available to Wes-FIC. Wesco's and Wes-FIC's boards of directors have authorized automatic acceptance of retrocessions of reinsurance offered by the Berkshire Insurance

Group 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 the Berkshire Insurance Group; (2) the Berkshire Insurance Group is to receive a ceding commission of 3% of premiums, probably less than the Berkshire Insurance Group 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) the Berkshire Insurance Group 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 agreed to the purchase of KBS by itself or a subsidiary 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 25 states and by the Department of the Treasury. Its product line for financial institutions includes policies for crime insurance, check kiting fraud indemnification, directors and officers liability, bank employment practices, and professional errors and omissions indemnity, as well as deposit guaranty bonds, which insure deposits in excess of federal deposit insurance limits. In 1997 and 1996, KBS ceded about 42% and 44%, respectively, 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, traveling employees. 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 13% of premiums written.

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 1997 amounted to less than .5% of their combined statutory surplus, compared to an industry average of about 105% based on figures reported for 1996.

Standard & Poor's Corporation, in 1994, recognized Wes-FIC's strong competitive position as a member of Berkshire's family of wholly and substantially owned insurance subsidiaries 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 super-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, as is the case with KBS, 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, which is operated by NICO, has no employees of its own. KBS has 14 employees.

INDUSTRIAL SEGMENT

Precision Steel, acquired in 1979 for approximately $15 million, and a subsidiary operate steel service centers at Franklin Park, Illinois (near Chicago) and 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 make parts of less costly materials.

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 .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 industrial segment 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 $6.1 million at December 31, 1997 from $6.0 million at December 31, 1996.

Approximately 250 full-time employees are engaged in the industrial segment 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. 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 unrelated to the insurance segment, (2) management of commercial real estate property in Pasadena, (3) development and liquidation of foreclosed real estate, 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 situated between the city hall and an indoor shopping mall in downtown Pasadena, California. The block's principal improvements are 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. 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 remaining space is leased to outside parties, including CenFed, law firms and others, under agreements expiring at dates extending to 2008. In addition to the office building and garage, the business block has contained a row of small, blighted commercial retail buildings; MS Property is in process of demolishing this portion of the block and is exploring options for redeveloping it, together with a parcel of land it owns in the next block which it has been using as a 100-car parking lot.

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

KBS leases 5,100 square feet of office space in a multistory office building in Topeka, Kansas under a lease which expires July 1, 2002. KBS has an option to renew the lease for an additional five-year term.

MS Property holds real estate in Southern California acquired by Mutual Savings or itself through foreclosure. The principal property consists of the remainder of a 22-acre parcel of largely oceanfront land near Santa Barbara, which it developed on an upscale basis over a period of many years; as of December 31, 1997, all 20 town houses and 12 residential lots had been sold, except for four lots that were in process of sale (in escrow). Other properties include several buildings that are leased to various small businesses in a small shopping center and a single-family residence.

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 that are expected to result in material loss.

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

None.

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 American Stock Exchange trading of Wesco shares for 1997 and 1996, based on data reported by the American Stock Exchange, as well as cash dividends paid by Wesco on each outstanding share:

	1997				1996		
	Sales Price		Dividends		Sales Price		Dividends
Quarter Ended	High	Low	Paid	Quarter Ended	High	Low	Paid
March 31	$214	$180	$0.275	March 31	$189	$164¾	$0.265
June 30	331	197	0.275	June 30	183	155	0.265
September 30	332	262	0.275	September 30	182	158½	0.265
December 31	339⅞	300	0.275	December 31	193	171¾	0.265
			$1.100				$1.060

There were approximately 750 shareholders of record of Wesco's capital stock as of the close of business on March 19, 1998. It is estimated that approximately 4,700 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 1997 consolidated financial statements appearing elsewhere in this report. (Amounts are in thousands except for amounts per share.)

	Year Ended December 31,				
	1997	1996	1995	1994	1993
Revenues:					
Sales and service revenues	$ 67,557	$ 63,654	$ 62,271	$ 62,143	$ 63,627
Insurance premiums earned	11,507	10,060	9,294	1,133	12,158
Dividends and interest on investments other than mortgage-backed securities	35,898	31,815	27,774	26,207	28,152
Interest on loans and mortgage-backed securities	654	1,498	2,499	2,810	7,952
Realized gains (losses), net, on securities and foreclosed property	102,348	(152)	7,428	323	1,783
Gain on disposition of Mutual Savings' loans and deposits	—	—	—	—	1,577
Other	1,087	1,144	1,791	2,842	2,109
	219,051	108,019	111,057	95,458	117,358
Costs and expenses:					
Cost of products and services sold	52,710	50,054	50,019	49,459	51,570
Insurance losses and expenses	860	4,264	1,501	(571)	12,894
Interest on savings accounts	—	—	—	—	5,792
Selling, general and administrative	9,393	10,849	11,142	13,411	16,051
Interest on notes payable	3,320	3,352	3,371	3,394	4,610
Decline in value of investment	—	—	—	9,000	—
Loss on sale of New America Electric	—	—	—	—	2,700
	66,283	68,519	66,033	74,693	93,617
Income before income taxes and cumulative effect of change in accounting for income taxes	152,768	39,500	45,024	20,765	23,741
Provision for income taxes	(50,959)	(8,881)	(10,483)	(1,793)	(5,046)
Income before cumulative effect of change in accounting for income taxes	101,809	30,619	34,541	18,972	18,695
Cumulative effect of change in accounting for income taxes	—	—	—	—	1,023
Net income	$ 101,809	$ 30,619	$ 34,541	$ 18,972	$ 19,718
Amounts per capital share:					
Income before cumulative effect of change in accounting for income taxes	$ 14.30	$ 4.30	$ 4.85	$ 2.66	$ 2.63
Net income	14.30	4.30	4.85	2.66	2.77
Cash dividends	1.10	1.06	1.02	.98	.94

