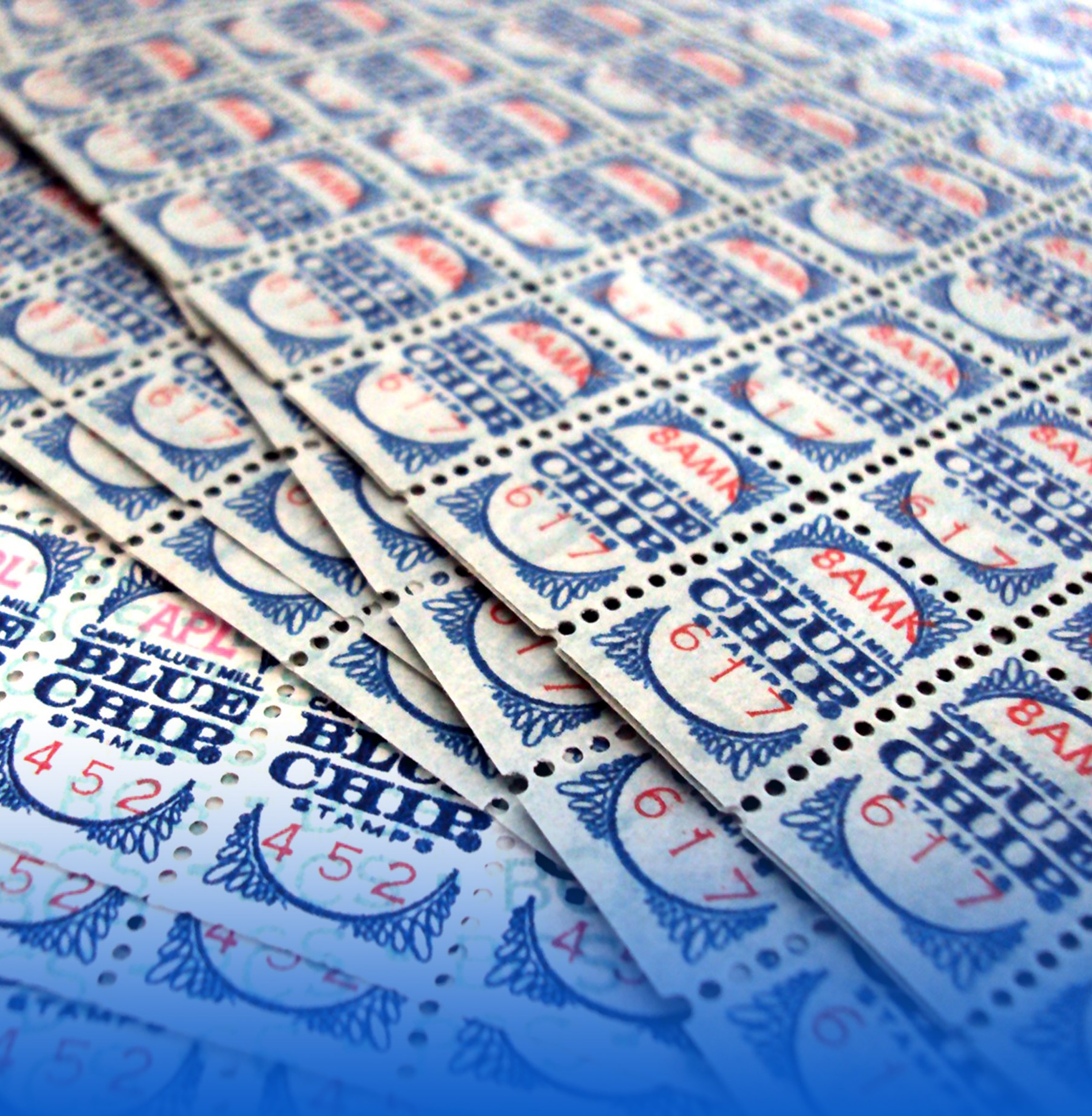

BLUE CHIP
STAMPS

1978-1982

Blue Chip Stamps

A case study of Warren Buffett and Charlie Munger's investment in and management of Blue Chip Stamps. Includes:

- Letters 1978-1982 (final letter before merger with Berkshire)
- Financials (https://docs.google.com/spreadsheets/d/1M_pui2-0EDdvo4ndIVbBJ-UrwpCQ9gpuo1dkP2WWWYo/edit?usp=sharing)

If you find any errors or have any other contributions, make a pull request or contact me through the Twitter handle @maxolson.

Contributors

- Max Olson (@maxolson)

To Our Stockholders

Consolidated normal operating income (i.e., before parent company gains from sale of securities) for the calendar year 1978 increased slightly, to $13,553,000 ($2.62 per share) from $12,893,000 ($2.49 per share) in the previous fiscal year.

Consolidated net income (i.e. , after parent company gains from sale of securities) decreased to $14,280,000 ($2.76 per share) from $16,993,000 ($3.28 per share) in the previous fiscal year.

Our constituent businesses produce fluctuating returns from normal operations as well as from gains or losses on sale of securities held to offset liabilities to trading stamp savers and others. Given this situation, our objective is to earn from all sources a fluctuating return on our shareholders' equity which amounts to a respectable average annual return over a period of years. Last year's total consolidated net income of $14,280,000 represented a return of 14.4% of our shareholders' equity of $99,251,000 at the start of the year. Over the last five years return on shareholders' equity has averaged 15%.

We have three major subsidiaries, See's Candy Shops, Incorporated (100% owned), Wesco Financial Corporation (80% owned) and Buffalo Evening News, Inc. (100% owned). If we used "equity accounting" instead of "consolidated accounting" for See's and the Buffalo Evening News as well as Wesco, our consolidated income for our two reporting years just ended would break down as follows:

Year ended about	Blue Chip equity in See's net income*1	Blue Chip equity in Wesco net income*2	Blue Chip equity in Buffalo Evening News net income (loss)*3	All other Blue Chip net income*4,5	Blue Chip consolidated net income*5
December 31, 1978	$5,802,000	$7,417,000	$(1,427,000)	$2,488,000	$14,280,000
Per Blue Chip share	1.12	1.43	(.27)	.48	2.76
December 31, 1977	5,750,000	5,715,000	340,000	5,188,000	16,993,000
Per Blue Chip share	1.11	1.10	.07	1.00	3.28

- 1 Afterreducing income by amortization· of intangibles arising from purchase of See's at a largepremium over its book value.
- 2 After increasing income by amortization of the discount from Wesco book value at which the interest was acquired.
- 3 After reducing income by amortization of relatively minOr intangibles arising at acquisition of the newspaper in April 1977;
- 4 After deduction of interest and other general corporate expenses. In each year there was an operating loss before securities transactions and before.crediting income for (i) interest and dividends resulting from investment of the funds available through "float" caused by trading stamps issued but not yet redeemed, plus (ii) income tax benefit caused by 85% exclusion of dividends in computing federal income taxes.
- 5 The 1978 amounts include $727,000 or $.14 per Blue Chip share from securities gains, net of taxes. In 1977 such securities gains were $4,100,000 or $.79 per Blue Chip share.

SEE'S CANDY SHOPS, INCORPORATED

By a razor-thin margin, our 100%-owned subsidiary, See's Candy Shops, Incorporated, had another record year under the skilled leadership of Charles Huggins. The nominal percentage gain in earnings (less than 1%) was much lower than the percentage gain in sales (17%). Comparative figures for See's for the last two years are set forth below:

Year ended about	Sales	Profits after taxes*	Number of pounds of candy sold	Number of stores open at yearend
December 31,				

1978	$73,653,000	$6,289,000	22,407,000	182
December 31, 1977	62,888,000	6,262,000	20,921,000	179

- These earnings figures are a little higher than Blue Chip Stamps' share of See's earnings shown in the table above because Blue Chip's share reflects (i) deduction of the approximately 1% share of See's earnings owned by minority stockholders of See's prior to June 6, 1978. (ii) amortization of intangibles arising from purchase of See's stock at a large premiumoverqook value, and (iii) state income taxes on See's dividends received by Blue Chip.

Boxed chocolate consumption' per capita in the United States continues to be essentially static, and the candy-store business has been subject to extraordinary cost pressure. Despite substantial increases in See's retail prices, its profits lagged substantially below year-earlier levels until December when an extraordinary burst of holiday-period sales caused the lag to be eliminated. It is very difficult to cope so successfully with the production and distribution problems ofa seasonal sales peak which becomes more extreme each year, and the flat earnings trend of 1978 represented outstanding managerial achievement. So far as we know the candy-store business is terrible to mediocre for all other companies, whereas it is quite profitable at See's for the simple reason that both new and old customers have a pronounced tendency to prefer its candy to all others. This customer enthusiasmis caused by a virtually fanatic insistence on expensive natural candy ingredients plus expensive manufacturing and distributing methods ensuring rigorous quality control and cheerful retail service. The fanaticism is rewarded by extraordinary sales per square foot in the stores. We greatly admire See's business methods, which have not been changed in any significant way in the seven years of our ownership. Our main managerial contribution has been to leave See's alone as its proven executives pursued its proven policies. In 1978 we paid $55 per See's share to acquire a tiny minority interest in See's. If our previously owned 99% interest in See's were valued at the same price per share, such interest would have had a total value at that time approximately $25 million more than its aggregate amortized cost in our consolidated financial statements.

WESCO FINANCIAL CORPORATION

Our equity in net income of our subsidiary, Wesco Financial Corporation (80% owned) increased to $7,417,000, a new record, compared with $5,715,000 in the previous year. The substantial improvement in Wesco's contribution was caused primarily by increased operating earnings in Wesco's savings and loan association subsidiary, Mutual Savings, headquartered in Pasadena, California. Conditions in 1978 generally favored savings and loan associations, and Mutual Savings is soundly capitalized and efficient. Wesco is a separate public corporation, with its stock listed on the American Stock Exchange. Summarized financial information for Wesco is contained in Note 1 to our consolidated financial statements and includes an exceptionally strong balance sheet, partly caused by substantial assets outside the subsidiary savings and loan association and available for commitment elsewhere. In February, 1979, Wesco purchased for approximately $15 million a midwestern steel service center business which reported after-tax earnings of $1,918,000 in the full year ended June 30, 1978. For more complete information we encourage Blue Chip shareholders to obtain a copy of Wesco's 1978 Annual Report, which embodies an unusual clarity of reporting and reflects an excellence of management—both directly attributable to Louis Vincenti, Chairman. Simply make your request to:

Wesco Financial Corporation
315 East Colorado Boulevard
Pasadena, California 91109
Attention: Mrs. Bette Deckard, Secretary & Treasurer

BUFFALO EVENING NEWS, INC.

Our 100%-owned subsidiary, Buffalo Evening News, Inc., was acquired in April of 1977 for approximately $34 million and reported, after litigaiton expenses stemming from equipment modernization, an after-tax operating loss of $1,427,000 in 1978, compared with net income of $340,000 in the portion of the previous year subsequent to acquisition.

The Buffalo Evening News had no Sunday edition when acquired; a competing paper published without opposition on Sundays. As we explained in detail in our Annual Report last year, the long-term survival or the Buffalo Evening News clearly required that it inaugurate a Sunday edition. (Real trouble has been the invariable eventual outcome for every other daily newspaper in the United States which relied overlong, in an important city, exclusively on weekday publication while a significant daily competitor enjoyed a Sunday monopoly.) Accordingly, the Buffalo Evening News commenced publishing Sundays late in 1977. In response, a lawsuit was the competing paper which for the first time faced the prospect of competition on Sundays as well as weekdays. The lawsuit, in turn, resulted in some interlocutory (i.e., temporary and not final) injunctions (now on appeal) which, among other things, created severe disruptions in normal circulation procedures under midwinter conditions and restricted business promotion practices of our subsidiary's paper while similar but more aggressive practices of the competing paper were allowed. Despite all the difficulties; the new Sunday edition now has a steady circulation of about 156,000, up slightly in recent months. The litigation has continued through 1978, including a counter-complaint by our subsidiary as well as defense against the competing paper's complaint, causing heavy direct litigation expense and other indirect costs. Affected by these factors, plus an unanticipated decrease in weekday circulation and advertising linage (now apparently arrested), operating results at our Buffalo newspaper have, of course, been unsatisfactory.

We anticipate better operating results in the future, although we also expect that improvement in our subsidiary's competitive position in Buffalo will, at best, be extremely slow and that operating results will continue to bear heavy charges for direct and indirect expense of litigation. Newspaper readership habits ordinarily change slowly, if at all, and litigation is notoriously time-consuming, inefficient, costly and unpredictable.

The ultimate security of the Buffalo Evening News remains indoubt, as it will for a very extended period. We purchased a newspaper subject not only to the normal hazards of business competition but also to the hazards of the modern tendency of competitors to seek protection from competition In the courts.

We believe that the Buffalo Evening News remains by far the most respected newspaper in Buffalo, with a tradition of editorial objectibity and integrity and good citizenship, the result of editorial control by autonomous, community-minded local editors. We have maintained and will continue to maintain this tradition of locally-created excellence, as well as an equally important tradition of fair-dealing with all newspaper employees and unions, who have performed loyally and well to help protect our common enterprise under difficult conditions. We expect that our policies eventually will cause our newspaper subsidiary to develop into a more satisfactory investment. But a long and prosperous future is not guaranteed. If the competing paper succeeds in obtaining the kind of permanent injunctions ot is seeking, or if any extended strike shuts down the Buffalo Evening News, we believe that it will probably be forced to cease operations and liquidate, at an after-tax cost which could exceed $10 million.

TRADING STAMP AND MOTIVATION BUSINESSES

The final componenets of our consolidated new income last year were provided by our trading stamp and motivation businesses. These businesses use the same headquarters and warehousing facilities. Combined, the businesses operated at a decreased profit last year (down from $5,188,000 to $2,488,000) after (properly) giving them credit for the entire income (interest and dividends, plus income tax benefits caused by dividends, plus securities gains) from investment of the funds available through "float" caused by trading stamps issued but not yet redeemed. However, the decrease in profit was entirely attributable to a decline in securities gains from the unusully high level of 1977. Profit before securities gains increased from $1,088,000 to $1,761,000.

Trading stamp service revenues increased by a minor amount to $16,531,000 last year compared with $15,723,000 in the previous year. Motivation business revenues increased substantially, from $2,485,000 to $3,791,000.

In our trading stamp business our "float"—resulting from past issuances of trading stamps when volume was many times greater than the current level—is large in relation to current issuances. (Trading stamp revenues peaked at $124,180,000 in fiscal 1970, and our 1978 revenues of $16,531,000 therefore represented a decline of 87% from peak volume.) Eventually, unless stamp issuances improve, earning from investing "float" will decline greatly. The decline in recent years, however, has proceeded at an extremely slow rate, and our estimated future redemption liability actually increased by a tiny amount in 1978 and was $66,832,000 at yearend.

As discussed extensively in previous annual reports (particularly for fiscal 1976), which we urge shareholders to review, accounting for trading stamp redemption liability (which involves estimating the number of stamps that will ultimately be redeemed and the cost per stamp) is a difficult process under any circumstances, but particularly so in an inflationary economy and when stamp issuances decline by a large percentage. We periodically revise our estimated future redemption liability as conditions warrant.

We intend to remain in the trading stamp business. Many of our present customers, aided by our stamp service, operated unsually successful supermarkers and other businesses, and we believe that, given the opportunity, we can also provide very useful service to new customers.

PINKERTON'S, INC.

At yearend 1978 we owned non-voting stock representing 32% of the equity in Pinkerton's, Inc., the leading national security and investigation service company. Our total investment at cost was $32,364,000.

CONSOLIDATED BALANCE SHEET AND OTHER DATA

Our consolidated balance sheet retains a strength befitting a company whose consolidated net worth supports large outstanding promises to others. As explained in Note 4 to the accompanying financial statements, the aggregate market value of our marketable securities is slightly lower than their aggregate cost.

A section entitled "Principle Business Activities" and "Summary of Operations" for a five year period are presented beginning on page 4, followed by notes and management's discussion and analysis of the summary. We invite your careful attention to those items and to our audited financial statements.

Cordially yours,

Charles T. Munger, Chairman of the Board
Donald A. Koeppel, President

February 28, 1979

To Our Stockholders

Consolidated normal operating income (i.e., before gains from sale of securities held outside our savings and loan subsidiary) for the calendar year 1979 increased slightly, to $14,303,000 ($2.76 per share) from $13,553,000 ($2.62 per share) in the previous fiscal year.

Consolidated net income (i.e., after gains from sale of securities held outside our savings and loan subsidiary) also increased slightly, to $15,526,000 ($3.00 per share) from $14,280,000 ($2.76 per share) in the previous year.

Earnings last year were assisted by our acquisition on February 28, 1979, of a new 80%-owned subsidiary, Precision Steel Warehouse, Inc., and also by increased earnings of Mutual Savings, our 80%-owned savings and loan subsidiary. Both of these subsidiaries are wholly owned by our 80%-owned Wesco Financial Corporation subsidiary. Gains from these sources were partially offset by increased losses at our 100%-owned Buffalo Evening News subsidiary.

The Precision Steel acquisition last year has required changes in the way we present financial data. We now consolidate everything except the savings and loan subsidiary, Mutual Savings, which we continue to include on an equity basis. Formerly, all the consolidated accounts of Wesco Financial Corporation, including those dealing with assets and earnings outside Mutual Savings, were included on an equity basis. In this report, 1978 figures have been restated slightly to conform to the new presentation, with no effect on net income or retained earnings.

