AR/S
P.E.
12/31/93

WESCO FINANCIAL CORPORATION

Annual Report 1993

Form 10-K Annual Report 1993

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 1993 decreased to $20,382,000 ($2.87 per share) from $22,500,000 ($3.16 per share) in the previous year.

Consolidated net income (i.e., after irregularly occurring items shown in the table below) increased to $19,718,000 ($2.77 per share) from $5,001,000 ($.70 per share) in the previous year.

Wesco in 1993 had three major subsidiaries: Mutual Savings, engaged until late in the year in the savings and loan business in Pasadena, Wesco-Financial Insurance Company, headquartered in Omaha and engaged principally in the reinsurance business, and 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, 1993		December 31, 1992	
	Amount	Per Wesco Share	Amount	Per Wesco Share
"Normal" net operating income of:				
Mutual Savings	$ 2,458	$ .35	$ 3,746	$ .52
Wesco-Financial Insurance business	12,434	1.75	13,146	1.85
Precision Steel's businesses	2,189	.31	2,075	.29
All other "normal" net operating income[2]	3,301	.46	3,533	.50
	20,382	2.87	22,500	3.16
Net gain on sales of marketable securities	1,156	.16	147	.02
Net loss on sales of foreclosed property	—	—	(146)	(.02)
Unusual income tax charges	(1,109)[3]	(.16)	(17,500)[4]	(2.46)
Gain on disposition of Mutual Savings' deposits and some loans	906	.13	—	—
Loss on disposition of approximately 80% interest in New America Electrical Corporation	(1,617)	(.23)	—	—
Wesco consolidated net income	$19,718	$2.77	$ 5,001	$ .70

(1) All figures are net of income taxes.

(2) After deduction of interest and other corporate expenses. Income was from ownership of the Wesco and Mutual Savings headquarters office building, primarily leased to outside tenants, interest and dividend income from cash equivalents and marketable securities owned outside the savings and loan and insurance subsidiaries, and the electrical equipment manufacturing business, 80%-owned by Wesco through June 30, 1993.

(3) Consists principally of effect of tax rate change on deferred tax on unrealized appreciation of marketable equity securities.

(4) Consists of income tax provision on about $47 million of Mutual Savings' net worth considered bad debt reserve for income tax (not financial statement) purposes, required to be recorded at 1992 yearend as a result of the decision to give up Mutual Savings' status as a regulated savings and loan association and thereby trigger recapture, for income tax purposes, of the bad debt reserve.

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

Mutual Savings and its Successors

On October 8, 1993, Mutual Savings closed the sale covered by its contract, previously made and announced, with CenFed Bank ("CENFED"), a highly regarded, insured institution also headquartered in Pasadena. In part, this buyer had been chosen to take over Mutual Savings' offices because it was considered likely to serve depositors safely and well.

In the closing of the transaction, Mutual Savings transferred to CENFED that part of Mutual Savings' liabilities (principally insured deposit liabilities) which was causing Mutual Savings to pay substantial deposit-insurance premiums in exchange for remaining a highly regulated savings and loan association. Also transferred to CENFED were some mortgage loans and a large amount of cash offset by deposits assumed.

At roughly the same time, Mutual Savings transferred certain troubled assets to a newly organized Wesco subsidiary that will conduct a slow liquidation of those assets. The transferred assets were:

(1) the unsold residue (with a book value of $23.1 million) of Mutual Savings' now-slow-selling residential real estate project, created in an attempt to maximize proceeds from foreclosed mostly-seaside land in the Montecito district of Santa Barbara, California, plus

(2) other foreclosed real estate with an aggregate book value of $8.2 million, plus

(3) seven troubled first mortgage loans on houses, with an aggregate book value of $1.9 million.

Then, a little later, Mutual Savings, now removed by the CENFED transaction from savings and loan regulation, merged into Wesco's long-existing Omaha-domiciled insurance subsidiary, Wesco-Financial Insurance Company ("Wes-FIC"), thus causing continuation of Mutual Savings' business and continued business holding of its main assets by Wes-FIC. Assets thus transferred incident to the merger with Wes-FIC consisted mostly of $45.8 million (at book value) in high quality mortgage-backed securities plus 7.2 million shares of Federal Home Loan Mortgage Corporation ("Freddie Mac") with a cost of $71.7 million and a market value of $359.1 million (based on the 1993 yearend NYSE quotation of $49.87 per Freddie Mac share).