	December 31,				
	1997	1996	1995	1994	1993
Assets:					
Cash and cash equivalents	$ 10,687	$ 23,039	$ 87,981	$ 15,800	$ 5,230
Investments —					
Securities with fixed maturities	279,697	176,885	119,575	183,089	202,126
Marketable equity securities	2,224,848	1,533,009	1,102,221	696,261	639,958
Excess of cost of KBS over net assets acquired	30,121	30,903	—	—	—
Real estate held for sale	5,240	15,831	19,021	23,414	29,935
Property and equipment	13,229	13,297	13,967	14,279	13,907
Other assets	24,290	25,441	22,962	28,918	23,999
Total assets	$2,588,112	$1,818,405	$1,365,727	$961,761	$915,155
Liabilities:					
Insurance losses and expenses	$ 41,437	$ 45,491	$ 34,195	$ 39,785	$ 53,818
Income taxes payable, principally deferred	733,488	468,370	324,341	191,858	180,722
Notes payable	33,635	37,162	37,369	37,557	37,896
Other liabilities	15,260	16,367	12,193	14,414	16,632
Total liabilities	$ 823,820	$ 567,390	$ 408,098	$283,614	$289,068
Shareholders' equity:					
Capital stock and surplus	$ 30,439	$ 30,439	$ 30,439	$ 30,439	$ 30,439
Unrealized appreciation of investments, net of taxes	1,290,939	871,640	601,326	349,122	309,057
Retained earnings	442,914	348,936	325,864	298,586	286,591
Total shareholders' equity	$1,764,292	$1,251,015	$ 957,629	$678,147	$626,087
Per capital share	$ 247.80	$ 175.71	$ 134.50	$ 95.25	$ 87.94

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

In reviewing this item, attention is directed to Item 6, Selected Financial Data, and Item 1, Business.

FINANCIAL CONDITION

Wesco's shareholders' equity at December 31, 1997 was $1.8 billion or $247.80 per share, up $.5 billion or $72.09 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, the net gains ultimately realized could differ substantially from recorded unrealized appreciation, which constituted 73% of shareholders' equity at December 31, 1997, compared to 49% at December 31, 1993.

Over half of the Wesco group's unrealized appreciation of securities at December 31, 1997 was attributable to its investment in Freddie Mac common stock (see Note 2 to the consolidated financial statements appearing elsewhere herein). Even if the market prices of the Freddie Mac and all other Wesco group investments dropped suddenly to original cost, the group would still be clearly viable. This can be seen by glancing at the following balance sheet totals, which result from removing all unrealized appreciation and related deferred taxes from balance sheet totals shown in the final table in Item 6 (in thousands except for amounts per share):

	December 31,				
	1997	1996	1995	1994	1993
Total assets	$ 603,178	$ 478,863	$ 442,439	$425,159	$441,952
Total liabilities	$ 129,825	$ 99,488	$ 86,139	$ 96,134	$124,922
Total shareholders' equity	$ 473,353	$ 379,375	$ 356,303	$329,025	$317,030
Per capital share	$66.48	$53.28	$50.04	$46.21	$44.53

Wesco's management believes the group has adequate liquidity and capital resources, including the ability to borrow, to minimize the impact of a downturn in its fortunes — even one as extreme and unrealistic as the worst-case scenario presented above solely for illustrative purposes.

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 has substantially liquidated the foreclosed real estate and problem loans acquired from Mutual Savings in December 1993. However, 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, which have declined in principal amount from $81 million originally to about $30 million at December 31, 1997. The managements of MS Property and Wesco believe any net overall loss in completing disposition of these items will 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. Precision Steel's 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

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., realized gains and losses on securities and foreclosed real estate) are shown separately from "normal" net operating income. (Amounts are in thousands, all after income tax effect.)