We have four major subsidiaries, See's Candy Shops, Incorporated (100%-owned), Mutual Savings (80%-owned), Precision Steel (80%-owned), and Buffalo Evening News, Inc. (100%-owned). If we used equity accounting instead of consolidated accounting for See's, Precision Steel's operating business, and the Buffalo Evening News as well as Mutual Savings, our consolidated income for our two reporting years just ended would break down as follows (in 000s except for per-share amounts):

Blue Chip's equity in net income (loss) of:

Year ended about	See's*1	Mutual Savings*2	Steel Business	Buffalo Evening News*3	All other net income*4,5	Blue Chip consolidated net income*5
December 31, 1979	$5,997	$6,795	$1,367	$(2,410)	$3,777	$15,526
Per Blue Chip share	1.16	1.31	.26	(.46)	.73	3.00
December 31, 1978	5,802	6,482	--	(1,427)	3,423	14,280
Per Blue Chip share	1.12	1.25	--	(.27)	.66	

- 1 After reducing income by amortization of intangibles arising from purchase of See's at a large premium over its book value
- 2 After increasing income by amortization of the discount from Mutual book value at which the interest was acquired.
- 3 After reducing income by amortization of relatively minor intangibles arising at acquisition of the newspaper in 1977.
- 4 After deduction of interest and other corporate expenses. In each year there was an operating loss from promotional services activities before residual consolidated net income was credited with (i) dividends and interest resulting from investment of the funds available through "float" caused by trading stamps issued but not yet redeemed, plus (ii) income tax benefit caused by 85% exclusion of dividends in computing federal income taxes, plus (iii) Blue Chip's share of dividends, interest and rent from securities and real estate held by the Wesco Financial Corporation group outside its saVings and loan and steel service activities, plus (iv) securities gains, net of minority interest.
- 5 The 1979 amounts include $1,223 or $.24 per Blue Chip share from securities gains, net of taxes and minority interest. In 1978 such securities gains were $727 or $.14 per Blue Chip share.

The foregoing breakdown differs somewhat from that required by the accounting conventions which govern presentation of financial results in our audited financial statements contained elsewhere in this report. We have taken the pains to prepare it, and to furnish it in this letter, because we believe it better explains what is really happening than does our consolidated income statement in conventional form. Generally, we are trying to disclose the things we like to be told, in the form we prefer, when roles are reversed and we are passive investors.

SEE'S CANDY SHOPS, INCORPORATED

The pre-tax earnings of our 100%-owned subsidiary, See's Candy Shops, Incorporated, declined slightly last year. However, a lower income tax rate allowed a nominal percentage gain in after-tax earnings (about 3%). This result was disappointing in view of the substantial percentage gain in sales (about 19%). Comparative figures for See's for the last two years are set forth below:

Year ended about	Sales	Profits after taxes*	Number of pounds of candy sold	Number of stores open at yearend
December 31, 1979	$87,314,000	$6,473,000	23,985,000	188
December 31, 1978	73,653,000	6,289,000	22,407,000	182

- These earnings figures are a little higher than Blue Chip Stamps' share of See's earnings shown in the table above because Blue Chip's share reflects (i) deduction of the approximately 1% share of See's earnings owned by minority stockholders of See's prior to June 6, 1978, (ii) amortization of intangibles arising from purchase of See's stock at a large premium over book value. and (iii) state income taxes on See's dividends received by Blue Chip.

Boxed chocolate consumption per capita in the United States continues to be essentially static, and the candy-store business remains subject to extraordinary cost pressure. It is very difficult for See's to cope as successfully as it does with the production and distribution problems of a business with a seasonal sales peak that becomes more extreme each year, and the flat earnings trend of the last two years has not diminished our confidence in See's management, including its outstanding leader, Charles Huggins. So far as we know the candy-store business continues to be terrible to mediocre for all other companies, yet it remains quite profitable at See's for the simple reason that both new and old customers have a pronounced tendency to prefer the taste and texture of its candy, as well as the extremely high level of retailing service which characterizes its distribution. This customer enthusiasm is caused by a virtually fanatic insistence on expensive natural candy ingredients plus expensive manufacturing and distributing methods that insure rigorous quality control and cheerful retail service. These qualities are rewarded by extraordinary sales per square foot in the stores, frequently two to three times those of competitors, and by a preference by gift recipients for See's chocolates, even when measured against much more expensive brands.

In 1978 we paid $55 per See's share to acquire a tiny minority interest in See's. If our previously owned 99% interest in See's were valued at the same price per share, such interest at that time would have had a total value approximately $25 million more than its aggregate amortized cost in our consolidated financial statements.

Our best guess is that See's earnings will increase at least modestly in 1980, because of forward contracts covering most candy ingredients at fixed prices which are now below market.

MUTUAL SAVINGS AND LOAN ASSOCIATION

Our equity in net income of our 80%-owned subsidiary, Mutual Savings, increased to $6,795,000, a new record, compared with $6,482,000 in the previous year.

However, prospects for 1980 appear poor. The entire saVings and loan industry is now required to pay much higher interest rates to hold saVings accounts while assets consist primarily of low-turnover portfolios of long-term mortgages at fixed or slowly changing rates below current market. Thus our best guess is that Mutual Savings' earnings will decline sharply from the record level of 1979.

Louis Vincenti, a chief executive well past normal retirement age, has guided Mutual Savings very skillfully for many years—both before and after we acquired it—not always along the standard course chosen by others in his industry. Deviations have been toward low costs, low credit losses and high ratios of capital compared to liabilities, while net worth has grown greatly during his tenure. Under Mr. Vincenti's mix of caution and innovation we expect Mutual Savings to continue to cope well with all challenges, including the difficulties we expect in 1980.

On March 25, 1980, just as this report and letter were going to press, Mutual Savings executed a contract with Brentwood Savings and Loan Association, a subsidiary of Jim Walter Corporation, providing for sale of all Mutual's offices except its headquarters office and a satellite thereto to be opened across the street. Closing of the contract is subject to regulatory approval. Under the terms of the contract Mutual Savings will transfer net branch office deposits (about $300,000,000), together with offsetting mortgage loans in equal amounts, and will also sell physical facilities A pre-tax gain of about $5,000,000 will be realized on the sale of physical facilities, but mortgage loans transferred will bear a higher interest rate than mortgage loans retained. It is anticipated that, after the closing: (a) a higher percentage of Mutual's total assets will consist of cash and equivalents, (b) average yield on Mutual's mortgage loans will decline significantly, and (c) Mutual's overall financial leverage will be lowered. Before or after the closing, adjustments in Mutual Savings' investments may be made, causing losses which offset part or all of any taxable profit from sale of branches; however, we do not have present plans for any such transactions. Whether, because of this sale, future earnings will be higher or lower than they otherwise would have been will depend on factors impossible now to predict, including future interest rates and future changes in laws and regulations affecting savings institutions. The proposed sale reflects a desire to restructure operations of Mutual Savings, which will continue in the savings and loan business.

PRECISION STEEL WAREHOUSE, INC.

Our 80%-owned Precision Steel subsidiary, located in the outskirts of Chicago at Franklin Park, Illinois, was acquired for approximately $15 million on February 28, 1979. It owns a long-established steel service center business and a subsidiary engaged in distribution of tool room supplies and other products sold under its own brand names. Precision Steel's operating businesses contributed $1,367,000 to our consolidated net income in 1979, on combined sales of $37,510,000, in the 10 months of our ownership. Precision Steel is led by David Hillstrom, a chief executive who has served the company for almost 30 years.

A steel service center business may strike some of our shareholders as a peculiar addition to a candy company, even one already joined to a savings and loan business. However, Precision Steel shares an extremely important quality with See's: a company-wide culture of constant concern for customer interests and fair dealing. We believe such quality, if maintained, in a business with at least reasonably attractive economic characteristics, will almost always produce good long-term business results and, accordingly, are optimistic about the future of our new subsidiary.

Both Mutual Savings and Precision Steel are owned by Blue Chip Stamps through 80% control of Wesco Financial Corporation, a public company with shares traded on the American Stock Exchange. For more complete information, we encourage Blue Chip shareholders to obtain a copy of Wesco's 1979 annual report. Simply make your request to:

Wesco Financial Corporation
315 East Colorado Boulevard
Pasadena, California 91109
Attention: Mrs. Bette Deckard, Secretary & Treasurer

BUFFALO EVENING NEWS, INC.

Our 100%-owned subsidiary, Buffalo Evening News, Inc., was acquired in April 1977 for approximately $34 million. Its reported financial results continue to be adversely affected by litigation expenses, increased depreciation and extraordinary expenses of "buy-outs" from labor contract provisions made in order to allow the News to benefit from equipment modernization. So affected, the after-tax operating loss was $2,410,000 in 1979, compared with a lower after-tax operating loss of $1,427,000 in the previous year.

However, some developments were quite favorable: (1) The position of the News in pending litigation with a daily newspaper competitor was supported by a unanimous and strongly worded decision of the Federal Court of Appeals in New York, reversing interlocutory injunctions which had interfered greatly with normal competitive operation of the News; (2) Circulation of the Sunday edition of the News has been rising steadily; (3) The "buy-outs" of labor contract provisions made in 1979 are expected to cause substantial cost reductions in following years; and (4) The owners of the competing Buffalo newspaper, who were responsible for commencing the pending litigation, sold their newspaper to the Minneapolis Star and Tribune Company, which shortly thereafter raised advertising rates by about 10%, thus reducing the pricing pressure applied by the previous owners who made a practice, after initiation of the News' Sunday edition, of increasing advertising rates by amounts far below inflation rates.

We now believe that the worst may be behind us in Buffalo, but we retell and extend the history so that shareholders can make their own judgments.

The News had no Sunday edition when acquired. The principal competitor, the Buffalo Courier-Express, published without opposition on Sundays. As we explained in detail in our 1977 and 1978 annual reports, the long-term survival of the News clearly required that it inaugurate a Sunday edition. (Of that there was simply no question. Real trouble has been the invariable eventual outcome for every other daily newspaper in the United States which relied overlong, in an important city, exclusively on weekday publication while a significant seven-day competitor enjoyed a Sunday monopoly. In fact, only three other "no-Sunday" papers, competing against such "with-Sunday" papers in important cities, survived as late as 1977, even though many such "no-Sunday" papers once had long histories of profitability derived from dramatic advantages in weekday circulation and advertising over their "with-Sunday" competitors. And since then one of the three survivors, the Cincinnati Post, has been preserved, after incurring huge losses, only through the grace of its competitor's absorbing it into a joint operation with approval of the U. S. Attorney General as required by the Federal Newspaper Preservation Act of 1970. Unless similar government-blessed joint operations occur, the other two surviving "no-Sunday" papers, the Cleveland Press and the New York Post. now appear almost surely doomed by apparently irreversible operating losses.) Under such circumstances, the News commenced publishing Sundays late in 1977, as it plainly had to do if it cared at all about its long-term future. In response, an antitrust lawsuit was filed by the competing paper which for the first time faced the prospect of competition on Sundays as well as weekdays. The lawsuit, in turn, resulted in some interlocutory (i.e., temporary and not final) injunctions which, among other things, created severe disruptions in normal circulation procedures under midwinter conditions and restricted certain business promotion practices of the News, commonplace within the newspaper industry, while similar but more aggressive practices of the competing paper were not prohibited. As above set forth, these interlocutory injunctions were reversed on appeal in 1979.

In its unanimous decision for reversal of the injunctions, the Federal Court of Appeals reasoned that the generally pro-competitive antitrust laws should not be used in an anti-competitive fashion by enjoining normal promotional practices, such as those used by the News, in the course of normal competition such as inauguration of a Sunday edition.

Of course, elimination of the harmful interlocutory injunctions does not automatically improve circulation and advertising lineage of the News' Sunday edition. Success in the market has to be won slowly, if it can be won at all, through creating a desirable value for customers. Moreover, achieving success has been made more difficult by the fact that it was beyond the power of the appellate court to reverse certain material damages to the News caused by the interlocutory injunctions and accompanying publicity. But some success is occurring despite the damaged beginning. The News' Sunday edition is now being recognized by subscribers for editorial merit and is being rewarded by a steady circulation growth, tending to close the lead enjoyed by the Sunday Courier-Express. Great credit must be given to Murray Light, Editor of the News, for consistent delivery of a product which deserves and has received increased acceptance by the Greater Buffalo community. The circulation of the News' Sunday edition reached approximately 173,000 copies in February, 1980, up from approximately 156,000 copies in February, 1979, with strength accelerating throughout the period. On weekdays circulation has also increased, and the weekday News continues to be greatly preferred to the weekday Courier-Express by both readers and advertisers.

Meanwhile, notwithstanding the decision in favor of the News by the Federal Court of Appeals, pre-trial proceedings in the ligitation with the Courier-Express have continued under supervision of the trial court through 1979, including discovery proceedings related to both a counterclaim by our subsidiary and a number of defenses against the competing paper's complaint, causing heavy direct litigation expenses and other indirect costs and detriments. Influenced by these factors, operating results at our Buffalo newspaper quite naturally remained unsatisfactory in 1979.

And even though signs are quite encouraging, causing us to anticipate better operating results in the future, the ultimate security of the Buffalo Evening News remains in doubt, as it will for a very extended period.

The evidence seems clear that the Buffalo Evening News is by far the most respected newspaper in Buffalo, with a tradition of editorial objectivity and integrity and good citizenship, the result of editorial control of autonomous, community-minded local editors. We have maintained and will continue to maintain this tradition of locally created excellence, as well as an equally important tradition of fair dealing with all newspaper employees and unions, who have performed loyally and well to help protect our common enterprise under difficult conditions. But even with such policies and position a long and prosperous future is not guaranteed. If the litigation continues and if the competing paper succeeds in somehow changing the law as enunciated by the Federal Court of Appeals and in obtaining the kinds of injunctions it is seeking, or if any extended strike shuts down the Buffalo Evening News, it will probably be forced to cease operations and liquidate, at an after-tax cost which could exceed $10 million. We don't think either of the possible causes for permanent closedown is likely to occur but believe our shareholders should be made aware of the hazard.

And as the hazard recedes, it should be emphasized that the News remains a valuable asset, with journalistic habits which should serve it well in the continuing competition.

Under its long-time editor, Alfred H. Kirchhofer, who still comes to the News every day at age 87, the paper developed many desirable practices, large and small, which contribute to our optimism. For instance, it became well known among journalists for the intensity with which'it insisted that names, including middle initials, always be exactly correct in News' stories. "If you don't get the reader's own name right," asked Kirchhofer, "why should he believe you are correct in whatever else you report?" It is said that an institution is often the lengthened shadow of a single man. That seems to be true at the News where we regard Murray Light as a fit successor to Kirchhofer, preserving his basic value system while continuing to improve the paper.

At Blue Chip Stamps we are in part engaged in the business of trying to invest in the lengthened shadows of the right sort of people. We think we did so in Buffalo and that better financial results will probably be obtained in due course as we earn such results through nurture of a type of accurate, reader-oriented journalism unlikely to go out of style.

We do find quite irritating one aspect of the situation in Buffalo. Possibly because of the recent sale of the competing paper by its former owners and because our distaste for operating losses is so obvious to all observers, we are plagued by occasional rumors that we intend to sell the Buffalo Evening News. We do not intend to sell and will not sell. Our policy is to improve and hold.

PROMOTIONAL SERVICES BUSINESS AND OTHER INCOME

The final components of our consolidated net income last year were provided by (1) earnings from our promotional services (mainly trading stamp and motivation) business, after deduction of interest and other general parent company expense, plus (2) our share of earnings, after deduction of interest and other Wesco general corporate expense, from securities and real estate held by Wesco outside the savings and loan and steel service activities of its subsidiaries.

The promotional services business operated at a slightly decreased profit, after parent company interest and other general expense and taxes, last year, down from $2,488,000 to $2,392,000, after (properly) giving it credit for the entire income (dividends and interest, plus income tax benefits caused by dividends, plus securities gains) from investment of the funds available through "float" caused by trading stamps issued but not yet redeemed. The decrease in profit was attributable to increased interest expense.

Trading stamp service revenues decreased by a minor amount to $15,967,000 last year compared with $16,531,000 in the previous year. Motivation business revenues decreased substantially from $3,791,000 to $2,310,000.

In our trading stamp business our "float"—resulting from past issuance of trading stamps when volume was many times greater than the current level—is large in relation to current issuances. (Trading stamp revenues peaked at $124,180,000 in fiscal 1970, and our 1979 revenues of $15,967,000 therefore represented a decline of 87% from peak volume.) Eventually, unless stamp issuances improve, earnings from investing "float" will decline greatly. The decline in recent years, however, has proceeded at an extremely slow rate, and our estimated future redemption liability actually increased by a tiny amount in 1979, as it also did in the previous year, and was $67,524,000 at yearend 1979.

As discussed extensively in previous annual reports (particularly for fiscal 1976), which we urge shareholders to review, accounting for trading stamp redemption liability (Which involves estimating the number of stamps that will ultimately be redeemed and the cost per stamp) is a difficult process under any circumstances, but particularly so in an inflationary economy and when stamp issuances decline by a large percentage. We periodically revise our estimated future redemption liability as conditions warrant.

We intend to remain in the trading stamp business. Many of our present customers, aided by our stamp service, operate unusually successful supermarkets and other businesses, and we believe that, given the opportunity, we can also provide very useful service to new customers.

One final item augments our consolidated net income. Our share of earnings, including securities gains but after deduction of interest and other Wesco general corporate expense, from securities and real estate held by Wesco outside the savings and loan and steel service activities of its subsidiaries. amounted to $1,385,000 in 1979, compared with $935,000 in the previous year.

PINKERTON'S, INC.

At yearend 1979 we owned non-voting stock representing 34% of the equity in Pinkerton's, Inc., the leading national security and investigation service company. Our total investment at cost was $23,364,000. Only the dividends we receive from Pinkerton's are included in our reported income.