Accordingly, 1993 was the last year in which Wesco will report any earnings from the savings and loan business. In 1994 and thereafter roughly all former savings and loan business earning power will augment reported results of Wesco's Wes-FIC subsidiary, now greatly enlarged in net worth.

As the table showing sources of income indicates, Mutual Savings got creditably through its last year, contributing $2.5 million to normal net operating income, down 34% from $3.7 million in 1992. A $2.0 million pre-tax writedown in the fourth quarter of the residue of Mutual Savings' Montecito residential real estate project caused almost all of the 1993 reduction in income.

In addition, an after-tax gain of $906,000 ($.13 per Wesco share) was realized in the transaction between Mutual Savings and CENFED. As part of this transaction Wesco loaned CENFED's parent corporation $4 million for three years at a market rate of interest and made some guarantees of loan quality. Also, CENFED leased from Wesco for 15 years at a market rental rate the groundfloor space formerly occupied by Mutual Savings in Wesco's retained building, formerly named the "Mutual Savings Building" and now renamed the "CenFed Bank Building" pursuant to terms of the lease. And, later, the building was transferred by Wesco to its new California real estate subsidiary.

The building, with its new name, is shown in the photograph at the front of this annual report. (We were proud of the economical old photograph, used successively over so many years that all the automobile models therein had eventually disappeared from the earth, but we finally shot a new photograph after the savings and loan charter, as well as the automobile models, had vanished from the scene.)

Because all failures and faults deserve extra attention in annual reports, we hereby state for the second time that it is not only Wes-FIC which has succeeded to former assets of Mutual Savings. As indicated above, Wesco now has a new real estate subsidiary that, mostly, it does not want. The subsidiary, named MS Property Company, will hereafter both (1) hold and operate Wesco's office and parking property in Pasadena, California and (2), as we said above, liquidate the $33.2 million (at yearend 1993 book value) of assets neither transferred to CENFED nor left in Mutual Savings when it was merged into Wes-FIC. The liquidation part of the game will occur in a poor climate for liquidations. The California real estate crash has been no small crash, and it has taken a large toll on values. Our best guess is that Wesco will eventually (and slowly) realize, from all real estate assets of MS Property Company combined, (1) more than present book value but (2) less than present book value plus a market rate of interest, after corporate taxes.

Generally, real estate holding, and even real estate development, when conducted in publicly held corporate form, subject to corporate income taxes, has a very poor record for serving shareholders well. This occurs because the real estate game, in which most market values are set in transactions involving people who are not paying corporate income taxes and many of whom pay virtually no taxes at all, is not ordinarily lucrative enough to create a decent return for persons in the same game, disadvantaged by a level of corporate taxes. We have no antidote for the share of this general investment disadvantage now being borne by Wesco shareholders.

Shareholders who wonder why tag-end real estate assets from the past should now bedevil a small percentage of Wesco's future will not find the experience reassuring as they appraise management. In retrospect, it appears (1) that some troubles — from poor loan quality — came because the writer was not paying enough attention and (2) that a more devoted approach didn't work very well either as troubles — from the slow-selling residential real estate project in Montecito — came because the writer gave too much effort and attention, even going so far as to create in the project a personal house now worth considerably less than he paid for it in cash, much of which went to Mutual Savings under firm-price conditions it would very much like to see again.

However, the writer does not wish to go too far in wearing a hair shirt. All things weighed, Mutual Savings' record was not so bad, and its Montecito project will some years hence be recognized as a minor, one-of-a-kind, extremely creditable place, reflecting well on its creators. Moreover, it seems to the writer that any patient person who now buys a needed residence therein is virtually sure to come out quite well. **Accordingly, every Wesco shareholder who is a prospective user of a Montecito residence is hereby invited to consider buying into our project.**

A last word on Mutual Savings is now appropriate in requiem. Many Wesco shareholders have an income tax basis of only a few pennies (or less) per Wesco share and are related to respected founders. All the value they now own in their Wesco shares has eventually come from a tiny savings and loan association carried through a tough 1930s economic climate by these founders, long ago. Under such circumstances, heightened by a prideful remembrance of much service to California housing, some tinge of regret is inevitable for these shareholders and, indeed, even for shareholders like Berkshire Hathaway that came in much later. But we make no apology for changing course. In our view, Freddie Mac, which has low costs and pays no deposit insurance premiums, is a much better business than Wesco had in its heavily regulated savings and loan operation, and Wesco did the logical thing as it deployed Mutual Savings' assets and momentum to the better Freddie Mac business.