	Year Ended December 31,		
	1997	**1996**	**1995**
Insurance segment:			
"Normal" net operating income	$ 33,507	$27,249	$26,496
Realized securities gains (losses)	32,843	(115)	2,424
Segment net income	66,350	27,134	28,920
Industrial segment net income (all "normal" net operating income)	3,622	3,033	2,386
Other than identified business segments:			
"Normal" net operating income	1,133	438	1,043
Gains, net, on sales of foreclosed real estate	850	14	283
Realized securities gains	29,854	—	1,909
Nonsegment net income	31,837	452	3,235
Consolidated net income	$101,809	$30,619	$34,541

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,		
	1997	**1996**	**1995**
Premiums written	$10,654	$ 5,353	$ 5,808
Premiums earned	$11,507	$10,060	$ 9,294
Underwriting gain	$10,647	$ 5,795	$ 7,794
Dividend and interest income	32,915	29,353	26,107
Income before income taxes	43,562	35,148	33,901
Income tax provision	(10,055)	(7,899)	(7,405)
"Normal" net operating income	$33,507	$27,249	$26,496

Premiums written by Wesco's insurance subsidiaries for 1997 were comprised of (1) $8.6 million attributable to KBS and (2) $2.1 million attributable to Wes-FIC, relating principally to its participation with the Berkshire Insurance Group in a large excess-of-loss super-catastrophe reinsurance policy covering hurricane risk in Florida for the first year of a three-year period that began January 1, 1997. Premiums written in 1996 consisted of (1) $4.2 million attributable to KBS and (2) $1.2 million attributable to Wes-FIC, relating principally to another super-catastrophe reinsurance policy covering hurricane risk in Florida, also retroceded to Wes-FIC by the Berkshire Insurance Group. Premiums from Berkshire Insurance Group super-catastrophe reinsurance retrocessions to Wes-FIC have declined from about $5.8 million in 1995 and $8.8 million in 1994. The decline has been attributed by the Berkshire group's management to increased competition; it has stated repeatedly that it will not knowingly write business at inadequate rates.

Earned premiums for 1997 included $8.7 million attributable to KBS; the remainder were attributable to Wes-FIC and related principally to super-catastrophe reinsurance participations. Earned premiums for 1996 included $4.6 million attributable to KBS; the remainder were attributable principally to Wes-FIC's super-catastrophe reinsurance participations. 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 contracts.

The underwriting gain for 1997 included $5.5 million attributable to KBS, and $5.1 million attributable to Wes-FIC, of which $2.3 million was attributable to two super-catastrophe reinsurance policies, and $2.8 million to quota-share reinsurance agreements; $2.6 million of the $2.8 million resulted from a downward revision of liabilities for losses and loss expenses with respect to Wes-FIC's reinsurance of Fireman's Fund business. The underwriting gain for 1996 included $1.7 million contributed by KBS; the balance was earned by Wes-FIC on expiration of several super-catastrophe reinsurance policies written in 1995. The underwriting gain for 1995 was earned by Wes-FIC principally on expiration of several one-year super-catastrophe reinsurance contracts. KBS's underwriting gain in 1997 and 1996 is net of $.8 million and $.4 million amortization of ''goodwill''; this excess of Wes-FIC's cost over the fair value of the identified net assets acquired in mid-1996 (about $31 million) is being written off over 40 years (or $.8 million per year).

Although no super-catastrophe reinsurance losses have been incurred to date, the managements of Berkshire, Wes-FIC and Wesco believe that large super-catastrophe reinsurance losses will inevitably occur from time to time. While such large losses are not expected to be significant in relation to Wes-FIC's capital base, the managements accept the prospect of increased volatility in Wes-FIC's short-term underwriting results in order to obtain what they believe will be better long-term results.

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

Dividend and interest income has been earned by the insurance group principally (1) on the assets (approximately $.4 billion 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, Wesco's insurance subsidiaries have maintained capital positions strong enough not only to absorb adverse estimation corrections but also to enable them 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,		
	1997	1996	1995
Revenues, principally sales and services	$67,693	$63,762	$62,382
Income before income taxes	$ 6,042	$ 5,076	$ 4,005
Income tax provision	(2,420)	(2,043)	(1,619)
''Normal'' net operating income	$ 3,622	$ 3,033	$ 2,386

Revenues of Precision Steel's businesses have improved in each of the past two years after having declined for several prior years. The revenue improvement is due to increased sales volume, which its management attributes principally to changing economic conditions and competitive pressures in the industrial sector of the economy. Sales volume, in terms of pounds of steel products sold, increased 16.7 percent for 1997 over the comparable 1996 figure, which, in turn, was 7.4% higher than its 1995 counterpart. Revenues per pound, however, decreased in 1997 following price decreases by mills and other suppliers.

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 78.0%, 78.6% and 80.3% for 1997, 1996 and 1995. The cost percentage typically fluctuates slightly from year to year as a result of changes in product mix and price competition at all levels. The improvement in the cost percentage in 1997 was attributable principally to the continuing decline in wholesale costs, begun in 1996. 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,		
	1997	1996	1995
Dividend and interest income	$ 3,148	$ 3,988	$ 5,709
Rental income, net, from commercial real estate	879	1,035	1,249
Interest expense	(3,609)	(3,858)	(5,007)
General and administrative expenses	(1,010)	(1,229)	(1,379)
Reduction (increase) in allowance for losses on foreclosed real estate and other assets	1,800	—	(1,000)
Other items, net	(393)	(508)	119
Income (loss) before income tax provision or benefit	815	(572)	(309)
Income tax benefit	318	1,010	1,352
''Normal'' net operating income	$ 1,133	$ 438	$ 1,043

''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, including adjustments of reserves for possible losses on sales of foreclosed real estate, and (2) interest and other corporate expenses — plus or minus income taxes related to such ''normal'' nonsegment items.