CONSOLIDATED BALANCE SHEET AND OTHER DATA

Our consolidated balance sheet retains a strength befitting a company whose consolidated net worth supports large outstanding promises to others. As explained in Note 4 to the accompanying financial statements, the aggregate market value of our marketable securities was higher than their aggregate cost at December 29, 1979 and approximately equal to such cost at March 17, 1980.

We did add $25,000,000 in long-term debt to our consolidated balance sheet last year, representing 12-year 10 1/8% notes sold in a public issue by our 80%-owned Wesco Financial Corporation subsidiary to pay for the Precision Steel acquisition and in anticipation of other needs. However, even after this issue of long-term notes, we remain in a conservative position when total debt is compared to total net worth and total liquid assets.

A section entitled "Principal Business Activities" and a "Summary of Operations" for a five-year period are presented beginning on page 7, followed by notes and management's discussion and analysis of the summary. We invite your careful attention to those items and to our audited financial statements.

A LOOK BACK AND A LOOK AHEAD

We began the last decade with a single business, trading stamps, which was destined to decline by 87%, and a portfolio of securities, offsetting stamp redemption liabilities, which had been selected by previous owners and would have created a perfect disaster if held through to the present time. (The portfolio, for instance, contained a substantial amount of very-long-term, low-coupon municipal bonds of issuers with declining credit ratings.) Starting with this shaky foundation, the Company has managed to earn an average, although fluctuating, return of about 15% per annum on its stockholders' equity over the years. The 15% return, while not outstanding, is respectable when achieved with a balance sheet position as conservative as ours and from such a poor starting position.

So far, the 1980s appear likely to present at least as many challenges as the 1970s, but we expect to use our balance sheet strength over the next 10 years, as we did in the last 10 years, to acquire additional businesses, and we hope to earn, on average, an even higher percentage return on our shareholders' investment. One cause of our hope for a higher return is our recognition of how many mistakes we made in the course of earning 15% on equity in the decade just past. There is plenty of room for improved decision-making, and we intend to improve if we can.

However, if the present inflation continues at double-digit rates through the 1980s, real investment returns for our shareholders may well be disappointing, even if we rank well among American corporations in terms of annual earnings expressed as a percentage of shareholders' equity. A 16% return on equity, for instance, obviously won't do much in real terms for shareholders if the inflation rate is 16%, or even 11% when we also allow for income taxes imposed on owners who must report taxable "profits" while only maintaining their position on the purchasing-power treadmill. We remind shareholders of this truism because we want them to know that we are not deluded by historically satisfactory numbers into believing all is well for them. It seems likely to us that a habit of always thinking about shareholders' interests in real terms may ultimately create some sort of plus factor in our stewardship.

Cordially yours,

Charles T. Munger, Chairman of the Board

Donald A. Koeppel, President

March 25, 1980

To Our Stockholders

Consolidated operating income (i.e., before all net gains from sales of corporate securities and important fixed assets) for the calendar year 1980 increased to $16,564,000 ($3.20 per share)from $14,312,000 ($2.76 per share) in the previous year.

Consolidated net income (i.e., after net gains from sale of corporate securities and important fixed assets) increased to $20,389,000 ($3.94 per share) from $15,526,000 ($3.00 per share) in the previous year.

We have four major subsidiaries, See's Candy Shops, Incorporated (100%-owned), Mutual Savings (80%-owned), Precision Steel (80%-owned), and Buffalo Evening News, Inc. (100%-owned), in addition to the basic business (primarily trading stamps) operated by the parent company. Our consolidated income for our two reporting years just ended breaks down as follows (in 000s except for per-share amounts):

Year ended about	See's*1	Mutual Savings*2	Steel Business	Buffalo Evening News*3	All other net income*4	Net gains on sales of securities & fixed assets*5	Blue Chip consolidated net income
December 31, 1980	$7,270	$4,181	$1,205	$(1,472)	$5,380	$3,825	$20,389
Per Blue Chip share	1.40	.81	.23	(.28)	1.04	.74	3.94
December 31, 1979	5,997	6,804	1,367	(2,410)	2,554	1,214	$15,526
Per Blue Chip share	1.16	1.31	.26	(.46)	.49	.24	3.00

- 1 After reducing income by amortization of intangibles arising from purchase of See's at alarge premium over its book value.
- 2 After increasing income by amortization of the discount from Mutual book value at which the interest was acquired.
- 3 After reducing income by amortization of relatively minor intangibles arising at acquisition of the newspaper.
- 4 After deduction of interest and other corporate expenses. In each year there was an operating loss from promotional services activities before residual consolidated net income was credited with (i) dividends and interest resulting from investment of the funds available through "float" caused by trading stamps issued but not yet redeemed, plus (ii) income tax benefit caused by 85% exclusion of dividends in computing federal income taxes, plus (iii) Blue Chip's share of dividends. interest and rent from securities and real estate held by the Wesco Financial Corporation group outside its savings and loan and steel service activities, plus (iv) in 1980 a net adjustment of Blue Chip's stamp liability account in the amount of $1,747 or $.34 per Blue Chip share, net of taxes, as explained below under "Promotional Services Business and Miscellaneous Sources of Operating Income."
- 5 The 1980 figures comprise $2,332 or $.45 per Blue Chip share attributable to Mutual's sale of 15 branch offices, as explained below under "Mutual Savings and Loan Association," and $1,493 or $.29 per Blue Chip share of net securities gains realized by the various entities including Mutual, net of taxes and minority interest. The 1979 figures relate solely to such net securities gains.

The foregoing breakdown (of the same aggregate earnings) differs somewhat from that used in (1) our letter to shareholders last year, and (2) our audited financial statements.

We have taken the pains to prepare our unconventional breakdown of earnings and to furnish it in this letter because we belleve it better explalns what is really happening than does our accompanying consolidated income statement in conventional form. Generally, we are trying to improve our annual letter to shareholders each year so as better to disclose the things we would want to be told if the roles were reversed and we were passive investors.

SEE'S CANDY SHOPS, INCORPORATED

The earnings of our 100%-owned subsidiary, See's Candy Shops, Incorporated, increased 19.7% last year. This was a welcome change from nominal increases in earnings which occurred in the two previous years. Comparative figures for See's last four years are set forth below:

Year ended about	Sales	Profits after taxes*	Number of pounds of candy sold	Number of stores open at yearend
December 31, 1980	$97,715,000	$7,747,000	24,065,000	191
December 31, 1979	87,314,000	$6,473,000	23,985,000	188
December 31, 1978	73,653,000	6,289,000	22,407,000	182

- These earnings figures are a little higher than Blue Chip Stamps' share of See's earnings shown in the table above because Blue Chip's share reflects (i) deduction of the approximately 1% share of See's earnings owned by minority stockholders of See's prior to June, 1978, (ii) amortization of intangibles arising from purchase of See's stock at a large permium over book value, and (iii) state income taxes on See's dividends recieved by Blue Chip.

Boxed chocolate consumption per capita in the United States continues to be essentially static, and the candy-store business remains subject to extraordinary cost pressures. When See's increases prices to reflect these cost pressures it never knows whether consumer resistance will cause net profits to fall instead of rise. Thus far, consumers have been willing to keep buying in the amounts required to keep See's profits rising at a moderate rate, but a continuation of this state of affairs logically cannot continue forever if See's costs keep increasing faster than the general rate of inflation.

Perhaps because price increases deter purchases for personal consumption more than purchases for gifts, See's seasonal sales peak becomes more extreme each year, causing many operating problems and a growing concentration of See's net income into the single month of December. Nonetheless, See's continues to make moderate average yearly progress under its outstanding leader, Charles Huggins.

So far as we know the candy-store business continues to be terrible to mediocre for all other companies, yet it remains quite profitable at See's, despite all the problems, for the simple reason that both new and old customers have a pronounced tendency to prefer the taste and texture of its candy, as well as the extremely high level of retailing service which characterizes its distribution. This customer enthusiasm is caused by a virtually fanatic insistence on expensive natural candy ingredients plus expensive manufacturing and distributing methods that ensure rigorous quality control and cheerful retail service. These qualities are rewarded by truly extraordinary sales per square foot in the stores, frequently two to three times those of competitors, and by a preference by gift ,recipients for See's chocolates, even when measured against much more expensive brands.

In 1978 we paid $55 per See's share to acquire a tiny minority interest in See's. If our previously owned 99% interest in See's were valued at the same price per share, such interest at that time would have had a total value approximately $25 million more than its aggregate amortized cost in our consolidated financial statements.

Our guarded forecast is that See's earnings will increase at least modestly in 1981.

MUTUAL SAVINGS AND LOAN ASSOCIATION

In last year's letter to shareholders we made the following prediction regarding our 80%-owned subsidiary, Mutual Savings:

> "Prospects for 1980 appear poor. The entire savings and loan industry is now required to pay much higher interest rates to hold savings accounts while assets consist primarily of low-turnover portfolios of long-term mortgages at fixed or slowly changing interest rates below current market. Thus our best guess is that Mutual Savings' earnings will decline sharply from the record level of 1979."

We also reported last year that Mutual Savings had contracted to sell, to Brentwood Savings and Loan Association all its offices except its headquarters office and satellite thereto directly across the street. As predicted, and for the reason predicted, our equity in Mutual Savings' operating income declined sharply in 1980 to $4,181,000 from $6,804,000 ih the previous year.

The sale of Mutual Savings' branch offices closed December 1,1980, after all regulatory approvals had been obtained, pursuant to the contract with Brentwood Savings.

The financial leverage of Mutual Savings, and the proportion of its assets not in cash and equivalents and marketable securities, were greatly reduced by the sale of the branch offices. These changes are evident when one compares the condensed balance sheets of Mutual Savings at December 31, 1980, and at December 31, 1979, set forth below:

ASSETS	December 31, 1980	December 31, 1979
Cash	$2,182,000	$2,744,000
Receivables, including accruals	2,580,000	6,070,000
Interest-bearing cash equivalents	73,982,000	54,239,000
Marketable securities	27,395,000	45,118,000
Loans on real estate, including participations	156,438,000	481,395,000
Office property	291,000	2,679,000
Other assets	9,630,000	9,361,000
	$272,498,000	$601,606,000
LIABILITIES AND NET WORTH		
Accounts payable, including accruals	$11,422,000	$11,318,000
Savings accounts, net of loans on the security thereof to savers [*1]	169,237,000	484,925,000
Notes payable to Federal Home Loan Bank	43,382,000	48,626,000
	224,041,000	544,869,000
Total capital and surplus (virtually all in reserves, withdrawal of which would cause imposition of income taxes)[*2]	48,457,000	56,737,000
	$272,498,000	$601,606,000

- 1 Includes $8,944,000 deposited by parent company in 1980 and $1,667,000 in 1979.
- 2 The lower capital and surplus in 1980 results from dividends paid to the parent company.

Real estate loans, before the sale of branch offices, were earning at an average annual interest rate of approximately 9.33%. Late in December, after the sale, the average annual interest rate being earned on the retained residue of real estate loans had been reduced to approximately 7.68%. The reduction occurred because most of the loans sold were from the highest-earning part of the pre-existing portfolio.

The income-reducing-effects of these low-interest-rate retained loans, so long as interest rates are roughly at their current level, will be more than offset by the income-increasing effects of (1) the high after-tax yields from other retained assets and (2) the elimination of all revenues and costs attributable to the branch offices, with the result that both Mutual Savings' average gross return on assets and its net earnings should be a little higher than they would have been had no sale of branch offices occurred.

However, if interest rates decline significantly and more or less permanently, aggregate future earnings will be much lower than would have been reported without the sale of branch offices. On the other hand, if, some time within the next few years, inflation and interest rates rise significantly and more or less permanently, the sale of branch offices will much improve aggregate future earnings. Thus Mutual Savings has taken action designed to protect itself from adverse effects of high inflation rather than action to position itself for maximum profit from low inflation. The action taken was not based on the belief that high inflation and-high interest rates in the future are inevitable, or even more likely than not. Instead the action reflects a desire, motivated by the margin-of-safety considerations intrinsic in engineering and still appropriate, we think, in financial institutions, to restructure Mutual Savings so that a sort of "earthquake risk" was reduced.

This "earthquake risk" was that at some future time interest rates would rise to such an extent that net operating losses might be created by a negative spread between interest rates on old, fixed-interest mortgage loans and the interest rates which would have to be paid to hold savings accounts. The savings and loan industry, with Mutual Savings included, has traditionally "lent long and borrowed short," to an extreme degree. The extremism worked well for decades but has not been wise in recent years. We should have learned this lesson earlier.

As part of the sale of the branch offices, the fixed assets (primarily real estate) of such offices were sold to the buyer at their current market value, which exceeded Mutual Sayings' depreciated cost. Our equity in the capital gain thus created was $2,332.000 and is included in the portion of earnings designated in this letter under the heading "Net Gains From Sales of Securities and Important Fixed Assets."

It is not pleasant work for a savings and loan association, motivated by a prudent concern for its shareholders and a desire to retain unquestioned financial strength, to sell off its carefully developed branch office network and see many of its long-term employees leave, even when they join a high-class organization like Brentwood Savings. Louis Vincenti, long-time chief executive of Mutual Savings, performed this unpleasant duty well, as he has every other duty in a long and successful career.

Mutual Savings plans to continue indefinitely in the savings and loan business, under Mr. Vincenti's able leadership so long as he is willing to serve. The savings and loan business is currently in considerable turmoil, not only because of generally poor operating results attributable to a combination of a high interest-rate environment with a borrowed-short, lent-long position, but also because the distinctions between banks and savings and loan associations are being reduced and the regulatory framework revised to increase competitive pressures. We expect Mutual Savings to adapt successfully to the new environment in some manner not presently predictable, which could even include eventual re-expansion by acquisition.

PRECISION STEEL WAREHOUSE, INC.

Our 80%-owned Precision Steel subsidiary, located in the outskirts of Chicago at Franklin Park, Illinois, was acquired for approximately $15 million on February 28,1979. It owns a long-established steel service center business and a subsidiary engaged in distribution of tool room supplies and other products sold under its own brand names, Precision Steel's operating businesses contributed $1,205,000 to our consolidated net income in 1980 from 12 months of operation compared with $1,367,000 in 1979 from 10 months of operation. The decline in earnings was roughly consonant with general conditions in the steel industry.

Both Mutual Savings and Precision Steel are owned by Blue Chip Stamps through 80% control of Wesco Financial Corporation, a public company with shares traded on the American Stock Exchange. For more complete information, we encourage Blue Chip shareholders to obtain a copy of Wesco's 1980 annual report. Simply make your request to:

Wesco Financial Corporation
315 East Colorado Boulevard
Pasadena, California 91109
Attention: Mrs. Bette Deckard, Secretary & Treasurer

BUFFALO EVENING NEWS, INC.

Our 100%-owned subsidiary, Buffalo Evening News, Inc., was acquired in April 1977 for approximately $34 million. It now constitutes only approximately $29 million of our consolidated net worth, as a result of about $5 million of aggregate after-tax operating losses after acquisition. This translates roughly into $1 aggregate operating losses before taxes.

However, the operating loss, before taxes, of the News in 1980 was lower than that of 1979, having declined to $2,805,000 from $4,617,000 in the previous year.

In our letter to shareholders last year we reported that "financial results continue to be adversely affected by litigation expenses, increased depreciation and extraordinary expenses of 'buy-outs' from labor contract provisions made in Order to allow the News to benefit from equipment modernization," and that "we now believe that the worst may be behind us in Buffalo . . ."

In 1980 the Buffalo Evening News experienced a continuation of all the above-listed factors which caused losses in previous years, plus two new factors: (1) Buffalo's greater-than-proportionate share of the national economic recession and (2) the first labor strike at the News since 1970, when publication was very briefly interrupted by a labor dispute, creating the only such interruption before last year which anyone now at the News can remember. Nonetheless, the operating loss did decrease as predicted and as above noted.

It is, of course, a temptations when writing an annual letter to shareholders to gloss over difficulties, like those in Buffalo, and comment extensively converning successes. We recommend exactly the opposite emphasis to business managers who report to us, and we believe in practicing what we preach. Accordingly, year after year, we re-tell and extend the history of the News, creating the largest single section of our annual letter. This year will be no exception.

The News had no Sunday edition when acquired. The principal competitor, the Buffalo Courier-Express, published without opposition on Sundays. As we explained in detail in our 1977 through 1979 annual reports, the long-term survival of the News clearly required that it inaugurate a Sunday edition. [Of that there was simply no question. Real trouble has been the invariable eventual outcome for every other daily newspaper in the United States, no matter how extreme its past record of prosperity and popularity, which relied overlong, in an important city, exclusively on weekday publication while a significant seven-day competitor enjoyed a Sunday monopoly, In fact, only three other "no-Sunday" papers, competing against such "with-Sunday" papers in important cities, survived as late as 1977, even though many such 'no-Sunday" papers once had long histories of profitability derived from dramatic advantages in weekday circulation and advertising over their "with-Sunday" competitors. Moreover, the three other survivors all were in serious trouble in 1977. And since then one of the three survivors, the Cincinnati Post, has been preserved, after incurring huge losses, only through the grace of its competitor's absorbing it into a minority share of a joint operation with approval of the U.S. Attorney General as required by the Federal Newspaper Preservation Act of 1970. A second of these "no-Sunday" survivors of 1977, the Cleveland Press, after also incurring huge losses, was recently sold by its experienced Ohio-based newspaper-chain owner (Scripps-Howard), under distress conditions, to a wealthy Cleveland man who forthwith announced that his resuscitation program included a plan to expend many millions of dollars in an attempt to publish Sundays as well as weekdays. Because of continuing and apparently irreversible operating losses, the Cleveland Press appears almost surely doomed, despite its belated recognition of the cause of its difficulty, as does what will shortly be the only remaining "no-Sunday" survivor, the New York Post. And, within a few years, when this last survivor disappears, the "no-Sunday" paper, competing in an important American city against a "with-Sunday" competitor, will be as extinct as the dodo bird.]