Precision Steel

The businesses of Wesco's Precision Steel subsidiary, headquartered in the outskirts of Chicago at Franklin Park, Illinois, contributed $2,189,000 to normal net operating income in 1993, compared with $2,075,000 in 1992. Sales increased from $58,048,000 to $60,127,000.

Under the skilled leadership of David Hillstrom, Precision Steel's businesses in 1993 continued to provide a fine return on resources employed.

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

Wes-FIC's normal net income for 1993 was $12,434,000, down slightly from $13,146,000 for 1992.

At the end of 1993 Wes-FIC retained about $39.3 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."

As reported last year, Wes-FIC in 1992 entered into another reinsurance arrangement with National Indemnity Company ("NICO"), a wholly owned subsidiary of Berkshire Hathaway, Wesco's ultimate parent, whereby NICO retroceded to Wes-FIC 50% of certain personal lines reinsurance it had assumed. This arrangement was responsible for almost the entire $12.2 million of Wes-FIC's earned premiums for 1993. However, it terminated during 1993 because the original source of the reinsurance stopped making cessions to NICO.

In last year's annual report we informed shareholders that Wes-FIC planned, through reinsurance to be retroceded by Berkshire Hathaway, to enter the business of super-catastrophe ("super-cat") reinsurance in late 1993 or 1994. This would occur after Wes-FIC's net worth and claims-paying capacity had been greatly augmented by the proposed merger (which has now happened) of Wesco's former savings and loan subsidiary into Wes-FIC.

The super-cat reinsurance business then seemed a very logical business for Wes-FIC. After all, Wes-FIC would have 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 become 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.

Unfortunately, after issuance of Wesco's 1992 Annual Report, other reinsurers, as 1993 progressed, hurried more and more into the super-cat field. As a consequence, volumes of super-cat reinsurance business available to NICO at prices that seemed rational were greatly reduced.

Under such circumstances of shortage at NICO of acceptable super-cat business, we later told shareholders (in the third quarter report) that NICO would probably have no surplus super-cat reinsurance business to cede to Wes-FIC.

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

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

Given Berkshire Hathaway's unwillingness to make plain giveaways to Wes-FIC and the 1993 reductions in opportunities in the super-cat reinsurance market, it appeared until very recently that we were right in the 1993 third quarter report in projecting poor prospects over the near term for Wes-FIC's acquisition of retroceded super-cat reinsurance. But what are the predictions of man! In February 1994, Wes-FIC was offered by NICO participations in four *very* unusual super-cat reinsurance contracts. Considering its other exposures to the same risks, NICO was willing to retrocede to Wes-FIC 20% of what was then available to NICO under each contract in return for a ceding commission amounting to 3% of Wes-FIC's premiums to be received. The remaining 80% of the risk was to be retained by NICO. A little later, a fifth retrocession was offered: 10% of a one-year NICO property loss contract with a maximum loss amount of $50 million. The annual premium is 5% of the maximum possible loss.

Wes-FIC promptly accepted all of these five unusual super-cat reinsurance participations offered by NICO.

In the first four contracts, in aggregate, Wes-FIC thus became exposed, during a single year, to either winning about $4 million pre-tax or losing about $20 million pre-tax. In addition, there is some slight possibility of a huge "long tail" loss for Wes-FIC and NICO many years after the four contracts end, because a minority part of the insurance is liability insurance written on an "occurrence" basis. This is not the first time such "long tail" risks have been accepted by Wes-FIC. There are also, it should be remembered, possibilities for unpleasant surprises involving similar possible large "long tail" losses, many years hence, from Wes-FIC's long-terminated reinsurance arrangement with Fireman's Fund Group. Wes-FIC, now as then, is willing to run such "long tail" risks, carefully weighed against prospects for gain, provided it is much better capitalized than other insurance companies more influenced by animal spirits and institutional momentums.

In the fifth super-cat retrocession to Wes-FIC from NICO, which covers only property loss, there is no possibility of a surprising "long tail" loss. However, for the year covered, Wes-FIC has a very small chance of losing $5 million pre-tax, while it can gain only $250,000, less 3%, leaving Wes-FIC's net proceeds $242,500, pre-tax.