''Normal'' net operating income other than from identified business segments typically fluctuates from period to period. The improvement in the figure for 1997 resulted principally from the beneficial effect of $1.1 million, after taxes, of the reversal into income of reserves for losses primarily on sales of foreclosed real estate, recorded in prior years; this compares with a nonadjustment of these reserves in 1996 and a $.6 million after-tax increase in 1995. MS Property has had success in selling various foreclosed properties at prices higher than were anticipated when the real estate market was extremely depressed. The beneficial effect of the foregoing adjustment was somewhat offset by (1) reductions in dividend income following conversions of installments of Salomon Inc 9% preferred stock into lower-yielding common stock held outside the insurance segment in the fourth quarters of 1997 and 1996, prior to Salomon's acquisition by Travelers Group, Inc., and (2) a decrease in net rental income from commercial real estate owned by MS Property in connection with the demolition and redevelopment of a portion of its business block in Pasadena. The most significant reason for the drop in ''normal'' net operating income from 1995 to 1996 was a reduction in dividend income upon disposition of the Champion International Corporation 9.25% preferred stock held outside the insurance segment in the second quarter of 1995.

Nonsegment interest expense was somewhat lower in 1997 than in 1996, and much lower in 1996 than in 1995, mainly due to repayment by Wesco (parent company) of borrowings from Wes-FIC beginning in mid-1995. (Insurance segment revenues decreased accordingly so that Wesco's consolidated net income was not affected.)

Wesco's nonsegment tax benefits appear at first glance to be anomalous compared to the pre-tax income. This is caused by the inclusion in pre-tax income or loss of large (but declining) amounts of dividend income, which is highly tax-favored; all other revenues and expense items are fully taxable or deductible, and net in total to a smaller (and declining) pre-tax loss.

* * * * *

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 unrealized price appreciation in Wesco's consolidated investment portfolio. (Wesco's shareholders' equity at December 31, 1997 contained $1.3 billion, or $181.32 per share, of unrealized appreciation of investments, net of taxes — about 73% of shareholders' equity.)

Wesco's consolidated earnings for 1997 contained securities gains, after income taxes, of $62.7 million, versus after-tax losses of $.1 million for 1996 and after-tax gains of $4.3 million for 1995. Of the 1997 figure, only $.1 million was realized through the *sale* of securities; the balance, $62.6 million, resulted from the exchange of the preferred and common shares of Salomon Inc owned by the Wesco group for preferred and common shares of The Travelers Group Inc. (''Travelers'') late in 1997 in connection with the merger of Salomon Inc with Travelers. Although the realized gain had a material impact on Wesco's reported earnings, it had a minor impact on Wesco's shareholders' equity:

Inasmuch as $48.5 million of the after-tax gain had previously been reflected in the unrealized gain component of Wesco's shareholders' equity as of September 30, 1997, that amount was merely switched from unrealized gains to retained earnings, another component of shareholders' equity.

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 33.4%, 22.5% and 23.3% in 1997, 1996 and 1995. (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. 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.

* * * * *

Many computer systems used today may be unable to interpret data correctly after December 31, 1999 because they allow only two digits to indicate the year in a date. Wesco and its subsidiaries have been engaged in (1) assessing this "Year 2000" issue as it relates to their businesses, including their electronic and other interactions with banks, vendors, customers and others, and (2) developing and implementing solutions. Management currently anticipates that the project will be completed in a timely manner, and will not have a material adverse impact on the operations of Wesco or its subsidiaries, or on Wesco's consolidated financial results or financial condition. However, Wesco's consolidated financial results could be adversely affected if one or more of the companies in which it has material investments were materially adversely affected by the Year 2000 issue.

Item 8. Financial Statements

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

Listed below are financial statement schedules required by the Securities and Exchange Commission to be included in this report. The data appearing therein 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 1998 annual meeting of shareholders (the ''1998 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 1998 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 1998 Proxy Statement is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions

Certain information set forth in the sections ''Election of Directors,'' ''Voting Securities and Holders Thereof,'' ''Compensation of Directors and Executive Officers'' and ''Board of Director Interlocks and Insider Participation'' in the 1998 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, 1997. 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, 1997.

SIGNATURES

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

WESCO FINANCIAL CORPORATION

By: Charles T. Munger — March 25, 1998
Chairman of the Board (principal executive officer)

By: Robert H. Bird — March 25, 1998
President (principal operating officer)

By: Jeffrey L. Jacobson — March 25, 1998
Vice President and Chief Financial Officer
(principal financial and accounting officer)

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

Robert H. Bird Director	March 25, 1998
Carolyn H. Carlburg Director	March 25, 1998
James N. Gamble Director	March 25, 1998
Charles T. Munger Director	March 25, 1998
David K. Robinson Director	March 25, 1998

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, 1997 and 1996, and the related consolidated statements of income and retained earnings and of cash flows for each of the three years in the period ended December 31, 1997. 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, 1997 and 1996, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1997, 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 6, 1998

WESCO FINANCIAL CORPORATION
CONSOLIDATED BALANCE SHEET

(Dollar amounts in thousands)