Under such circumstances, the News commenced publishing Sundays late in 1977, as it plainly had to do if it cared at all about its long-term future. In response, an antitrust lawsuit was filed by the competing paper which for the first time faced the prospect of competition on Sundays as well as weekdays. The lawsuit, in turn, resulted in some interlocutory (i.e., temporary and not final) injunctions which, among other things, created severe disruptions in normal circulation procedures under midwinter conditions and restricted certain business promotion practices of the News, commonplace within the newspaper industry, while similar but more aggressive practices of the competing paper were not prohibited.

These interlocutory injunctions against the News were reversed on appeal in 1979. In its unanimous decision for reversal of the injunctions, the Federal Court of Appeals reasoned that the generally pro-competitive antitrust laws should not be used in an anti-competitive fashion by enjoining normal promotion practices, such as those used by the News, in the course of normal competition such as inauguration of a Sunday edition.

Of course, the elimination of the harmful interlocutory injunctions did not automatically improve the circulation and advertising linage of the News’ Sunday edition. Success in the market had to be won slowly, if it could be won at all, through creating a desirable value for customers. Moreover, achieving success was made more difficult by the fact that it was beyond the power of the appellate court to reverse certain material damage on an infant at birth impairs its subsequent life even after the people in charge of the operating room have decided that different delivery procedures would have been appropriate.

Despite the damage at birth, there was a gradual trend towards success. The Sunday edition of the News has been recognized by subscribers for editorial merit and rewarded by steady circulation growth, needed considering the substantial Sunday-circulation lead of its principal competitor. Great credit must be given to Murray Light, Editor of the News, and other editors and reporters, for consistent delivery of a product which deserves and has received increased acceptance by the Greater Buffalo community. The circulation of the News' Sunday edition reached approximately 178,000 copies in February 1981, up from approximately 173,000 copies in February 1980 which, in turn, was up from

156,000 copies in February 1979. Weekday circulation has also increased in 1980, as it did in 1979, and the weekday News continues to be greatly preferred to the weekday Courier-Express by both readers and advertisers.

However, the 1980 gains which occurred in both the Sunday and the weekday circulation of the News were not accompanied by declines in either the weekday or the Sunday circulation of the competing Courier-Express, both of which also increased. Thus Buffalo, suffering more than its share of a national recession, nonetheless saw circulation of every edition published by its two competing major newspaper operations increase last year, exactly as one might expect in a boom city in an oil-saturated Sunbelt state like Texas. The twin gains on Sunday were particularly impressive. This every-edition-of-each-paper circulation growth obviously can't occur each year in the future if such growth remains inconsistent, as it was last year, with national and regional trends. Aggregate weekday circulation in Buffalo may well decline at some point as circulation prices increase and/or promotional efforts decrease in response to business conditions. Aggregate Sunday circulation is likely to continue to increase, reflecting the overwhelming and growing relative importance of Sunday newspapers.

The News' share of the total advertising linage of the two major newspaper operations in Buffalo increased very slightly in 1980, to about 59.6%. The increase in the News' share would have been greater, except for its strike which prevented publication and shifted business to its competitor on two big advertising days shortly before Christmas.

The News, and presumably the competing Courier-Express as well, lost money last year despite very substantial increases in prices forced by economic pressure. Overall, this situation is not desirable for employees or shareholders. And labor relations are affected in a none-too-predictable fashion when employers are unable to incur additional costs without bearing unacceptable losses.

Approximately 83% of the News' employees are members of its 13 different labor unions which through bargained settlements over many years have helped create collective bargaining agreements some of which contain provisions, designed to save jobs, which prevent technological change. With occasional exceptions, all in recent years, as each new collective bargaining agreement was negotiated the union involved sought to improve, from its own point of view, on the expiring collective bargaining agreement, with the net effect that (1) the newspaper was often left weaker on account of inefficient operations and (2) there was often some leapfrogging of benefits, giving a particular union more than its proportionate share of aggregate available economic advantage.

By the time Blue Chip Stamps purchased the News in 1977, this process, combined with a similar process at the Courier-Express and the general state of the newspaper business in Buffalo, had greatly reduced profits of both newspapers. In fact, profits were so minimal that unless more rapid technological progress were allowed and the leapfrogging process ended in favor of conservative pattern settlements, one of the two major newspapers eventually would be forced to cease publication, as has happened in response to similar pressures in major city after major city, on both sides of the Atlantic. In recognition of these facts, the Courier-Express in the years immediately preceding 1977 obtained needed union concessions and suffered no strikes.

There were also grounds for optimism concerning labor relations at the News. We believed in 1977 when we purchased the News that the enterprise-destroying pattern of labor relations which had killed so many metropolitan newspapers was unlikely to kill the News in Buffalo. For one thing, the News had an up-from-the-ranks labor-relations executive, Richard Feather, whom we instantly admired and trusted as fair-minded and constructive and perceived as likely to be so regarded by union members at the News. For another, we made a point, before closing the acquisition, of meeting some of the union leaders and their counsel, and they likewise impressed us favorably. Further, we noticed a great professionalism in employees at the News. Production people and reporters alike cared about the quality of their product, causing us to conclude that they would care similarly about the security and continuation of a common enterprise. Still further, we perceived a high level of friendship and communication among employees of the News, across craft-union lines. Indeed, the enterprise is so old and its jobs so well regarded that jobholders of all kinds have for decades urged their relatives and friends to join the News, often in different craft unions, creating as the years went by something more like a family business than might seem possible to anyone not familiar with it. Finally, we had enjoyed constructive relations with diverse and major labor unions elsewhere and did not enter Buffalo with any plan to seek destruction of long-established benefits, although we did hope to use negociated voluntary “buy-outs” to make some particularly important reductions in future costs. All these factors, together with the News’ long history of labor peace, contributed to our willingness to purchase the News, although at least two other prospective buyers, perhaps more fearful of the risks from having an unusually large number of separate unions, had refuse to pay the asking price for the paper.

Until 1980 the long no-strike history continued much as we expected, despite economic forces and troubles which frequently caused operating losses for the News and disappointing wage and salary increases for union members and other employees.

However, with 13 different unions and serious external pressures from competition and inflation, labor peace requires that 14 different groups (the News' management plus all 13 unions), without any exception, understand well the common danger, and, even if moving backward in inflation-adjusted economic terms, be wise and considerate of one another at all times. Even in the presence of the unusually favorable conditions for labor peace at the News, such unanimous wisdom and restraint are a lot to expect, given (1) the limitations of human nature, including that on management's side of the table, (2) the tradition, carried over from a different era, at each union that its main preoccupation should be vigorously to enhance and protect the interests of its own members, and (3) the fact that technological changes do not arrive at a steady pace and with effects allocated equally to each union.

The long labor peace ended in December 1980, when one small union group went on strike in an effort to insert new manning requirements, and new requirements of pay for work even if not performed, into its collective bargaining agreement. Most of the other unions' members, recognizing the pattern-breaking nature of the striking union group's demands, ignored a picket line and reported for work, but, finally, most of the News' pressmen refused to continue working, and the News was unable to continue publishing.

The gravity of the strike, its harmful effect on the potentiality for continued existence of the News, can hardly be overstated. An area-wide metropolitan newspaper which is closed down by a strike while a similar competitor continues publishing does not merely lose a lot of money while the strike goes on and then return to publishing at approximately the same annual profit (or loss) as before. Instead, because the competing paper gains circulation rapidly during the strike, the closed-down paper usually suffers such a loss of competitive position that it fairly soon reaches a point where it is unwise to reopen at all. For instance, in Montreal what had long been the overwhelmingly dominant English-language newspaper recently lost many millions of dollars, before its ultimate expiration, in a fruitless and foolish attempt to reopen after a strike of several months during which its main competitor continued to publish.

Such being the facts of life, the News had no practicable alternative, when its strike occurred last year, except to prepare to face rationally whatever degree of impaired position resulted from the strike. Clearly, if the strike was an extended one, the sensible decision would be not to renew publication. Nor was the News willing to settle its disagreement with the striking union group in any manner unfair to other unions involved, under conditions of common external hazard, in serial bargaining of union contracts. A resolution of the dispute unfair to unions which had settled earlier would lead to a ruinous resumption of leapfrogging to the ultimate detriment of the News and all its employees, including those attempting to take the first jump.

Fortunately, the amount of good will and good sense at the News was sufficient, as the matter worked out, to cause the strike to end in two days without, in the News' view, unfairness to unions which had settled earlier. However, the strike augmented the News' pre-tax losses by several hundred thousand dollars and also caused a small loss of competitive position. Both economic results, of course, diminish the capacity of the News to compensate its employees in the future as well as its prospects for beginning to pull its economic weight for shareholders.

The litigation against the News, filed by the Courier-Express in 1977 when the News commenced publishing on Sundays, remains pending. However, the litigation has been less active and costly in 1980, following purchase of the Courier-Express by the Minneapolis Star and Tribune Company, which has a history of preferring the exercise of business and journalistic skills over court battles. On the other hand, possibly as a result of this preference, the Courier-Express is now a more effective competitor that it was under its former owners.

Encouraged by the News' reduced operating loss in 1980, despite the strike and Buffalo's depressed economy, we expect a further improvement in operating results in 1981. Moreover, because we own what we believe to be one of society's best service institutions and much the better of Buffalo's two major newspapers, we still hope and expect that the News in due course will earn annual profits consistent with its value to Buffalo and appropriate to our level of investment. Our policy remains to improve and hold the News and not to sell it.

The News remains a salable property, even with its current troubles, so long as its share of circulation and advertising is stable-to-inching-ahead, and we could easily improve our consolidated operating earnings and the percentage return we earn on our shareholders' investment by selling the News and reinvesting the proceeds, after tax effects, in profit-earning assets. That we are not even slightly tempted to do so demonstrates our conviction that the proper course is to stay with the News until it either expires, or, much more likely, becomes a solid earner and employer.

Despite our confidence in the probable long-term success of the News, a certain caution is probably appropriate based on the record to date and the nature of the situation. We therefore repeat to our shareholders our warning in previous years regarding what we now believe are unlikely contingencies: "If the litigation continues and if the competing paper succeeds in somehow changing the law as enunciated by the Federal Court of Appeals and in obtaining the kinds of injunctions it is seeking, or if any extended strike shuts down the Buffalo Evening News, it will probably be forced to cease operations and liquidate, at an after-tax cost which could exceed $10 million."

PROMOTIONAL SERVICES BUSINESS AND MISCELLANEOUS SOURCES OF OPERATING INCOME

The final components of our consolidated net operating income last year were provided by (1) operating earnings from our promotional services (mainly trading stamp and motivation) business, after deduction of interest and other general parent company expense, plus (2) our share of operating earnings, after deduction of interest and other Wesco general corporate expense, from securities and real estate held by Wesco outside the savings and loan and steel service activities of its subsidiaries.

The promotional services business operated at a sharply increased operating profit, after parent company interest and other general expense and taxes, last year, up to $4,293,000 from $1,932,000 after (properly) giving it credit for the entire income (dividends and interest, plus income tax benefits caused by dividends) from investment of the funds available through "float" caused by trading stamps issued but not yet redeemed. Our shareholders should not be much impressed by most of the increase in operating profit, which was attributable primarily to revisions in our estimates of our liability to redeem outstanding trading stamps. The revisions, which by their nature will not frequently recur, increased 1980 operating income by $1,747,000. However, operating income was also increased by $721,000 through changing our motivation business from a loss to a profit position, a condition we hope will recur indefinitely.

Trading stamp service revenues increased by a minor amount to $16,672,000 last year compared with $15,967,000 in the previous year. Motivation business revenues increased to $2,771,000 from $2,310,000.

In our trading stamp business our "float" — resulting from past issuance of trading stamps when volume was many times greater than the current level — is large in relation to current issuances. (Trading stamp revenues peaked at $124,180,000 in fiscal 1970, and our 1980 revenues of $16,672,000 therefore represented a decline of 87% from peak volume). Eventually, unless stamp issuances improve, earnings from investing "float" will decline greatly. The decline in "float" in recent years, however, has proceeded at an extremely slow rate, and our "float" was $64,053,000 at yearend 1980.

As discussed extensively in previous annual reports (particularly for fiscal 1976), which we urge shareholders to review, accounting for trading stamp redemption liability (which involves estimating the number of stamps that will ultimately be redeemed and the cost per stamp) is a difficult process under any circumstances, but particularly so in an inflationary economy and when stamp issuances decline by a large percentage. We periodically revise our estimated future redemption liability as conditions warrant. In 1980 we made revisions increasing operating income as above described, as explained in detail in Note 2 to our accompanying financial statements.

We intend to remain in the trading stamp business. Many of our present customers, aided by our stamp service, operate unusually successful supermarkets, bowling alleys and other businesses, and we believe that, given the opportunity, we can also provide very useful service to new customers.

One final item augments our consolidated net operating income. Our share of operating earnings, after deduction of interest and other Wesco general corporate expense, from securities and real estate held by Wesco outside the savings and loan and steel service activities of its subsidiaries, amounted to $695,000 in 1980, compared with $492,000 in the previous year.

NET GAINS ON SALES OF CORPORATE SECURITIES AND IMPORTANT FIXED ASSETS

In our total assets, located among our five operating businesses, we hold considerably more corporate securities than might be expected in a consolidated enterprise of our size at the close of 1980, as we report consolidated revenues of $219 million and consolidated net worth of $146 million (see Note 3 to our accompanying consolidated financial statements).

Most of these holdings of corporate securities are held because of the very nature of the particular business in which they are owned. For instance, the trading stamp business owns liquid assets to provide for ultimate redemption of stamps, and the savings and loan business holds liquid assets to provide for repayment of savings account holders. The remaining security holdings exist temporarily, primarily in Wesco Financial Corporation, pending their disposition to provide funds for use in buying additional businesses.

Only Mutual Savings, which is barred by law from owning most common stocks, has significant holdings of preferred stocks. Most holdings, therefore, are of common stocks. Our reported operating earnings include only the dividends from our stockholdings, after taxes. And, because the corporations whose common stock we own also have and reinvest earnings not paid out as dividends, a process which ultimately raises market value of the stock we own, we also realize irregularly net capital gains from sales of portions of our holdings.

In addition, our various businesses occasionally sell important buildings, machinery or other fixed assets, as such businesses adjust to changing conditions. In 1980 the sale of branch office facilities by Mutual Savings fell into this category.

In 1980 our share of the gain from sale of Mutual Savings' branch office facilities was $2,332,000, and our total share of the net gains from sale of corporate securities was $1,493,000. Our aggregate share of both types of capital gains combined was $3,825,000, compared with $1,214,000 in the previous year.

PINKERTON'S, INC.

At yearend 1980 we owned non-voting stock representing 35% of the equity in Pinkerton's, Inc., the leading national security and investigation service company.

Our ownership of this non-voting interest demonstrates that, when all factors are considered, we often would rather buy stock we can't or won't vote than absolute control. We think the rationality of use-of-capital decisions is improved when the repertoire of a corporate manager includes purchases of business interests which do not augment the number of people to whom the manager can give orders. However, we have generally observed a low interest among corporate managers.in passive investments, even when available at much better price/earnings and price/book value ratios than controlling positions. The strong preference for controlling positions is ordinarily justified by (1) expected improvements from a change in control based on a high appraisal of the business skills of the managers of the corporate investor compared to the managers of the corporate investee and (2) a low appraisal of the likelihood that the managers of the corporate investee, if free to act independently, will make decisions which best serve the interests of ultimate shareholders. Our view is different, and, although we expect always to concentrate our activities primarily in operating businesses, we also have an uncommon interest in passive positions for the following reasons:

1. We know that our business skills are frequently inferior by a wide margin to those of others, as we can prove from comparative figures and our audited record reflecting gross errors;
2. We believe that many corporate managers can be trusted to serve the shareholders' interests even when the shareholders have no practical power to control or replace management;
3. We think the advantage of buying at a non-premium price, because control is absent, often counterbalances the disadvantage, if any, from lack of control;
4. Our consolidated enterprise includes operating businesses required by their nature to own significant passive investments.

We hope to become better known for our uncommon willingness to own "non-voting-partnership" interests in businesses and to attract other offerings like that which produced our Pinkerton's holding. And we are sure, based on five years' observation from our non-voting position, that Pinkerton's wouldn't have been managed one whit better or one whit more in its shareholders' interests if we had purchased voting control.

Our total investment in Pinkerton's at cost was $23,364,000 which, with respect to the major portion thereof constituting marketable securities, is substantially below current market value. See Note 3 to our accompanying financial statements. Only the dividends we receive from Pinkerton's are included in our reported income. These dividends have increased regularly in recent years, creating part of the income reported above under the heading: "Promotional Services Business and Miscellaneous Sources of Operating Income." The part created by Pinkerton's dividends was $1,429,000 in 1980 and $1,201,000 in 1979.

CONSOLIDATED BALANCE SHEET AND OTHER DATA

Our consolidated balance sheet retains a strength befitting a company whose consolidated net worth supports large outstanding promises to others. As explained in Note 3 to the accompanying financial statements, the aggregate market value of our marketable securities was higher than their aggregate cost at December 27, 1980. We remain in a prudent position when total debt is compared to total net worth and total liquid assets.

Retaining the impeccable bank credit facilitated by a prudent balance sheet position is very important to us. When combined with our practice of doing a certain amount of long-term borrowing in advance of specific need, it gives us maximum financial flexibility to face both hazards and opportunities.