Needless to say, NICO does not believe that the average yearly loss to be expected from writing over many years a great series of super-cat reinsurance contracts like the five new ones it has retroceded in part to Wes-FIC would be as high as the one-year premiums to be received. But such super-cat reinsurance, like other super-cat reinsurance, is not for the faint of heart. A huge variation in annual results, with some *very* unpleasant years, 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 wholly owned 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" seller 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 significant 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 *acceptable* long-term results. We see no possibility for bonanza.

It should also be noted that Wes-FIC, in the arrangements recently made with NICO, receives a special business-acquisition advantage from using Berkshire Hathaway's better credit rating and general reputation. Under all the circumstances, a 3% ceding commission 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, an important word 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 Berkshire Hathaway insurance subsidiaries. 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, more or less as we have done here.

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 already proved poor prognosticators. We can only say that we hope so and that more reinsurance should come, albeit irregularly and with long intermissions, if buyers of super-cat coverage are rational.

We have also examined other possible insurance-writing opportunities, and even insurance company acquisitions, not involving Berkshire Hathaway.

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.

All Other "Normal" Net Operating Income

All other "normal" net operating income, net of interest paid and general corporate expenses, decreased to $3,301,000 in 1993 from $3,533,000 in 1992. Sources were (1) rents ($2,848,000 gross, excluding rent from Mutual Savings) from Wesco's Pasadena office property (predominantly leased to outsiders and with CENFED as the new ground floor tenant), (2) interest and dividends from cash equivalents and marketable securities held outside the savings and loan and insurance subsidiaries, and (3) results from New America Electrical Corporation until its disposition.

Net Gains on Sales of Securities

Wesco's aggregate net gains on sales of securities, combined, after income taxes, increased to $1,156,000 in 1993 from $147,000 in 1992.

Convertible Preferred Stockholdings

At the end of 1993, Wesco and its subsidiaries owned $135 million, at cost, in convertible preferred stocks, all requiring redemption at par value within ten years or so from date of acquisition:

Security	Preferred Dividend Rate	Par Value of Holding	Conversion Price at Which Par Value May Be Exchanged for Common Stock	Market Price Common Stock on 12/31/93
Salomon Inc	9.00%	$100 Million	$38.00	$47.63
USAir Group, Inc.	9.25%	12 Million	38.74	12.88
Champion International Corporation	9.25%	23 Million	38.00	33.38

These preferred stocks were purchased at the same time Wesco's parent corporation, Berkshire Hathaway, purchased additional amounts of the same stocks at the same price per share.

In previous years we described these convertible preferred stock investments as "sound but not exciting," noting that "few, if any, investors have ever prospered mightily from investing in convertible preferred stocks of leading corporations." Our ideas have not changed. But in aggregate our holdings at yearend 1993 were worth more than we paid for them. We estimate that (1) the $100 million Salomon holding was worth about 25% more than we paid for it, (2) the $12 million USAir holding was worth about 25% less than we paid for it, and (3) the $23 million Champion holding was worth about 5% more than we paid for it. These figures when combined created $23.1 million in net appreciation, before taxes, at the 1993 yearend.

New America Electrical Corporation ("New America Electric")

It was not just Wesco's savings and loan privileges that left our corporate fold in 1993. New America Electric, of which Wesco has owned about 80% since 1988, sold its business last year to a long-established and high-quality midwestern firm engaged in similar businesses. During 1993, Wesco's share of net loss was $192,000 for the six-month period preceding sale of the business, and Wesco realized an additional after-tax loss of $1.6 million ($.23 per Wesco share) on final disposition of its interest.

The sale decision was made entirely by Glen Mitchel, New America Electric's CEO and 20% owner, who did not wish to wait for an eventual upturn in commercial construction after years of enduring a worst-since-the-1930s business climate to which he had adjusted through several painful downsizings. The bad timing of Wesco in entering the electrical equipment field when it did was entirely the result of misjudgment by the writer, caused by a strong, near-lifelong preference for predicting relative consequences from business and human quality while not attempting to predict business cycles.

Considering the very hostile business climate we later encountered, New America Electric's business was always run extremely well by Glen Mitchel, and his dedication and skill prevented us from losing much more than we did. The writer caused Wesco's loss, not Glen Mitchel.