	December 31, 1997	December 31, 1996
ASSETS		
Cash and cash equivalents	$ 10,687	$ 23,039
Investments:		
Securities with fixed maturities	279,697	176,885
Marketable equity securities	2,224,848	1,533,009
Accounts receivable	7,148	7,940
Real estate held for sale	5,240	15,831
Property and equipment	13,229	13,297
Excess of cost over net assets of acquired business	30,121	30,903
Other assets	17,142	17,501
	$2,588,112	$1,818,405
LIABILITIES AND SHAREHOLDERS' EQUITY		
Insurance losses and loss adjustment expenses	$ 41,437	$ 45,491
Income taxes payable, principally deferred	733,488	468,370
Notes payable	33,635	37,162
Other liabilities	15,260	16,367
	823,820	567,390
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	1,290,939	871,640
Retained earnings	442,914	348,936
Total shareholders' equity	1,764,292	1,251,015
	$2,588,112	$1,818,405

See accompanying notes to consolidated financial statements.

WESCO FINANCIAL CORPORATION
CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

(Dollar amounts in thousands except for amounts per share)

	Year Ended December 31,		
	1997	**1996**	**1995**
Revenues:			
Sales and service revenues	$ 67,557	$ 63,654	$ 62,271
Insurance premiums earned	11,507	10,060	9,294
Dividend and interest income	36,552	33,313	30,273
Realized gains (losses), net, on securities and foreclosed property	102,348	(152)	7,428
Other	1,087	1,144	1,791
	219,051	108,019	111,057
Costs and expenses:			
Cost of products and services sold	52,710	50,054	50,019
Insurance losses, loss adjustment and underwriting expenses	860	4,264	1,501
Selling, general and administrative expenses	9,393	10,849	11,142
Interest on notes payable	3,320	3,352	3,371
	66,283	68,519	66,033
Income before income taxes	152,768	39,500	45,024
Provision for income taxes	(50,959)	(8,881)	(10,483)
Net income	101,809	30,619	34,541
Retained earnings — beginning of year	348,936	325,864	298,586
Cash dividends declared and paid	(7,831)	(7,547)	(7,263)
Retained earnings — end of year	$442,914	$348,936	$325,864
Amounts per capital share based on 7,119,807 shares outstanding throughout each year:			
Net income	$ 14.30	$ 4.30	$ 4.85
Cash dividends	$ 1.10	$ 1.06	$ 1.02

See accompanying notes to consolidated financial statements.

WESCO FINANCIAL CORPORATION
CONSOLIDATED STATEMENT OF CASH FLOWS

(Dollar amounts in thousands)

	Year Ended December 31,		
	1997	1996	1995
Cash flows from operating activities:			
Net income	$ 101,809	$ 30,619	$ 34,541
Adjustments to reconcile net income with cash flows from operating activities —			
Realized (gains) losses, net, on securities and foreclosed property, before taxes	(102,348)	152	(7,428)
Provision for depreciation and amortization	2,056	1,672	1,395
Increase (reduction) in allowance for losses on real estate held for sale and other assets	(1,800)	—	1,000
Decrease in liabilities for losses and loss adjustment expenses of insurance businesses	(4,054)	(2,816)	(5,590)
Deferred income taxes on realized securities gain	38,168	—	—
Increase (decrease) in income taxes payable currently	2,421	1,325	(1,114)
Other, net	(1,377)	(6,228)	(3,140)
Net cash flows from operating activities	34,875	24,724	19,664
Cash flows from investing activities:			
Purchases of securities with fixed maturities	(176,235)	(65,918)	—
Proceeds from maturities and redemptions of securities with fixed maturities	35,215	10,521	38,181
Proceeds from sales of securities with fixed maturities	95,122	45,389	35,046
Purchases of marketable equity securities	—	—	(20,687)
Acquisition of business, net of cash and cash equivalents acquired	—	(77,320)	—
Principal collections on loans	1,425	5,102	3,154
Other, net	8,604	314	4,274
Net cash flows from investing activities	(35,869)	(81,912)	59,968
Cash flows from financing activities:			
Repayments of notes	(3,527)	(207)	(188)
Payment of cash dividends	(7,831)	(7,547)	(7,263)
Net cash flows from financing activities	(11,358)	(7,754)	(7,451)
Increase (decrease) in cash and cash equivalents	(12,352)	(64,942)	72,181
Cash and cash equivalents — beginning of year	23,039	87,981	15,800
Cash and cash equivalents — end of year	$ 10,687	$ 23,039	$ 87,981
Supplementary disclosures:			
Interest paid during year	$ 3,320	$ 3,352	$ 3,371
Income taxes paid, net, during year	11,934	10,794	13,939
Noncash investing activities —			
Fair value of investments exchanged	180,772	—	—

See accompanying notes to consolidated financial statements.

WESCO FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands except for amounts per share)

Note 1. Presentation

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.

In connection with Mutual Savings' sale of approximately $81,000 principal amount of first mortgage real estate loans in 1993 (paid down to about $30,000 as of yearend 1997), Wesco agreed to indemnify the buyer with respect to at least 90% of any losses that might be sustained on the loans sold. Losses to date amount to less than $100.