Sections entitled "Principal Business Activities," "Selected Financial Data" and "Management's Discussion and Analysis" are presented beginning on page 13. We invite your careful attention to these items and to our audited financial statements.

A LOOK BACK AND A LOOK AHEAD

We began the 1970s with a single business, trading stamps, which was destined to decline to a small fraction of its former size, and a portfolio of securities, offsetting stamp redemption liabilities, which had been selected by previous owners and would have led to a disastrous result if held through to the present time. (The portfolio, for instance, contained a substantial amount of very-long-term, low-coupon municipal bonds of issuers with declining credit ratings.)

We began the 1980s with five constituent businesses instead of one. In order of acquisition they are: (1) trading stamps and other promotional services, (2) See’s Candy Shops, Incorporated , (3) Mutual Savings, (4) Buffalo Evening News, and (5) Precision Steel.

Our five constituent businesses have more in common than might be noted by a casual observer:

1. They are all high-grade operations, manned by high-grade people operating within a long tradition emphasizing reliable and effective service, and
2. When functioning properly each business will usually generate substantial amounts of cash not claimed by compulsory reinvestment in the same business and therefore available for purchases of new businesses or debt repayment.

The second of these two common characteristics needs additional explanation. Many businesses, once good investments when inflation was low, are now, under inflationary conditions, unable to produce much, if any, cash even when physical volume is constant. Any such business, always cash-starved even while reporting apparently satisfactory profits, is not a candidate, absent some special factor, to become a new subsidiary of ours.

Our balance sheet net worth at February 27, 1971 was about $43 million. By the end of 1980 our balance sheet net worth had increased to approximately $146 million, up 240% in ten years. At February 27, 1971 our equity in aggregate securities was worth about $5 million less than balance sheet cost. At the end of 1980 our equity was worth about $25.6 million more than balance sheet cost. Our average annual total percentage return earned on shareholders investment over the ten years ending December 27, 1980 was approximately 15% per annum, without counting the favorable swing from unrealized loss to unrealized profit in our equity in marketable securities. The percentage return earned was acceptable in a moderate-inflation environment, considering the headwinds in our initial trading stamp business.

In 1980, the year just ended, our total percentage return on the beginning investment of our shareholders was approximately 16%. This percentage return fluctuates from year to year, depending upon various factors including changes in amounts of capital gains realized. The percentage return figure for any one year is not very significant, although the average figure over a period of years, and the trend in such average figure, are of vital importance.

We hope to earn a higher average (though fluctuating) annual total percentage return on shareholders' investment in the future than we have in the past. Our total percentage return on shareholders' investment is now depressed by our substantial commitment to the Buffalo Evening News, producing losses instead of profits. We are trying to correct this condition. Moreover, we expect from time to time to acquire additional businesses which will produce higher returns than the assets disposed of to fund their purchase.

However, even if we succeed in increasing our average annual total percentage return on shareholders' investment (no sure thing), our performance as a company may not do very much for our shareholders as investors if inflation continues at the present rate. As we stated last year , “A 16% return on equity obviously won't do much in real terms for shareholders if the inflation rate is 16%, or even 11% when we also allow for income taxes imposed on owners who must report taxable ‘profits’ while only maintaining their position on the purchasing-power treadmill.”

Inflation is a very effective form of indirect taxation on capital represented by holdings of common stock. We know of no adequate countermeasure, generally available to corporate managers who wish to protect shareholders, to this form of indirect taxation. But, even so, we think a habit of always thinking about shareholders’ interests in real terms, instead of rationalizing growth of managed assets regardless of real effects on shareholders, is quite useful and may fairly be expected of corporate managements. We make a very conscious effort, perhaps with occasional inadvertent lapses, to have and reinforce this habit.

For one example, low stock prices, caused by inflation, together with our preoccupation with real shareholder interests, have intensified our resistance to most proposals that we issue new common stock. We haven't issued a new share, for any reason, for a long time. With rare exceptions American corporations now cannot get as much intrinsic value as they give when new common stock is issued. Our corporation is no exception. And, quite clearly, a corporation can't further its own shareholders' long-term interests by diluting, through new stock issuances, the value underlying each outstanding share. Our unwillingness to accept any such dilution explains our long-unchanged common stock capitalization.

We believe that our (1) heavy emphasis on the cash-generating characteristics of businesses, (2) reluctance to issue new stock and (3) strong balance sheet position are all likely to enjoy increased recognition in future years as qualities to be emphasized by selectors of common stocks for investment.

Cordially yours,

Charles T. Munger, Chairman of the Board
Donald A. Koeppel, President

February 25, 1981

To Our Stockholders

Consolidated operating income (i.e., before all net gains from sales of securities, mortgages and important fixed assets) for the calendar year 1981 increased to $20,895,000 ($4.03 per share) from $16,564,000 ($3.20 per share) in the previous year.

Consolidated net income (i.e., after net gains from sale of securities, mortgages and important fixed assets) increased to $27,626,000 ($5.33 per share) from $20,389,000 ($3.94 per share) in the previous year.

We have four major subsidiaries, See's Candy Shops, Incorporated (100%-owned), Mutual Savings (80%-owned), Precision Steel (80%-owned), and Buffalo Evening News, Inc. (100%-owned), in addition to the basic business (primarily trading stamps) operated by the parent company. Our consolidated income for our two reporting years just ended breaks down as follows (in 000s except for per-share amounts):

Net operating income (loss) of

Year ended about	See's*1	Mutual Savings*2	Steel Business	Buffalo Evening News*3	All other net income*4	Net gains on sales of securities & fixed assets*5	Blue Chip consolidated net income
December 31, 1981	$10,647	$3,393	$1,560	$(531)	$5,826	$6,731	$27,626
Per Blue Chip share	2.06	.65	.30	(.10)	1.12	1.30	5.33
December 31, 1980	$7,270	$4,181	$1,205	$(1,472)	$5,380	$3,825	$20,389
Per Blue Chip share	1.40	.81	.23	(.28)	1.04	.74	3.94

- 1) After reducing income by amortization of intangibles arising from purchase of See's at a large premium over its book value.
- 2) After increasing income by amortization of the discount from Mutual Savings' book value at which the interest was acquired and eliminating gains and losses from sale by Mutual Savings of securities, mortgages and important fixed assets.
- 3) After reducing income by amortization of relatively minor intangibles arising at acquisition of the newspaper.
- 4) After deduction of interest and other corporate expenses. In each year there was an operating loss from promotional services activities before residual consolidated net income was credited with (i) dividends and interest resulting primarily from investment of the funds available through "float" caused by trading stamps issued but not yet redeemed, plus (ii) income tax benefit caused by 85% exclusion of dividends in computing federal income taxes, plus (iii) Blue Chip's share of dividends, interest and rent from securities and real estate held by the Wesco Financial Corporation group outside its savings and loan and steel service activities, plus (iv) in 1980 a net adjustment of Blue Chip's stamp liability account in the amount of $1,747 or $.34 per Blue Chip share, net of taxes, as explained below under "Promotional Services Business and Miscellaneous Sources of Operating Income."
- 5) The 1980 figures comprise $2,332 or $.45 per Blue Chip share attributable to Mutual Savings' sale of 15 branch offices, as explained below under "Mutual Savings and Loan Association," and $1,493 or $.29 per Blue Chip share of net securities gains realized by the various entities including Mutual Savings, net of taxes and minority interest. The 1981 figures relate solely to such net securities gains.

The foregoing breakdown (of the same aggregate earnings) differs somewhat from that used in our audited financial statements. We take the pains to prepare our unconventional breakdown of earnings and to furnish it in this letter because we believe it better explains what is really happening than does our accompanying consolidated income statement in conventional form. Generally, we are trying to improve our annual letter to shareholders each year so as better to disclose the things we would want to be told if the roles were reversed and we were passive investors. However, we make no effort to provide fresh or novel descriptions. Repetition seems appropriate to us where facts remain both true and analytically important over many years and where certain ideas are part of our fixed business catechism. Accordingly, where previously used words, sentences or paragraphs appear adequate we simply repeat them, inserting up-to-date numbers.

SEE'S CANDY SHOPS, INCORPORATED

The earnings of our 100%-owned subsidiary, See's Candy Shops, Incorporated, increased 43.7% last year, a phenomenal performance considering the general state of retailing in the current recession. We have now owned See's for exactly ten years. Comparative figures for See's for the entire ten-year period of our ownership are set forth below:

Year ended about	Sales	Profits after taxes*	Number of pounds of candy sold	Number of stores open at year end
December 31, 1981	$112,578,000	$11,130,000	24,052,000	199
December 31, 1980	97,715,000	7,747,000	24,065,000	191
December 31, 1979	87,314,000	6,473,000	23,985,000	188
December 31, 1978	73,653,000	6,289,000	22,407,000	182
December 31, 1977	62,886,000	6,262,000	20,921,000	179
December 31, 1976	56,333,000	5,618,000	20,553,000	173
December 31, 1975	50,492,000	5,308,000	19,134,000	172
December 31, 1974	41,248,000	3,229,000	17,883,000	170
December 31, 1973	35,050,000	2,069,000	17,813,000	169
December 31, 1972	31,337,000	2,332,000	16,954,000	167

- These earnings figures are a little higher than Blue Chip Stamps' share of See's earnings shown in the table on page 1 because Blue Chip's share reflects (i) amortization of intangibles arising from purchase of See's stock at a large premium over book value and (ii) state income taxes on See's dividends received by Blue Chip.

See's aggregate sales in pounds held up well last year, being essentially unchanged from the previous year even though prices were increased at a rate which turned out to be somewhat higher than the inflation rate. Shop sales increased, but only because of the impact of additional stores. Shops operating throughout both years registered an aggregate decrease in poundage of 1.6%. Christmas season quantity order sales to businesses declined for the first time since the 1974 recession. Ingredient costs in 1981 increased only moderately and, with revenues up about 15%, See's profits rose sharply to an all-time record.

See's is by far the finest business we have ever purchased, exceeding our expectations, which were quite conservative. Our record as foretellers of the future is often poor, even with respect to businesses we have owned for many years, and we so greatly underestimated See's future that we were lucky to acquire it at all.

However, we have at least had the good sense all these last ten years to want See's chief executive, Chuck Huggins, who has spent his working life in its business, to run the company in his and its traditional way. Chuck Huggins is a splendid man and a splendid manager. It is no minor privilege to be associated with him and the kind of quality enterprise he and his predecessors and co-workers have created.

Boxed chocolate consumption per capita in the United States continues to be essentially static, and the candy-store business remains subject to extraordinary cost pressures, offset to some extent in 1981 by subnormal increases in ingredient costs. When See's increases prices each year to reflect cost pressures, it never knows whether consumer resistance will cause net profits to fall instead of rise. Thus far, consumers have been willing to keep buying in the amounts required to keep See's profits rising irregularly at an average rate which, aided by large recent gains, has turned out to be quite satisfactory. This state of affairs logically cannot continue forever if, on average, See's costs keep increasing faster than the general rate of inflation. Moreover, in some future years commodity and ingredient prices will rise sharply and unexpectedly, causing unanticipated decreases in profits.

Perhaps because price increases deter purchases for personal consumption more than purchases for gifts, See's seasonal sales peak becomes more extreme each year, causing many operating problems and a growing concentration of See's net income in the single month of December.

See's success to date becomes even more remarkable when its industry background is examined in more detail. So far as we know the candy-store business continues to be terrible to mediocre for all other companies, which tend to suffer from a combination of (1) low sales per square foot of retailing space plus (2) the great seasonality of the business which requires staffing and maintenance of stores at minimum levels grossly unjustified by sales during about 90% of each year.

We believe that See's exceptional profits occur, despite all the problems, mainly because both new and old customers prefer the taste and texture of See's candy, as well as the extremely high level of retailing service which characterizes its distribution. This customer enthusiasm is caused by a virtually fanatic insistence on expensive natural candy ingredients plus expensive manufacturing and distributing methods that ensure rigorous quality control and cheerful retail service. These qualities are rewarded by extraordinary sales per square foot in the stores, frequently two to three times those of competitors, and by a strong preference by gift recipients for See's chocolates, even when measured against much more expensive brands.

At the end of 1981, the portion of Blue Chip's consolidated net worth represented by its interest in See's amounted to $38.3 million and included liquid assets adequate to finance See's substantial annual build-up of pre-Christmas inventories. Obviously, based on See's 1981 earnings of $11.1 million, this investment in See's is worth considerably more than its carrying value in Blue Chip's consolidated balance sheet.

Last year we made "a guarded forecast that See's earnings would increase at least moderately in 1981." In 1982 See's will try again to increase earnings and a modest increase is quite conceivable.

MUTUAL SAVINGS AND LOAN ASSOCIATION

Our equity in Mutual Savings' operating income declined sharply in 1981 to $3,393,000 from $4,181,000 in the previous year.

Earning these reduced profits was an achievement of some note, because in 1981 almost all other savings and loan associations suffered large operating losses and some failed and were absorbed by stronger companies under pressure from governmental regulatory authorities. The financial pressure has continued into 1982. The troubles are caused by a borrowed-short, lent-long position, combined with high current interest rates associated with past and anticipated inflation and removal of much former regulation limiting rate competition for savings accounts. Associations have been forced to pay interest rates to hold savings accounts which are higher than can be covered by locked-in yields from long-term, fixed-rate mortgages acquired years ago in what now seems like a different world.

The sorry state of the savings and loan industry is one more example of the operation of Garrett Hardin's principle for soft sciences (like business, politics, economics and law) that bad ideas are born good. A well-intentioned idea of some kind works fine for a while, then stops working and goes into reverse, as did the basic savings and loan idea of borrowing short and lending long to an extreme degree while depending on governmental regulation to force savers to take an inadequate return in an inflationary period. If, as seems likely, Hardin's principle is part of an inevitable human legacy, tragedy can be averted, partially, only by reversing course when the danger flags start flying as the cherished ideas of the past are faithfully followed. Unfortunately, another perverse phenomenon interferes here — the tendency of the mind to reject the message from a danger signal which is inconsistent with a cherished idea.

At Mutual Savings we were too blind for too long, exactly as Hardin would have predicted, but like the rest of the savings and loan industry we started coping better with reality when it stopped waving the danger flags at us and started using them to poke us in the head and stomach.

The eventual result of our efforts to cope with reality has been that Mutual Savings has continued to make modest profits despite having a substantial borrowed-short, lent-long position, including a fixed-rate mortgage portfolio bearing what is probably the very lowest average interest rate among all U.S. associations (7.6% per annum at the end of 1981). The 1981 profits occurred, notwithstanding this handicap, because Mutual Savings has had:

1. so far as we know, a higher ratio of shareholders' equity to total interest-bearing liabilities than any other mature U.S. association;
2. a higher-than-normal proportion of assets in short-term, interest-bearing cash equivalents; and
3. a far-higher-than-normal proportion of assets in intermediate-term, tax-exempt bonds and utility preferred stocks producing a tax-equivalent yield of about double that prevailing on the mortgage portfolio of the typical association.

Mutual Savings' balance sheet at the end of 1981 is set forth in summary form in Note 1 to our accompanying financial statements.

Mutual Savings' unusual asset-liability structure was caused in part by the sale in 1980 of all its branch offices, one incident of which was retention of only the lowest-yielding mortgages, albeit those with the shortest remaining terms, In selling all branch offices in 1980 the institution shortened sail to allow for hurricane conditions, not because a hurricane was clearly foreseen, but because of the effect that being poked with danger flags had on our generally cautious nature. A hurricane came in 1981, the end of which is yet to be seen. There is, of course, a price to be paid when caution purchases safety. If interest rates decline sharply and more or less permanently, Mutual Savings will have greatly penalized future earnings through sale of its branch offices.

Moreover, what Mutual Savings has left is no jewel of a business. As it keeps its books it had $48.5 million in shareholders' equity at the end of 1980, on which its operating income was only $3.5 million in 1981, or at the inadequate rate of 7.2% per annum. However, as Blue Chip reports earnings from its equity in this less-than-mediocre business, the results are somewhat better because Blue Chip's equity was originally purchased at a large discount from its book value on the books of Mutual Savings. At the end of 1980 Blue Chip's equity in Mutual Savings was carried in Blue Chip's consolidated balance sheet, net of minority interest, at $19.4 million, and this equity contributed $3.4 million to Blue Chip's consolidated earnings in 1981, or at the rate of 17.5% per annum, including $.6 million of amortization into income, at the rate of 1/40th per year, of the discount from book value at which the equity originally was purchased.

Some additional perspective on the current situation may be obtained by examining the following table:

Calendar year	Blue Chip's average equity in Mutual Savings as carried in Blue Chip's consolidated balance sheet	Blue Chip's share of the cash dividend paid by Mutual Savings during the year	Annual percentage return on Blue Chip's equity from the Mutual Savings dividend
1975	$11,975,000	$1,932,000	16.1%
1976	20,570,000	3,226,000	15.7
1977	23,928,000	3,845,000	16.1
1978	25,285,000	5,287,000	20.9
1979	25,630,000	6,728,000	26.3
1980	22,381,000	9,852,000	44.0
1981	18,778,000	1,922,000	10.2

In 1982 for sure, and perhaps in 1983, Mutual Savings will realize reportable, tax-deductible losses by making sales and reinvestments involving mortgages which will have the effects of bringing the market value of its assets closer to their book value and causing recognition for accounting and income-tax purposes of a portion of the real economic deterioration already in place, caused by interest rates at current levels. Such sales and reinvestments will almost surely cause suspension of dividends from Mutual Savings to its parent corporation, Wesco, in 1982, ending for at least a year or two the important cash flow shown in the immediately preceding table. However, the income and cash-flow effects of a portfolio restructuring at Mutual Savings, after partially offsetting favorable income-tax effects, could quite conceivably increase in a very material way the dividends Mutual Savings will be able to pay at a later time, perhaps as early as 1984. All restructuring decisions will be made with a view to long-term benefit, ignoring considerations of image.