Consolidated Balance Sheet And Related Discussion

As indicated in the accompanying financial statements, Wesco increased its net worth, as accountants compute it under their conventions, from $411.7 million at yearend 1992 to $626.1 million at yearend 1993.

This increase in reported net worth happened only in very small measure ($13.0 million) because of retention of 1993 income after deduction of dividends paid. Virtually the entire balance of the 1993 net worth increase occurred through accounting quirk and without real economic import, because (1) before 1993 only unrealized appreciation in equity securities of the Wes-FIC insurance subsidiary, after provision for income taxes to become due if the securities were sold, was included in Wesco's reported consolidated net worth, leaving all other securities valued at cost, whereas (2) in 1993, due to changed notions in accounting, all of

Wesco's consolidated unrealized appreciation in equity securities was given the same accounting treatment formerly in place at the Wes-FIC insurance subsidiary.

Even after the new accounting notions were applied, the result at yearend 1993 still leaves out of Wesco's consolidated net worth of $626.1 million a residue of unrealized appreciation — in Wesco's consolidated holdings of non-equity securities. This residue of unrealized appreciation exists almost entirely in Wesco's convertible preferred stocks, and, after tax provision, amounted to about $15.2 million more.

If this additional $15.2 million were added to the $626.1 million of Wesco's consolidated net worth reported at yearend 1993, the resulting figure of $641.3 million, or about $90 per Wesco share, would give an approximation of Wesco's after-tax liquidation value at yearend 1993.

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

Of course, so long as Wesco does not liquidate, and does not sell any appreciated assets, it has, in effect, an interest-free "loan" from the government equal to its deferred income taxes on unrealized gains, subtracted in determining its net worth. This interest-free "loan" from the government is at this moment working for Wesco shareholders and amounted to about $24 per Wesco share at yearend 1993.

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 $24 per Wesco share. Instead, the present value of Wesco's shareholders' advantage must logically be much lower than $24 per Wesco share. In the writer's judgment, the value of Wesco's advantage from its temporary, interest-free "loan" was probably about $8 per Wesco share at yearend 1993.

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 $8 per Wesco share at yearend 1993, and after-tax liquidating value was then about $92 per share (figures that seem plenty high to the writer), Wesco's intrinsic value per share would become only about $100 per share at yearend 1993.

And, finally, this reasonable-to-this-writer, $100-per-share-figure for intrinsic per share value of Wesco stock should be compared with the $129.50 per share price at which Wesco stock was selling on December 31, 1993. This comparison indicates that Wesco stock was then selling about 30% above intrinsic value.

There are, to be sure, at least some circumstances where presence of some superior management in place at some corporation as large as Wesco would rationally justify an investor's payment of so large a premium over intrinsic value. It may even be remotely conceivable that the market's present implicit optimistic appraisal of Wesco's managerial quality will be justified by outcomes to follow. But it may also be that new buyers of Wesco stock are making a mistake similar to the one that would be made if the past performance of a very old NFL quarterback, including some performance that occurred long ago, was projected as likely to indicate long-term performance to come.

It has never been the writer's view that the unvarying duty of management is to whoop up the stock price. Instead, the duty is to "tell-it-like-it-is." Now, for some reason, perhaps the relative novelty of our approach, our "tell-it-like-it-is" attitude seems to be a contributing factor in pushing Wesco's stock price up — perhaps even higher than it would be if we followed the more normal whoop-it-up policy.

As part of a "tell-it-like-it-is" policy we now report that some recent Wesco stock-buying enthusiasm plainly has irrational roots. Indeed, some people have gone so far as to suggest that Wesco stock is a better buy than stock of Berkshire Hathaway because Wesco is smaller or because Wesco's stock price per share is lower. Such reasoning processes constitute arrant nonsense in method. Also nonsensical is the notion that business and human quality in place at Wesco is anywhere near 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 plainly provides much less intrinsic value than a similar dollar of book value at Berkshire Hathaway.

All that said, we make no attempt to appraise relative attractiveness for investment of Wesco vs Berkshire Hathaway stock at present stock-market quotations. Instead, we simply communicate, out of a feeling of duty, the writer's opinion that more caution is probably needed in some quarters as prospects for new buyers of Wesco stock are evaluated.

On January 26, 1994 Wesco increased its regular dividend from 23½ cents per share to 24½ cents per share, payable March 9, 1994, to shareholders of record as of the close of business on February 9, 1994.

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 23, 1994