The outstanding stock of KBS was purchased for approximately $80,000. The excess of purchase cost over the fair value of the identified 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

In 1997, the Financial Accounting Standards Board issued two Statements of Financial Accounting Standards (''SFAS'') required to be adopted at the end of 1997: No. 128 — ''Earnings per Share,'' and No. 129 — ''Disclosure of Information About Capital Structure.'' SFAS No. 128 requires publicly owned companies to compute and report ''basic'' and, if applicable, ''diluted'' earnings per share; because Wesco has not had any dilutive share equivalents, only the basic per-share earnings are shown in its consolidated financial statements. SFAS No. 129 relates to disclosures concerning equity and debt securities issued by the reporting entity; Wesco's only class of equity securities, capital stock, has no unusual features requiring disclosure, and its one issue of debt securities, the 8⅞% Notes due November 1999, is discussed in Note 6.

Two other SFASs will be adopted at the beginning of 1998: No. 130 — ''Reporting Comprehensive Income,'' which establishes standards for the reporting of so-called comprehensive income and its components; and No. 131 — ''Disclosures about Segments of an Enterprise and Related Information,'' which establishes new standards for reporting information about operating segments in interim and annual financial statements. Adoption of these standards is not expected to have a material effect on Wesco's 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 until realized.

Investments in marketable equity securities and securities with fixed maturities at December 31, 1997 and 1996 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 very significantly from recorded unrealized appreciation, which constituted 73% and 70% of Wesco's shareholders' equity at December 31, 1997 and 1996.

Following is a summary of securities with fixed maturities:

	December 31, 1997		December 31, 1996	
	Amortized cost	Estimated Fair (Carrying) Value	Amortized cost	Estimated Fair (Carrying) Value
Mortgage-backed securities	$ 4,861	$ 4,896	$ 13,236	$ 13,308
Preferred stocks —				
Salomon Inc, 9%	—	—	60,000	66,000
The Travelers Group Inc., 9%	90,000	96,000	—	—
US Airways Group, Inc., 9.25%	3,000*	19,200	3,000*	10,800
State and municipal bonds	12,145	12,240	21,114	21,172
Obligations of U.S. Government and its agencies	131,392	147,361	65,421	65,605
	$241,398	$279,697	$162,771	$176,885

* Net of writedown (see below).

At 1997 year end, the estimated fair values of securities with fixed maturities contained $38,349 of unrealized gains and $50 of unrealized losses, compared with $14,375 of unrealized gains and $261 of unrealized losses at 1996 yearend.

Dollar amounts in thousands except for amounts per share

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 Travelers Group Inc. (''Travelers'') preferred stock (and common stock) was received by the Wesco group late in 1997 in exchange for its remaining preferred (and common) shares of Salomon Inc (''Salomon'') upon merger of Salomon with Travelers. The Salomon preferred stock had been 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 in October 1996 and $20,000 was converted in October 1997. The remaining $40,000 of Salomon preferred was exchanged for $40,000 par value of essentially identical Travelers preferred, which must be redeemed in $20,000 installments on October 31, 1998 and 1999 to the extent the installments are still outstanding. Wesco's holding of Travelers preferred was recorded at $90,000 (and its investment in common stock was recorded at $90,771), estimated fair values as of the date of the merger, as required under generally accepted accounting principles. The excess of total fair value of the Travelers securities over the combined carrying values of the Salomon preferred and common shares surrendered represented a realized securities gain of $100,772 before taxes ($62,604, or $8.79 per Wesco share, after taxes) on the accompanying consolidated income statement; however, no gain or loss is recognized on the tax return until Travelers securities are sold. Although the gain had a material impact on Wesco's reported earnings, most of the gain had already been reflected in shareholders' equity as unrealized appreciation, which under accounting convention is credited directly to shareholders' equity, net of taxes, without being reflected in earnings.

The Wesco group's investment in preferred stock of US Airways Group, Inc. (''US Air'') was made in 1989 at par, $12,000. If not called or converted prior to August 7, 1999, the stock is redeemable by US Air at par plus accrued dividends. At yearend 1994, because US Air had incurred significant losses for several years and had suspended payment of dividends, Berkshire and Wesco managements concluded that an other-than-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 the carrying value of the investment to estimated fair value of $3,000. US Air managed to pay all dividend arrearages, plus interest, in the second half of 1996 and first quarter of 1997. Consequently, at yearend 1996, Berkshire and Wesco managements estimated the fair value of Wesco's investment to be $10,800. Following US Air's subsequent return to profitability, the trading price of its common stock appreciated significantly, and as of 1997 yearend Berkshire and Wesco managements estimated that the fair value of Wesco's investment was $19,200. The increases in estimated fair value of Wesco's investment over the $3,000 adjusted cost ($7,800 at yearend 1996 and an additional $8,400 at yearend 1997) 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, without effect on the consolidated statement of income.

US Air has called the preferred stock owned by Wesco and Berkshire for redemption on March 15, 1998. Wesco intends to convert its preferred stock investment to 309,718 shares of US Air common stock prior to the repurchase date.