But, no matter what is done, it looks to us as if operating a savings and loan association in the future is going to present a challenge which, so far, we haven't fully figured out how to meet. We do have a lot of options, including expansion by acquisition, with or without additional investment in Mutual Savings, and we are trying to keep all options open as we ride out the storm.

We do not have any intention to sell Mutual Savings. We hope that it will ultimately find a way to earn higher profits, sufficient at least to permit payment of dividends causing realization of a satisfactory rate of return on the carrying value of Blue Chip's equity.

No savings and loan executive has had an easy time in the last few years. Louis Vincenti, chief executive of both Mutual Savings and Wesco, is no exception. In our view the record he has created is better than those of his peers, reflecting both unusual talent and a very high sense of stewardship for savers and shareholders.

PRECISION STEEL WAREHOUSE, INC.

Our 80%-owned Precision Steel subsidiary, located in the outskirts of Chicago at Franklin Park, Illinois, was acquired for approximately $15 million on February 28, 1979. It owns a long-established steel service center business and a subsidiary engaged in the manufacture and distribution of tool room supplies and other products sold under its own brand names. Precision Steel's operating businesses contributed $1,560,000 to our consolidated net income in 1981 compared with $1,205,000 in 1980.The increase in earnings was more than proportionately attributable to operations in the first three quarters of 1981. In the last quarter of 1981 and the first quarter of 1982, earnings have declined substantially, reflecting severe recessionary conditions in the steel industry.

Even under recessionary conditions operations remain profitable, and we anticipate no great change in earnings for the full year 1982.

The minimum shareholders' equity, at Blue Chip's carrying value, required to operate Precision Steel's business at its 1981 level is about $14 million, on which the business earned $1.9 million in 1981 or at a rate of 13.6% per annum.

We knew when we purchased Precision Steel that earning a return, satisfactory under inflationary conditions, on the unleveraged equity capital required to operate its business would be difficult, and we supplied some leverage by borrowing the purchase price, refinancing at a fixed rate as soon as practicable. We ordinarily have reservations concerning financial leverage but are willing, as in this case, to borrow money to purchase as part of our mix of businesses a clean and moderately profitable company like Precision Steel where inventories carried on the LIFO basis represent a substantial part of total assets and where reported earnings are expected usually to turn up in cash, absent optional expansion.

Both Mutual Savings and Precision Steel are owned by Blue Chip Stamps through 80% control of Wesco Financial Corporation, a public company with shares traded on the American Stock Exchange. For more complete information, we encourage Blue Chip shareholders to obtain a copy of Wesco's 1981 annual report.

Simply make your request to:
Wesco Financial Corporation
315 East Colorado Boulevard
Pasadena, California 91109
Attention: Mrs. Jeanne Leach, Treasurer

BUFFALO EVENING NEWS, INC.

Our 100%-owned subsidiary, Buffalo Evening News, Inc., was acquired in April 1977 for approximately $34 million. It now constitutes only approximately $28.5 million of our consolidated net worth, as a result of about $5.5 million of aggregate after-tax operating losses after acquisition. This translates roughly into $11 million of aggregate operating losses before taxes.

However, the operating loss, before taxes, of the News in 1981 was lower than that of 1980, having declined to

$1,091,000 from $2,805,000 in the previous year, which in turn had declined from $4,617,000 in 1979.

The steady reduction in operating loss has been made possible by a combination of aggressive price increases, intense efforts at general cost containment, and reduction or elimination of expenses or losses in three specific categories: (1) litigation expense, (2) expense of "buy-outs" from labor contract provisions made in order to allow the News to benefit from equipment modernization, and (3) the strike losses of 1980. A lot of effort has gone into reducing the overall operating loss — except that more "buy-outs" would have been preferred — and the 1981 results reflect some success.

We predicted accurately the financial improvement in 1980 and 1981. For 1982 we confidently predict a lack of improvement. We anticipate terrible market conditions for the News in 1982.

Buffalo has been hit harder than the average U.S. city by the current recession, and the attrition rate among retailers is sharply and permanently reducing the demand for the advertising service provided by the two main newspapers. In 1981 the News and the Buffalo Courier-Express, the News' main competitor, ran 4,000,000 lines of advertising (10% of their aggregate retail advertising linage) from retailers which by the end of 1982 either will not be in business at all or will be in business as mere remnants of their former selves. Although the Courier-Express is bearing a share of the retailing contraction, that will not stem the losses faced by the News.

It is particularly discouraging that continuing operating losses occur despite aggressive circulation and advertising price increases in the recent past. The News, for instance, increased circulation revenues by 15.2% in 1981, a figure exceeding that achieved in many cities less affected by the recession, helping cause a small but painful reduction in weekday subscribers, and will be forced to be conservative when it again increases circulation prices later in 1982. Based on the News' experience to date, it does not dare go faster in raising circulation prices. And, with a retailing contraction now in progress, the outlook for any above-normal increases in advertising prices also appears very dim. Greater, not smaller, operating losses for the News almost surely lie immediately ahead.

Not all of the difficulties come from purely regional trends. Since publication of our 1980 annual report there have also been a number of adverse developments in newspaper economics not limited to areas like Buffalo which are bearing more than their share of the current recession. Certain important print advertisers, once thought certain to rely almost 100% on newspapers, are experimenting with alternate forms of delivery. As the world has changed, the Washington Star, once by far the strongest daily newspaper in what remains a prosperous and growing Washington, D.C. metropolitan area, has ceased publication, as has the Philadelphia Bulletin, which once occupied a position of seemingly impregnable dominance in its city. The Bulletin was late in starting a Sunday edition, never caught up on Sunday, and eventually lost its weekday advantage as well, cascading to extinction. The ranking of the News among the nation's evening newspapers has been moving steadily upward, not because its circulation is growing but because large evening newspapers are disappearing.

In many of America's remaining two-or-more-metropolitan-newspaper cities, one or two of the newspapers have been reported to be losing money, including but by no means limited to the Boston Herald American, the Los Angeles Herald Examiner, the New York Post, the New York Daily News, the Seattle Post Intelligencer, the Trenton Times, the Cleveland Press, the Detroit Evening News and the Detroit Free Press. In fact, we know of only five metropolitan areas (above 250,000) in the U.S. where two separately owned and economically competing daily newspapers are both now profitable — Houston, Dallas, Denver, San Antonio and Chicago. Houston and Dallas are booming sunbelt cities aided by the OPEC energy cartel, and we suspect that profits in the weaker papers in Denver, San Antonio and Chicago are marginal.

Even more ominous, operating trends have been poor in a number of two-daily newspaper cities, more prosperous than Buffalo, where both newspapers have the same owner. That operating trends can be poor even under such conditions tends to confirm that more aggressive pricing by the News and its main competitor in Buffalo — which might appear akin to the solution hoped for by airlines when they anticipate the end of price wars — is not likely to cause termination of the operating miseries of the News. Pricing in Buffalo, with some limited exceptions, is already quite aggressive, all factors considered. The economic demand for both reading material and advertising service is price-sensitive, and does not necessarily increase, or even remain static, when prices are increased only as much as necessary to cover inexorable increases in the energy-intensive and people-intensive operating costs of our newspaper. Economic forces are at work which are plainly beyond anyone s control, and we are catching at least our share of a widespread malaise. We know of no easy solution.

It is, of course, a temptation when writing an annual letter to shareholders to gloss over difficulties, like those in Buffalo, and comment extensively concerning successes. We recommend exactly the opposite emphasis to business managers who report to us, and we believe in practicing what we preach. Accordingly, year after year, we re-tell and extend the history of the News, creating the largest single section of our annual letter. This year we surpass all previous records.

The News had no Sunday edition when acquired. The principal competitor, the Buffalo Courier-Express, published without opposition on Sundays. As we explained in detail in our 1977 through 1980 annual reports, the long-term survival of the News clearly required that it inaugurate a Sunday edition. [Of that there was simply no question. Real trouble has been the invariable eventual outcome for every other daily newspaper in the United States, no matter how extreme its past record of prosperity and popularity, which relied overlong, in an important city, exclusively on weekday publication while a significant seven-day competitor enjoyed a Sunday monopoly. In fact, only three other "no-Sunday" papers, competing against such "with-Sunday" papers in important cities, survived as late as 1977, even though many such "no-Sunday" papers once had long histories of profitability derived from dramatic advantages in weekday circulation and advertising over their "with-Sunday" competitors. Moreover, the three other survivors all were in serious trouble in 1977. And since then one of the three survivors, the Cincinnati Post, has been preserved, after incurring huge losses, only through the grace of its competitor's absorbing it into a minority share of a joint operation with approval of the U.S. Attorney General as required by the Federal Newspaper Preservation Act of 1970. A second of these "no-Sunday" survivors of 1977, the Cleveland Press, after also incurring huge losses, was recently sold by its experienced Ohio-based newspaper-chain owner (Scripps-Howard), under distress conditions, to a wealthy Cleveland man who forthwith spent millions of dollars inaugurating a Sunday edition. Even after so recognizing the cause of its difficulties, and despite tying Sunday circulation to a very substantial daily circulation base, the Cleveland Press now appears almost surely doomed to continuing and apparently irreversible operating losses by its reluctance or inability to create a Sunday edition at a timely point in its history. The only other remaining "no-Sunday" survivor is the New York Post, controlled by the able Rupert Murdoch, which has been losing many millions of dollars per year and which has announced it must have a Sunday edition to survive. Prospects for its survival looked virtually nil until 1981 when the New York Post's principal competitor, the New York Daily News, by far the biggest newspaper in New York City, announced it was tired of losing money and was looking for a buyer. If the New York Daily News eventually closes, the New York Post may well survive, aided by the Sunday edition it would then surely have. In any event, one way or another, within a very few years the "no-Sunday" paper, competing in an important American city against a "with-Sunday" competitor, will be as extinct as the dodo bird.]

Under such circumstances, the News commenced publishing Sundays late in 1977, as it plainly had to do if it cared at all about its long-term future. In response, an antitrust lawsuit was filed by the competing paper which for the first time faced the prospect of competition on Sundays as well as weekdays. The lawsuit, in turn, resulted in some interlocutory (i.e., temporary and not final) injunctions which, among other things, created severe disruptions in normal circulation procedures under midwinter conditions and restricted certain business promotion practices of the News, commonplace within the newspaper industry, while similar but more aggressive practices of the competing paper were not prohibited.

These interlocutory injunctions against the News were reversed on appeal in 1979. In its unanimous decision for reversal of the injunctions, the Federal Court of Appeals reasoned that the generally pro-competitive antitrust laws should not be used in an anti-competitive fashion by enjoining normal promotional practices, such as those used by the News, in the course of normal competition such as inauguration of a Sunday edition.

Of course, the elimination of the harmful interlocutory injunctions did not automatically improve the circulation and advertising linage of the News' Sunday edition. Success in the market had to be won slowly, if it could be won at all, through creating a desirable value for customers. Moreover, achieving success was made more difficult by the fact that it was beyond the power of the appellate court to reverse certain material damage suffered by the News as a result of the interlocutory injunctions and accompanying publicity. Damage inflicted on an infant at birth impairs its subsequent life even after the people in charge of the operating room have decided that different delivery procedures would have been appropriate.

Despite the damage at birth, there was a gradual trend toward success. The Sunday edition of the News has been recognized by subscribers for editorial merit and rewarded by steady circulation growth, needed considering the substantial Sunday-circulation lead of its principal competitor. Great credit must be given to Murray Light, Editor of the News, and other editors and reporters, for consistent delivery of a product which deserves and has received increased acceptance by the Greater Buffalo community. The circulation of the News' Sunday edition was over 183,000 copies in February 1982, up from approximately 178,000 copies in February 1981 which, in turn, was up from 173,000 copies in February 1980. We expect Sunday gains to continue. Weekday circulation decreased slightly in 1981, after increases in both 1980 and 1979, and the weekday News continues to be greatly preferred to the weekday Courier-Express by both readers and advertisers. As this is written we believe that, measured against levels twelve months earlier and ignoring at both papers meaningless temporary fluctuations caused by special promotion, circulation at the Courier-Express is essentially unchanged on both weekdays and Sundays whereas at the News Sunday circulation is up about 3% and weekday circulation is down about 2%. The News' total weekday circulation is still more than twice that of the Courier-Express, and the weekday circulation split in the close-in areas most important to advertisers remains considerably more favorable to the News than the split in total circulation. Moreover, to this point the News has pretty well held its own on weekdays as a strictly afternoon newspaper without following the practice in most other major two-competing-newspaper cities (e.g., in Dallas, Houston, Seattle, Detroit and Denver) where the afternoon newspaper has gone "all-day" by commencing publication of a morning edition for limited distribution by street sales and home delivery in outlying areas.

On Sundays, the Courier-Express continues to have a little less than 60% of the two newspapers' combined circulation.

We do not know precisely the News' share of the combined advertising revenues of the two newspapers, but we believe it was essentially unchanged during the last two years at about 60%, or perhaps a bit higher. Presumably the Courier-Express lost at least as much money as the News last year.

Overall, this situation is not desirable for our employees or shareholders. And labor relations are affected in a none-too-predictable fashion when employers are unable to incur additional costs without bearing unacceptable losses.

Approximately 83% of the News' employees are members of its 13 different labor unions which through bargained settlements over many years have helped create collective bargaining agreements some of which contain provisions, designed to save jobs, which prevent technological change. With occasional exceptions, all in recent years, as each new collective bargaining agreement was negotiated the union involved sought to improve, from its own point of view, on the expiring collective bargaining agreement, with the net effect that (1) the newspaper was often left weaker on account of inefficient operations and (2) there was often some leapfrogging of benefits, giving a particular union more than its proportionate share of aggregate available economic advantage.

By the time Blue Chip Stamps purchased the News in 1977, this process, combined with a similar process at the Courier-Express and the general state of the newspaper business in Buffalo, had greatly reduced profits of both newspapers. In fact, profits were so minimal that unless more rapid technological progress were allowed and the leapfrogging process ended in favor of conservative pattern settlements, one of the two major newspapers eventually would be forced to cease publication, as has happened in response to similar pressures in major city after major city, on both sides of the Atlantic. In recognition of these facts, the Courier-Express in the years immediately preceding 1977 obtained needed union concessions and suffered no strikes.

There were also grounds for optimism concerning labor relations at the News. We believed in 1977 when we purchased the News that the enterprise-destroying pattern of labor relations which had killed so many metropolitan newspapers was unlikely to kill the News in Buffalo. For one thing, the News had an up-from-the-ranks labor-relations executive, Richard Feather, whom we instantly admired and trusted as fair-minded and constructive and perceived as likely to be so regarded by union members at the News. For another, we made a point, before closing the acquisition, of meeting some of the union leaders and their counsel, and they likewise impressed us favorably. Further, we noticed a great professionalism in employees at the News. Production people and reporters alike cared about the quality of their product, causing us to conclude that they would care similarly about the security and continuation of a common enterprise. Still further, we perceived a high level of friendship and communication among employees of the News, across craft-union lines. Indeed, the enterprise is so old and its jobs so well regarded that jobholders of all kinds have for decades urged their relatives and friends to join the News, often in different craft unions, creating as the years went by something more like a family business than might seem possible to anyone not familiar with it. Finally, we had enjoyed constructive relations with diverse and major labor unions elsewhere and did not enter Buffalo with any plan to seek destruction of long-established benefits, although we did hope to use negotiated voluntary "buy-outs" to make some particularly important reductions in future costs. All these factors, together with the News' long history of labor peace, contributed to our willingness to purchase the News, although at least two other prospective buyers, perhaps more fearful of the risks from having an unusually large number of separate unions, had refused to pay the asking price for the paper.

Until 1980 the long no-strike history continued much as we expected, despite economic forces and troubles which frequently caused operating losses for the News and disappointing wage and salary increases for union members and other employees.

However, with 13 different unions and serious external pressures from competition and inflation, labor peace requires that 14 different groups (the News' management plus all 13 unions), without any exception, understand well the common danger, and, even if moving backward in inflation-adjusted economic terms, be wise and considerate of one another at all times. Even in the presence of the unusually favorable conditions for labor peace at the News, such unanimous wisdom and restraint are a lot to expect, given (1) the limitations of human nature, including that on management's side of the table, (2) the tradition, carried over from a different era, at each union that its main preoccupation should be vigorously to enhance and protect the interests of its own members, and (3) the fact that technological changes do not arrive at a steady pace and with effects allocated equally to each union.

The long labor peace ended in December 1980, when one small union group went on strike in an effort to insert new manning requirements, and new requirements of pay for work even if not performed, into its collective bargaining agreement. Most of the other unions' members, recognizing the pattern-breaking nature of the striking union group's demands, ignored a picket line and reported for work, but, finally, most of the News' pressmen refused to continue working, and the News was unable to continue publishing.

The gravity of the strike, its harmful effect on the potentiality for continued existence of the News, can hardly be overstated. An area-wide metropolitan newspaper which is closed down by a strike while a similar competitor continues publishing does not merely lose a lot of money while the strike goes on and then return to publishing at approximately the same annual profit (or loss) as before. Instead, because the competing paper gains circulation rapidly during the strike, the closed-down paper usually suffers such a loss of competitive position that it fairly soon reaches a point where it is unwise to reopen at all. For instance, in Montreal what had long been the overwhelmingly dominant English-language newspaper recently lost many millions of dollars, before its ultimate expiration, in a fruitless and foolish attempt to reopen after a strike of several months during which its main competitor continued to publish.