Investments in state and municipal bonds, obligations of the U.S. Government and its agencies and mortgage-backed securities as of 1997 yearend are expected to mature as follows:

	Amortized Cost	Market Value
In one year or less	$ 11,023	$ 11,036
After one year through five years	21,475	21,701
After five years through ten years	160	168
After ten years	110,879	126,696
	143,537	159,601
Mortgage-backed securities	4,861	4,896
	$148,398	$164,497

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

		December 31, 1997		December 31, 1996	
	Number of Shares	Cost	Quoted Market (Carrying) Value	Cost	Quoted Market (Carrying) Value
Freddie Mac	28,800,000	$ 71,729	$1,207,814	$ 71,729	$ 794,700
The Coca-Cola Company	7,205,600	40,761	480,527	40,761	379,195
The Gillette Company	3,200,000	40,000	321,402	40,000	248,800
Wells Fargo & Company	169,340	11,351	57,480	11,351	45,679
American Express Company	647,700	20,687	57,807	20,687	36,595
Salomon Inc	—	—	—	20,000	24,803
The Travelers Group Inc.	1,784,204	90,771	96,124	—	—
Other		2,914	3,694	2,914	3,237
		$278,213	$2,224,848	$207,442	$1,533,009

The market values of marketable equity securities contained no unrealized losses at 1997 or 1996 yearends. During 1997 and 1996, unrealized appreciation of investments increased $645,392 and $416,257, respectively, with corresponding increases in deferred income tax liabilities of $226,093 and $145,943.

Note 3. Real Estate Held for Sale

Real estate held for sale 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 consists of the minor residue of 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 1997, four town houses and three lots were sold; the four remaining lots at 1997 yearend were in escrow, with sales expected to be completed in 1998. The net book value of the project decreased to $4,367 at 1997 yearend from $9,708 one year earlier; these carrying values reflect allowances for possible losses of approximately $600 and $2,000 as of those dates, resulting from writedowns to estimated net realizable values taken prior to 1996.

Dollar amounts in thousands except for amounts per share

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 $7,432 and $8,505 at December 31, 1997 and 1996 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 1997 and 1996 yearends 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:

	1997	1996	1995
Balance at beginning of year	$45,491	$34,195	$39,785
Less ceded liabilities	(840)	—	—
Balance at beginning of year	44,651	34,195	39,785
Liabilities of KBS at date of acquisition	—	12,639	—
Incurred losses recorded during year —			
For current year	6,563	984	1
For all prior years*	(7,453)	(194)	(1,014)
Total incurred losses	(890)	790	(1,013)
Payments made during year —			
For current year	1,579	1,224	—
For all prior years	2,085	1,749	4,577
Total payments	3,664	2,973	4,577
Plus ceded liabilities at end of year	1,340	840	—
Balance at end of year	$41,437	$45,491	$34,195

* 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 1997 and 1996 yearends:

	December 31, 1997	December 31, 1996
Deferred tax liabilities, relating to —		
Appreciation of investments, principally unrealized	$729,012	$464,752
Other items	8,180	12,400
	737,192	477,152
Deferred tax assets	(5,380)	(8,037)
Net deferred tax liabilities	731,812	469,115
Taxes currently payable (recoverable)	1,676	(745)
Income taxes payable	$733,488	$468,370

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 balance sheet 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:

	1997	1996	1995
Federal	$45,781	$ 8,578	$ 9,917
State	5,178	303	566
Provision for income taxes	$50,959	$ 8,881	$10,483
Current	$13,021	$11,028	$13,046
Deferred provision (benefit)	37,938	(2,147)	(2,563)
Provision for income taxes	$50,959	$ 8,881	$10,483

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:

	1997	1996	1995
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	(3.8)	(14.4)	(13.7)
Exclusion from taxable income of a significant portion of interest income on state and municipal bonds	(0.2)	(0.6)	(0.6)
State income taxes, less federal tax benefit	2.2	0.5	0.8
Other differences, net	0.2	2.0	1.8
Effective income tax provision rate	33.4%	22.5%	23.3%

Dollar amounts in thousands except for amounts per share

Wesco and its subsidiaries join with other Berkshire subsidiaries in the filing of consolidated federal income tax returns for the Berkshire group. The consolidated federal tax liability is apportioned among group members pursuant to methods that result in each member of the group paying or receiving an amount that approximates the 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, 1997	December 31, 1996
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%, prepaid in full in 1997	—	3,527
Industrial revenue bonds due December 2014, bearing interest at 7¾% payable semiannually	2,600	2,600
Note payable, due January 2002, bearing interest, payable monthly, at 10% through 1998 and 7⅝% thereafter	1,035	1,035
	$33,635	$37,162

Notes payable at 1997 yearend mature as follows: 1999, $30,000; 2002, $1,035; and 2014, $2,600.

The 8⅞% notes are not convertible. The indenture contains 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, 1997 and December 31, 1996 were approximately $35,300 and $39,100. These figures were calculated using discounted cash flow computations based upon estimates as to interest rates prevailing on those dates for comparable borrowings.