Such being the facts of life, the News had no practicable alternative, when its strike occurred in 1980, except to prepare to face rationally whatever degree of impaired position resulted from the strike. Clearly, if the strike was an extended one, the sensible decision would be not to renew publication. Nor was the News willing to settle its disagreement with the striking union group in any manner unfair to other unions involved, under conditions of common external hazard, in serial bargaining of union contracts. A resolution of the dispute unfair to unions which had settled earlier would lead to a ruinous resumption of leapfrogging to the ultimate detriment of the News and all its employees, including those attempting to take the first jump.

Fortunately, the amount of good will and good sense at the News was sufficient, as the matter worked out, to cause the strike to end in two days without, in the News' view, unfairness to unions which had settled earlier. However, the strike augmented the News' pre-tax losses by several hundred thousand dollars in 1980 and also caused a small loss of competitive position. Both economic results, of course, diminish the capacity of the News to compensate its employees in the future as well as its prospects for beginning to pull its economic weight for shareholders.

In 1981 there was no major labor crisis at the News although hardships were being shared instead of advances. With a very few exceptions the News' economic difficulties in recent years have come in spite of an overall attitude of understanding in its employees and not on account of a lack of such understanding. The ultimate survival of the News continues to depend not only on its competitive position but also on repetitive success on the part of management and all unions in dealing fairly and wisely with one another, under very difficult conditions, changing habits formed in a different era.

The litigation against the News, filed by former owners of the Courier-Express in 1977 when the News commenced publishing on Sundays, remains pending. However, the litigation has been dormant in 1981, following purchase of the Courier-Express by the Minneapolis Star and Tribune Company, which has a history of preferring the exercise of business and journalistic skills over court battles. On the other hand, possibly as a result of this preference, the Courier-Express is now a more effective competitor than it was under its former owners.

However, the improved Courier-Express is not making headway against the News, which is also improving. And even though we anticipate an unsatisfactory 1982 year, we anticipate better operating results in the more remote future. Because we own what we believe to be one of society's best service institutions and much the better of Buffalo's two major newspapers, we still hope and expect that the News in due course will earn annual profits consistent with its value to Buffalo and appropriate to our level of investment. This generally has been the outcome for the better of two competing seven-day newspapers and despite some new economic variables affecting metropolitan newspapers, we believe that such outcome is likely for the News.

This is not to say that we will ever really get well, considering all effects of our initial decision to buy the News. Shareholders can easily calculate that the reported losses of the News are a small part of the economic detriment our decision created. While convention doesn't require reporting of "opportunity cost" losses to shareholders, we believe they are just as important as conventional reported losses and should be faced just as squarely. If we hadn't purchased the News in 1977 but had simply earned returns on the unspent purchase price comparable with the average earning power of the rest of our shareholders' equity, we would now have about $70 million in value of other assets, earning over $10 million per year, in place of the Buffalo Evening News and its current red ink. No matter what happens in the future in Buffalo we are about 100% sure to have an economic place lower than we would have occupied if we had not made our purchase. In a period like the present one, where passive returns on capital before inflation are high, an inadequate or negative return persisting for any extended period is almost impossible to make up through later success, after allowing for probable returns from alternative capital uses. When other capital is sprinting, remaining in the starting blocks for a long time prevents one from ever catching the field.

Of course, we can't now relive the past but must simply adopt the correct business strategy for the present situation. That strategy is clearly for the News to keep doing the very best job it can for its city, its employees, its readers and its advertisers, seven days a week, unless and until some combination of our principal competitor's relative strength, our intolerable losses, and our labor-trouble weakness makes the long-term future look hopeless. There is no such situation now and we think it extremely improbable that such a situation will occur in the future. If it ever does, we will face it. But we will first exert every effort to make certain it never occurs, believing as we do that the News has both the product and the acceptance that should make its efforts successful.

The News remains a salable property, even with its current troubles, so long as its share of circulation and advertising is stable-to-inching-ahead, and we could easily improve our consolidated operating earnings and the percentage return we earn on our shareholders' investment by selling the News and reinvesting the proceeds, after tax effects, in profit-earning assets. That we are not even slightly tempted to do so demonstrates our conviction that Buffalo will have a reasonably felicitous future as a city and that the fine people who work at the News will ultimately succeed in making it a sound business for its owners and employees, through continued provision of sound service to its customers. We still plan to stay with the News until it either expires, or, far more likely, becomes a solid earner and employer.

Despite our confidence in the probable long-term success of the News, caution is appropriate based on the record to date and the nature of the situation. We therefore repeat to shareholders our warning in previous years regarding what we now believe are unlikely contingencies: "If the litigation continues and if the competing paper succeeds in somehow changing the law as enunciated by the Federal Court of Appeals and in obtaining the kinds of injunctions it is seeking, or if any extended strike shuts down the Buffalo Evening News, it will probably be forced to cease operations and liquidat, at after tax cost which could exceed $10 million."

PROMOTIONAL SERVICES BUSINESS AND MISCELLANEOUS SOURCES OF OPERATING INCOME

The final components of our consolidated net operating income last year were provided by (1) operating earnings from our promotional services (mainly trading stamp and motivation) business, after deduction of interest and other general parent company expense, plus (2) our share of operating earnings, after deduction of nterest and other Wesco general corporate expense, from securities and real estate held by Wesco outside the savings and loan and steel service activities of its subsidiaries.

The promotional services business operated at a sharply decreased profit, after parent company interest and other general expense and income taxes, last year, down to $3,659,000 from $4,293,000 after (properly) giving it credit for the entire income (dividends and interest, plus income tax benefits caused by dividends) from investment of the funds available through "float" caused by trading stamps issued but not yet redeemed. Our shareholders should not be discouraged by the decrease in after-tax profit, which was attributable to the fact b 8U that favorable revisions in our estimates of our liability to redeem outstanding trading stamps were made in but not in 1981. The revisions, which by their nature will not frequently recur, increased 1980 after-tax profit by $1,747,000, and, therefore, in the absence of such revisions after-tax profit would have improved last year.

Although trading stamp service revenues decreased by only a minor amount to $15,619,000 in 1981 compared with

$16,672,000 in 1980, they are expected to drop materially in 1982. By the time this report is distributed, we understand that the Stater Bros. supermarket chain, which accounted for 51% of our trading stamp revenues in 1981 and which has recently been for sale, will have publicly announced that it will discontinue giving trading stamps on April 1, 1982. Loss of the Stater Bros. account will present us with a serious challenge: We must not only continue our efforts in adding to our customer base (for example, in the retail gasoline trade, where we have recently had considerable success) but also try to replace the lost grocery business by signing up a competing grocery chain, which we have been unable to do in the past because of our commitment to Stater Bros. We are as convinced as ever that trading stamps are an effective point-of-purchase sales promotion device for supermarkets, service stations, bowling alleys and the like. We intend to remain in the trading stamp business.

In our trading stamp business our "float" — resulting from past issuance of trading stamps when volume was many times greater than the current level — is large in relation to current issuances. (Trading stamp revenues peaked at $124,180,000 in fiscal 1970, and our 1981 revenues of $15,619,000 therefore represented a decline of 87% from peak volume.) Eventually, unless stamp issuances improve, earnings from investing "float" will decline greatly. The decline in "float" in recent years, however, has proceeded at an extremely slow rate, and our reserved liability for trading stamp redemption was $64,262,000 at yearend 1981.

As discussed extensively in previous annual reports (particularly for fiscal 1976), which we urge shareholders to review, accounting for trading stamp redemption liability (which involves estimating the number of stamps that will ultimately be redeemed and the cost per stamp) is a difficult process under any circumstances, but particularly so in an inflationary economy and when stamp issuances decline by a large percentage. We periodically revise our estimated future redemption liability as conditions warrant. In 1980 we made revisions increasing operating income as above described, as explained in detail in Note 2 to our accompanying financial statements.

Motivation business revenues decreased to $1,446,000 from $2,771,000, but are expected to rise in 1982.

One final item augments our consolidated net operating income. Our share of operating earnings, after deduction of interest and other Wesco general corporate expense, from securities and real estate held by Wesco outside the savings and loan and steel service activities of its subsidiaries, amounted to $1,665,000 in 1981, compared with $695,000 in the previous year.

NET GAINS ON SALES OF CORPORATE SECURITIES, MORTGAGES AND IMPORTANT FIXED ASSETS

In our total assets, located among our five operating businesses, we hold considerably more corporate securities than might be expected in a consolidated enterprise of our size at the close of 1981, as we report consolidated revenues of $246 million and consolidated net worth of $169 million (see Note 3 to our accompanying consolidated financial statements).

Most of these holdings of corporate securities are held because of the very nature of the particular business in which they are owned. For instance, the trading stamp business owns liquid assets to provide for ultimate redemption of stamps, and the savings and loan business holds liquid assets to provide for repayment of savings account holders. The remaining security holdings exist temporarily, primarily in Wesco Financial Corporation, pending their disposition to provide funds for use in buying additional businesses.

Only Mutual Savings, which is barred by law from owning most common stocks, has significant holdings of preferred stocks. Most holdings, therefore, are of common stocks. Our reported operating earnings include only the dividends from our stockholdings, after taxes. And, because the corporations whose common stock we own also have and reinvest earnings not paid out as dividends, a process which ultimately raises market value of the stock we own, we also realize irregularly net capital gains from sales of portions of our holdings.

In addition, our various businesses occasionally sell important buildings, machinery or other fixed assets, as such businesses adjust to changing conditions. In 1980 the sale of branch office facilities by Mutual Savings fell into this category. No significant sale of fixed assets occurred in 1981.

In 1980 our share of the gain from sale of Mutual Savings' branch office facilities was $2,332,000, and our total share of the net gains from sale of corporate securities was $1,493,000. Our aggregate share of all types of special gains combined was $3,825,000 in 1980, compared with $6,731,000 in 1981, all from the sale of securities.

PINKERTON'S, INC.

At yearend 1981 we owned non-voting stock representing 37% of the equity in Pinkerton's, Inc., the leading national security and investigation service company.

Our ownership of this non-voting interest demonstrates that, when all factors are considered, we often would rather buy stock we can't or won't vote than absolute control. We think the rationality of use-of-capital decisions is improved when the repertoire of a corporate manager includes purchases of business interests which do not augment the number of people to whom the manager can give orders. However, we have generally observed a low interest among corporate managers in passive investments, even when available at much better price/earnings and price/book value ratios than controlling positions. The strong preference for controlling positions is ordinarily justified by (1) expected improvements from a change in control based on a high appraisal of the business skills of the managers of the corporate investor compared to the managers of the corporate investee and (2) a low appraisal of the likelihood that the managers of the corporate investee, if free to act independently, will make decisions which best serve the interests of ultimate shareholders. Our view is different, and, although we expect always to concentrate our activities primarily in operating businesses, we also have an uncommon interest in passive positions for the following reasons:

1. We know that our business skills are frequently inferior by a wide margin to those of others, as we can prove from comparative figures and our audited record reflecting gross errors;
2. We believe that many corporate managers can be trusted to serve the shareholders' interests even when the shareholders have no practical power to control or replace management;
3. We think the advantage of buying at a non-premium price, because control is absent, often counterbalances the disadvantage, if any, from lack of control;
4. Our consolidated enterprise includes operating businesses required by their nature to own significant passive investments.

We hope to become better known for our uncommon willingness to own "non-voting-partnership" interests in businesses and to attract other offerings like that which produced our Pinkerton's holding. And we are sure, based on five years' observation from our non-voting position, that Pinkerton's wouldn't have been managed one whit better or one whit more in its shareholders' interests if we had purchased voting control.

Our total investment in Pinkerton's at cost was $23,364,000, which, with respect to the major portion thereof constituting marketable securities, is substantially below current market value. See Note 3 to our accompanying financial statements. Only the dividends we receive from Pinkerton's are included in our reported income. These dividends have increased regularly in recent years, creating part of the income reported above under the heading: "Promotional Services Business and Miscellaneous Sources of Operating Income." The part created by Pinkerton's dividends was $1,730,000 in 1981 and $1,429,000 in 1980.

CONSOLIDATED BALANCE SHEET AND OTHER DATA

Our consolidated balance sheet retains a strength befitting a company whose consolidated net worth supports large outstanding promises to others. As explained in Note 3 to the accompanying financial statements, the aggregate market value of our marketable securities was higher than their aggregate cost at December 26, 1981. In addition, an office building and related real estate owned by Wesco Financial Corporation has a market value substantially in excess of carrying value. We remain in a prudent position when total debt is compared to total net worth and total liquid assets.

Retaining the impeccable bank credit facilitated by a prudent balance sheet position is very important to us. When combined with our practice of doing a certain amount of long-term borrowing in advance of specific need, it gives us maximum financial flexibility to face both hazards and opportunities.

Sections entitled "Principal Business Activities," "Selected Financial Data" and "Management's Discussion and Analysis" are presented beginning on page 13. We invite your careful attention to these items and to our audited financial statements.

A LOOK BACK AND A LOOK AHEAD

We began the 1970s with a single business, trading stamps, which was destined to decline to a small fraction of its former size, and a portfolio of securities, offsetting stamp redemption liabilities, which had been selected by previous owners and would have led to a disastrous result if held through to the present time. (The portfolio, for instance, contained a substantial amount of very-long-term, low-coupon municipal bonds of issuers with declining credit ratings.)

We began the 1980s with five constituent businesses instead of one. In order of acquisition they are: (1) trading stamps and other promotional services, (2) See's Candy Shops, Incorporated, (3) Mutual Savings, (4) Buffalo Evening News, and (5) Precision Steel.

Our five constituent businesses have more in common than might be noted by a casual observer:

1. They are all high-grade operations suffused to a considerable extent with the business ideas of Benjamin Franklin, manned by high-grade people operating within a long tradition emphasizing reliable and effective service, and
2. When functioning properly each business will usually generate substantial amounts of cash not claimed by compulsory reinvestment in the same business and therefore available for purchases of new businesses or debt repayment.

The second of these two common characteristics gets more important every year as inflation continues. Many businesses, once good investments when inflation was low, are now, under inflationary conditions, unable to produce much, if any, cash even when physical volume is constant. Any such business, always cash-starved even while reporting apparently satisfactory profits, is not a candidate, absent some special factor, to become a new subsidiary of ours.

Our balance sheet net worth at March 4, 1972 was about $46 million. By the end of 1981 our balance sheet net worth had increased to approximately $169 million, up 267% in ten years, after payment of regular dividends. At March 4, 1972 our equity in aggregate securities was worth about $3 million less than balance sheet cost. At the end of 1981 this equity was worth about $26.7 million more than balance sheet cost. Our average annual total percentage return earned on shareholders' investment over the ten years ending December 26, 1981 was approximately 15% per annum, without counting the favorable swing from unrealized loss to unrealized profit in our equity in marketable securities. The percentage return earned was acceptable in a moderate-inflation environment, considering the headwinds in our initial trading stamp business.

In 1981, the year just ended, our total percentage return on the beginning investment of our shareholders was approximately 19%. This percentage return fluctuates from year to year, depending upon various factors including changes in amounts of capital gains realized. The percentage return figure for any one year is not very significant, although the average figure over a period of years, and the trend in such average figure, are of vital importance.

We hope to earn a higher average (though sharply fluctuating) annual total percentage return on shareholders' investment in the next ten years than we have in the ten years just past. Our total percentage return on shareholders' investment is now depressed by our substantial commitment to the Buffalo Evening News, producing losses instead of profits. We are trying to correct this condition. Moreover, we expect from time to time to acquire additional businesses which eventually will produce higher returns than the assets disposed of to fund their purchase. A better experience in the future is far from a sure thing, but it may well be achieved if future errors, headwinds, and reverses are no worse than the ample number characterizing our past.

However, even if we succeed in increasing our average annual total percentage return on shareholders' investment, our performance as a company may not do very much for our shareholders as investors if inflation continues at the present rate. As we point out year after year, "A 16% return on equity obviously won't do much in real terms for shareholders if the inflation rate is 16%, or even 11% when we also allow for income taxes imposed on owners who must report taxable 'profits' while only maintaining their position on the purchasing-power treadmill."

Inflation is a very effective form of indirect taxation on capital represented by holdings of common stock. We know of no adequate countermeasure, generally available to corporate managers who wish to protect shareholders, to this form of indirect taxation, But, even so, we think a habit of always thinking about shareholders' interests in real terms, instead of rationalizing growth of managed assets regardless of real effects on shareholders, is quite useful and may fairly be expected of corporate managements. We make a very conscious effort, perhaps with occasional inadvertent lapses, to have and reinforce this habit.

For one example, low stock prices, caused by inflation, together with our preoccupation with real shareholder interests, have intensified our resistance to most proposals that we issue new common stock. We haven't issued a new share, for any reason, for a long time. With rare exceptions American corporations now cannot get as much intrinsic value as they give when new common stock is issued. Our corporation is no exception. And, quite clearly, a corporation can't further its own shareholders' long-term interests by diluting, through new stock issuances, the value underlying each outstanding share. Our unwillingness to accept any such dilution explains our long-unchanged common stock capitalization.

We believe that our (1) heavy emphasis on the cash-generating characteristics of businesses, (2) reluctance to issue new stock and (3) strong balance sheet position are all likely to enjoy increased recognition in future years as qualities to be emphasized by selectors of common stocks for. investment.

Cordially yours,

Charles T. Munger, Chairman of the Board
Donald A. Hoeppel, President

March 18, 1982

To Our Stockholders:

Consolidated operating income (i.e., before all net gains from sales of securities, mortgages and important fixed assets) for the calendar year 1982 increased to $22,241,000 ($4.30 per share) from $20,895,000 ($4.03 per share) in the previous year.

Consolidated net income (i.e., after net gains from sale of securities, mortgages and important fixed assets) increased to $45,342,000 ($8.76 per share) from $27,626,000 ($5.33 per share) in the previous year.