Note 7. Quarterly Financial Information

Unaudited quarterly financial information for 1997 and 1996 follows:

	Quarter Ended December 31, 1997	September 30, 1997	June 30, 1997	March 31, 1997
Total revenues	$129,778	$30,133	$29,084	$30,056
Net income excluding securities gains	$ 11,347	$ 9,246	$ 8,736	$ 9,783
Per capital share	1.59	1.30	1.23	1.37
Realized securities gains (losses), net of income tax effect	62,555	142	—	—
Per capital share	8.79	.02	—	—
Net income	$ 73,902	$ 9,388	$ 8,736	$ 9,783
Per capital share	10.38	1.32	1.23	1.37

Dollar amounts in thousands except for amounts per share

	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 capital share	1.08	1.12	.92	1.20
Realized securities gains (losses), net of income tax effect	—	(115)	—	—
Per capital share	—	(.02)	—	—
Net income	$ 7,673	$ 7,803	$ 6,573	$ 8,570
Per capital share	1 .08	1.10	.92	1.20

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.

	1997	1996	1995
Revenues:			
Insurance	$ 95,729	$ 39,714	$ 39,241
Industrial	67,693	63,762	62,382
Not identified with a business segment	55,629	4,543	9,434
	$219,051	$108,019	$111,057
Operating profit before taxes:			
Insurance	$ 94,161	$ 34,972	$ 37,632
Industrial	6,243	5,278	4,005
Interest expense on notes payable	(3,320)	(3,352)	(3,371)
Not identified with a business segment	55,684	2,602	6,758
	$152,768	$ 39,500	$ 45,024

The above revenue and pre-tax operating profit data include realized gains and losses on securities and foreclosed property — notably the gain recognized for financial statement purposes on conversion of Salomon preferred and common stock to preferred and common stock of Travelers in 1997, explained in Note 2 — as summarized below:

	1997	1996	1995
Insurance	$ 50,528	$ (177)	$ 3,730
Not identified with a business segment	51,820	25	3,698
	$ 102,348	$ (152)	$ 7,428

Dollar amounts in thousands except for amounts per share

Additional business segment data follow:

	1997	1996	1995
Capital expenditures:			
Insurance	$ 68	$ 19	$ —
Industrial	614	452	275
Not identified with a business segment	495	—	697
	$ 1,177	$ 471	$ 972
Depreciation and amortization of tangible assets other than investments:			
Insurance	$ 36	$ 15	$ —
Industrial	849	879	929
Not identified with a business segment	388	353	360
	$ 1,273	$ 1,247	$ 1,289
Identifiable assets at yearend:			
Insurance	$2,440,141	$1,710,475	$1,259,279
Industrial	23,084	22,001	20,062
Not identified with a business segment	124,887	85,929	86,386
	$2,588,112	$1,818,405	$1,365,727

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, 1997	December 31, 1996
ASSETS		
Cash and cash equivalents	$ 13	$ 17
Marketable equity securities	48,062	12,401
Convertible preferred stocks	48,000	33,000
Investment in subsidiaries, at cost plus equity in subsidiaries' undistributed earnings and unrealized appreciation:		
Wes-FIC and KBS	1,684,978	1,201,182
Precision Steel	46,735	41,203
MS Property	13,080	24,248
Other assets	693	852
	$1,841,561	$1,312,903
LIABILITIES AND SHAREHOLDERS' EQUITY		
Intercompany advances	$ 22,672	$ 28,657
Income taxes payable, principally deferred	23,095	1,727
Notes payable	31,035	31,035
Other liabilities	467	469
Total liabilities	77,269	61,888
Shareholders' equity (see consolidated balance sheet)	1,764,292	1,251,015
	$1,841,561	$1,312,903

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

	Year Ended December 31, 1997	1996	1995
Revenues:			
Dividend income	$ 2,692	$ 3,375	$ 4,704
Realized securities gains	50,386	—	2,339
Other	118	197	768
	53,196	3,572	7,811
Expenses:			
Interest on notes payable	3,104	3,320	4,165
General and administrative	414	366	348
	3,518	3,686	4,513
Income (loss) before items shown below	49,678	(114)	3,298
Income tax (provision) benefit	(19,654)	760	(222)
Equity in undistributed earnings of subsidiaries	71,785	29,973	31,465
Net income	101,809	30,619	34,541
Retained earnings — beginning of year	348,936	325,864	298,586
Cash dividends declared and paid	(7,831)	(7,547)	(7,263)
Retained earnings — end of year	$442,914	$348,936	$325,864

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, 1997	1996	1995
Cash flows from operating activities:			
Net income	$101,809	$ 30,619	$ 34,541
Adjustments to reconcile net income with cash flows from operating activities —			
Realized securities gains	(50,386)	—	(2,339)
Deferred income taxes on realized securities gain	20,532	—	—
Increase (decrease) in income taxes payable currently	836	(1,196)	(19)
Equity in undistributed earnings of subsidiaries	(59,034)	(29,973)	(31,465)
Other, net	55	163	(373)
Net cash flows from operating activities	13,812	(387)	345
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
Net cash flows from investing activities	—	4,000	20,750
Cash flows from financing activities:			
Advances from (repayments to) subsidiaries, net	(5,985)	3,883	(13,861)
Payment of cash dividends	(7,831)	(7,547)	(7,263)
Other, net	—	—	75
Net cash flows from financing activities	(13,816)	(3,664)	(21,049)
Increase (decrease) in cash and cash equivalents	(4)	(51)	46
Cash and cash equivalents — beginning of year	17	68	22
Cash and cash equivalents — end of year	$ 13	$ 17	$ 68

See notes to consolidated financial statements

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