We have four major subsidiaries, See's Candy Shops, Incorporated (100%-owned), Mutual Savings (80%-owned), Precision Steel (80%-owned), and Buffalo Evening News, Inc. (100%-owned), in addition to the basic business (primarily trading stamps) operated by the parent company. Our consolidated income for our two reporting years just ended breaks down as follows fin 000s except for per-share amounts):

Net operating income (loss) of

Year ended about	See's(1)	Mutual Savings(2)	Steel Business	Buffalo Evening News(3)	All other net income(4)	Net gains on sales of securities & fixed assets(5)	Blue Chip consolidated net income
December 31, 1982	$12,217	$3,296	$276	$(598)	$7,050	$23,101	$45,342
Per Blue Chip share	2.36	.64	.05	(.11)	1.36	4.46	8.76
December 31, 1981	$10,647	$3,393	$1,560	$(531)	$5,826	$6,731	$27,626
Per Blue Chip share	2.06	.65	.30	(.10)	1.12	1.30	5.33

1. After reducing income by amortization of intangibles arising from purchase of See's at a large premium over its book value.
2. After increasing income by amortization of the discount from Mutual Savings' book value at which the interest was acquired and eliminating gains and losses from sale by Mutual Savings of securities, mortgages and important fixed assets.
3. After reducing income by amortization of relatively minor intangibles arising at acquisition of the newspaper.
4. After deduction of interest and other corporate expenses. In each year there was an operating loss from promotional services activities before residual consolidated net income was credited with (i) dividends and interest resulting primarily from investment of the funds available through "float" caused by trading stamps issued but not yet redeemed, plus (ii) income tax benefit caused by 85% exclusion of dividends in computing federal income taxes, plus (iii) Blue Chip's share of dividends, interest and rent from securities and real estate held by the Wesco Financial Corporation group outside its savings and loan and steel service activities, plus (iv) in 1982 a net adjustment of Blue Chip's stamp liability account in the amount of $339 or $.07 per Blue Chip share, net of taxes, as explained below under "Promotional Services Business and Miscellaneous Sources of Operating Income."
5. The 1982 figures comprise $(1,943) or $(.38) per Blue Chip share attributable to Mutual Savings' sale of mortgage-backed securities at a loss, as explained below under "Mutual Savings and Loan Association," and $25,044 or $4.84 per Blue Chip share of net securities gains realized by the various entities net of taxes and minority interest. The 1981 figures relate solely to such net securities gains.

The foregoing breakdown (of the same aggregate earnings) differs somewhat from that used in our audited financial statements.

We have taken the pains to prepare our unconventional breakdown of earnings and to furnish it in this letter because we believe it better explains what is really happening than does our accompanying consolidated income statement in conventional form. Generally, we have tried to improve our annual letter to shareholders each year so as better to disclose the things we would want to be told if the roles were reversed and we were passive investors. However, we have made no effort to provide fresh or novel descriptions. Repetition seems appropriate to us where facts remain both true and analytically important over many years and where certain ideas are part of our fixed business catechism. Accordingly, where previously used words, sentences or paragraphs appear adequate we simply repeat them, inserting up-to-date numbers. We see no more advantage in avoiding repetition in basic information documents like letters to shareholders than, say, in successive editions of a service manual for a slowly-changing engine.

We have no illusion that our type of repetitive annual report, restricted to letters and figures in black and white, represents an optimum. We recognize that the invention of graphs and color pictures improved communication, yet we continue in our own way because it seems adequate in our special case, is cheaper, and is less associated with financial public relations practices we prefer not to emulate.

SEE'S CANDY SHOPS, INCORPORATED

The earnings of our 100%-owned subsidiary, See's Candy Shops, Incorporated, increased 13.8% last year, a respectable performance considering the general state of retailing in the 1981-1982 recession. We have now owned See's for exactly 11 years. Comparative figures for See's for the entire 11-year period of our ownership are set forth below:

Year ended about	Sales	Profits after taxes*	Number of pounds of candy sold	Number of stores open at year end
December 31, 1982	$123,662,000	$12,661,000	24,216,000	202
December 31, 1981	112,578,000	11,130,000	24,052,000	199
December 31, 1980	97,715,000	7,747,000	24,065,000	191
December 31, 1979	87,314,000	6,473,000	23,985,000	188
December 31, 1978	73,653,000	6,289,000	22,407,000	182
December 31, 1977	62,886,000	6,262,000	20,921,000	179
December 31, 1976	56,333,000	5,618,000	20,553,000	173
December 31, 1975	50,492,000	5,308,000	19,134,000	172
December 31, 1974	41,248,000	3,229,000	17,883,000	170
December 31, 1973	35,050,000	2,069,000	17,813,000	169
December 31, 1972	31,337,000	2,332,000	16,954,000	167

- These earnings figures are a little higher than Blue Chip Stamps' share of See's earnings shown in the table on page 1 because Blue Chip's share reflects (i) amortization of intangibles arising from purchase of See's stock at a large premium over book value and (ii) state income taxes on See's dividends received by Blue Chip.

See's aggregate sales in pounds held up well last year, being essentially unchanged from the previous year even though prices were increased at a rate which turned out to be somewhat higher than the inflation rate. Shop sales decreased 1.0% despite the impact of additional stores. Shops operating throughout both years registered a a greater decrease in poundage of 2.3%. Ingredient costs per pound decreased slightly, the first such decrease in years, but other costs increased sharply. The failure to control these other costs so as to more closely match inflation prevented an earnings increase which, considering the favorable trend in ingredient costs, otherwise would have been greater than the 13.8% reported.

See's is by far the finest business we have ever purchased, exceeding our expectations, which were quite conservative. Our record as foretellers of the future is often poor, even with respect to businesses we have owned for many years, and we so greatly underestimated See's future that we were lucky to acquire it at all.

However, we have at least had the good sense all these last eleven years to want See's chief executive, Chuck Huggins, who has spent his working life in its business, to run the company in his and its traditional way. Chuck Huggins is a splendid man and a splendid manager. It is no minor privilege to be associated with him and the kind of quality enterprise he and his predecessors and co-workers have created.

Boxed chocolate consumption per capita in the United States continues to be essentially static, and the candy-store business remains subject to extraordinary cost pressures, offset to some extent in 1981 and 1982 by a subnormal increase followed by a decrease in ingredient costs. When See's increases prices each year to reflect cost pressures, it never knows whether consumer resistance will cause net profits to fall instead of rise. Thus far, consumers have been willing to keep buying in the amounts required to keep See's profits rising irregularly at an average rate which, aided by large recent gains, has turned out to be quite satisfactory. This state of affairs logically cannot continue forever if, on average, See's costs keep increasing faster than the general rate of inflation. Moreover, in some future years commodity and ingredient prices will rise sharply and unexpectedly, causing unanticipated decreases in profits.

Perhaps because price increases deter purchases for personal consumption more than purchases for gifts, See's seasonal sales peak becomes more extreme each year, causing many operating problems and a growing concentration of See's net income in the single month of December.

See's success to date becomes even more remarkable when its industry background is examined in more detail. So far as we know the candy-store business continues to be terrible to mediocre for all other companies, which tend to suffer from a combination of (1) low sales per square foot of retailing space plus (2) the great seasonality of the business which requires staffing and maintenance of stores at minimum levels grossly unjustified by sales during about 90% of each year.

We believe that See's exceptional profits occur, despite all the problems, mainly because both new and old customers prefer the taste and texture of See's candy, as well as the extremely high level of retailing service which characterizes its distribution. This customer enthusiasm is caused by See's virtually fanatic insistence on expensive natural candy ingredients plus expensive manufacturing and distributing methods that ensure rigorous quality control and cheerful retail service. These qualities are rewarded by extraordinary sales per square foot in the stores, frequently two to three times those of competitors, and by a strong preference by gift recipients for See's chocolates, even when measured against much more expensive brands.

At the end of 1982, the portion of Blue Chip's consolidated net worth represented by its interest in See's amounted to $50.5 million and included liquid assets more than adequate to finance See's substantial annual build-up of pre-Christmas inventories. Obviously, based on See's 1982 earnings of $12.7 million, this investment in See's is worth considerably more than its carrying value in Blue Chip's consolidated balance sheet.

Last year we stated that See's would try again to increase earnings in 1982 and that a modest increase was quite conceivable. This same statement now seems appropriate with respect to 1983.

MUTUAL SAVINGS AND LOAN ASSOCIATION

Our equity in Mutual Savings' operating income declined slightly in 1982 to $3,296,000 from $3,393,000 in the previous year.

The 1982 operating income equity of $3,296,000 is before deduction of Blue Chip's $1,943,000 share of an after-tax loss from Mutual Savings' sale last year of mortgage-backed securities. This special loss contribution of $1,943,000 has been included, instead, in computing "Net Gains on Sales of Securities, Mortgages and Important Fixed Assets," the final category in our earnings breakdown for purposes of this letter.

Earning any operating income at all was an achievement because in 1982 almost all other savings and loan associations suffered operating losses. The generally poor results are caused by a borrowed-short, lent-long position, combined with high current interest rates associated with past and anticipated inflation and removal of much former regulation limiting rate competition for savings accounts. Associations have been forced to pay interest rates to hold savings accounts which are higher than can be covered by locked-in yields from long-term, fixed-rate mortgages acquired years ago in what now seems like a different world.

The sorry state of the savings and loan industry is one more example of the operation of Garrett Hardin's principle for soft sciences (like business, politics, economics and law) that bad ideas are born good. A well-intentioned idea of some kind works fine for a while, then stops working and goes into reverse, as did the basic savings and loan idea of borrowing short and lending long to an extreme degree while depending on governmental regulation to force savers to take an inadequate return. If, as seems likely, Hardin's principle is part of an inevitable human legacy, tragedy can be averted, partially, only by reversing course when the danger flags start flying as the cherished ideas of the past are faithfully followed. Unfortunately, another perverse phenomenon interferes here — the tendency of the mind to reject the message from a danger signal which is inconsistent with a cherished idea.

At Mutual Savings we were too blind for too long, exactly as Hardin would have predicted, but like the rest of the savings and loan industry we started coping better with reality when it stopped waving the danger flags at us and started using them to poke us in the head and stomach.

The eventual result of our efforts to cope with reality, including a massive sale of branch offices, has been that Mutual Savings has continued to earn a modest amount of operating income despite having a substantial borrowed-short, lent-long position, including a fixed-rate mortgage portfolio bearing what is probably the very lowest average interest rate among all U.S. associations (7.4% per annum at the end of 1982). The 1982 operating income occurred, notwithstanding this handicap, because Mutual Savings has had:

1. so far as we know, a higher ratio of shareholders' equity to total interest-bearing liabilities than any other mature U.S. association;
2. a higher-than-normal proportion of assets in short-term, interest-bearing cash equivalents; and
3. a far-higher-than-normal proportion of assets in intermediate-term, tax-exempt bonds and utility preferred stocks producing a tax-equivalent yield of about double that prevailing on the mortgage portfolio of the typical association.

Mutual Savings' balance sheet at the end of 1982 is set forth in summary form in Note 1 to our accompanying financial statements.

Mutual Savings' unusual asset-liability structure was caused in part by the sale in 1980 of all its branch offices, one incident of which was retention of only the lowest-yielding mortgages, albeit those with the shortest remaining terms. In selling all branch offices in 1980 as interest rates were rising, the institution shortened sail to allow for hurricane conditions, not because a hurricane was clearly foreseen, but because of the effect that being poked with danger flags had on our generally cautious nature. A hurricane came in 1981, the end of which is yet to be seen, although industry conditions are now considerably improved from their worst state, due to a substantial decline in interest rates incident to recession.

What Mutual Savings has left is a less-than-mediocre business in terms of the return it earns on the capital it employs. As it keeps its books it had $46.2 million in shareholders' equity at the end of 1981, on which its operating income was of less-than highest quality and amounted to only $3.3 million in 1982, or at the inadequate rate of 7.1% per annum. (The operating income was of less-than-highest quality because it came largely from tax savings through inclusion in its parent's consolidated income tax return, and such income, while real, has less cushion in reserve against future adversity than the highest quality income on which full income taxes have been paid in cash and are recoverable from the IRS in the event of future losses.) However, as Blue Chip reports earnings from its equity in this less-than-mediocre business, the results are considerably better because Blue Chip's equity was originally purchased at a large discount from its book value on the books of Mutual Savings. At the end of 1981 Blue Chip's equity in Mutual Savings was carried in Blue Chip's consolidated balance sheet, net of minority interest, at $18.2 million, and this equity contributed $3.3 million to Blue Chip's consolidated operating earnings in 1982, or at the rate of 18.1% per annum, including $.6 million of amortization into income, at the rate of 1/40th per year, of the discount from book value at which the equity originally was purchased.

Some additional perspective on the current situation may be obtained by examining the following table:

Calendar year	Blue Chip's average equity in Mutual Savings as carried in Blue Chip's consolidated balance	Blue Chip's share of the cash dividend paid by Mutual Savings during the	Annual percentage return on Blue Chip's equity from the Mutual Savings

	sheet	year	dividend
1975	$11,975,000	$1,932,000	16.1%
1976	20,570,000	3,226,000	15.7
1977	23,928,000	3,845,000	16.1
1978	25,285,000	5,287,000	20.9
1979	25,630,000	6,728,000	26.3
1980	22,381,000	9,852,000	44.0
1981	18,778,000	1,922,000	10.2
1982	20,965,000	801,000	3.8

This table pretty well reflects the essence of real, and on balance quite favorable, economic effects on Blue Chip shareholders caused by Blue Chip's acquisition of a large interest in Mutual Savings.

In last year's letter we reported that we expected Mutual Savings to pay no dividend at all in 1982. Instead, despite the loss from an unusual sale of mortgage-backed securities, a modest 1982 dividend was paid, as reflected in the table above, and we now guardedly forecast a larger dividend from Mutual Savings in 1983. Any increase would be welcome, because the present dividend return on Blue Chip's carrying value of its investment is inadequate, and not in any small degree.

Operating a savings and loan association under the more competitive conditions which will almost surely prevail in the future as a consequence of deregulation of rates of interest paid to savers is going to present a challenge which, so far, we haven't fully figured out how to meet. We are sobered by the examples of deregulation effects presented by trucking companies and airlines, and by the possibility of shocks to the whole bank/savings and loan system which now appear more conceivable than at any other time after World War II. National legislators in both political parties, pressured by our financial institutions, have recently augmented the hermaphroditic part of the bank/savings and loan system, where deposits are insured (in effect) by the U. S. Treasury while interest rates paid to depositors on those deposits can be (roughly) whatever an insured institution decides to pay. We hope we are wrong in foreseeing, from the recent changes in the system, increased encouragement of what in the long run will be unsound practice by institutions needing encouragement in precisely the opposite direction.

We do have one central determination: to preserve a lot of options by retaining financial strength and by remaining very flexible with respect to expansion (including acquisition), contraction and revisions of services designed to create more differentiation in the market place from standard financial services provided by others.

We do not have any intention to sell Mutual Savings. We hope that it will ultimately find a way to earn higher profits, sufficient at least to permit payment of dividends causing realization of a more satisfactory rate of return on the carrying value of Blue Chip's equity.

No savings and loan executive has had an easy time in the last few years. Louis Vincenti, chief executive of both Mutual Savings and Wesco, is no exception. In our view the record he has created is better than those of his peers, reflecting both unusual talent and a very high sense of stewardship for savers and shareholders.

PRECISION STEEL WAREHOUSE, INC.

Our 80%-owned Precision Steel subsidiary, located in the outskirts of Chicago at Franklin Park, Illinois, was acquired for approximately $15 million on February 28, 1979. Our 80% share of the price was thus about $12 million. It owns a long-established steel service center business and a subsidiary engaged in the manufacture and distribution of tool room supplies and other products sold under its own brand names. Precision Steel's operating businesses contributed $276,000 to our consolidated net income in 1982 compared with $1,560,000 in 1981. The decrease in earnings was caused by a continuation of (1) severe recessionary conditions in the steel industry, and (2) effects of a business mistake, now corrected at substantial cost, namely entry into a small measuring-tool distribution business, closed down in 1982.

Even under recessionary conditions operations remain profitable, and we anticipate at least some improvement in earnings for 1983.

The minimum shareholders' equity, at Blue Chip's carrying value per unit of equity, required to own and operate 100% of Precision Steel's business at its 1982 level is about $13 million on which the business earned $.3 million in 1982 or at a very inadequate rate of 2.3% per annum.

We knew when we purchased Precision Steel that earning a return, satisfactory under inflationary conditions, on the unleveraged equity capital required to operate its business would be difficult, and we supplied some leverage by borrowing the purchase price, refinancing at a fixed rate as soon as practicable. We ordinarily have reservations concerning financial leverage but are willing, as in this case, to borrow money to purchase as part of our mix of businesses a clean and moderately profitable company like Precision Steel where inventories carried on the LIFO basis represent a substantial part of total assets and where reported earnings are expected usually to turn up in cash, absent optional expansion.

After acquisition, as above reported, Precision Steel's earnings have been a disap-pointment, but its facilities and balance sheet remain in first-class shape.

Both Mutual Savings and Precision Steel are owned by Blue Chip Stamps through 80% control of Wesco Financial Corporation, a public company with shares traded on the American Stock Exchange. For more complete information, we encourage Blue Chip shareholders to obtain a copy of Wesco's 1982 annual report. Simply make your request to:

Wesco Financial Corporation
315 East Colorado Boulevard
Pasadena, California 91109
Attention: Mrs. Jeanne Leach, Treasurer

BUFFALO EVENING NEWS, INC.

The operating loss, before taxes, of our 100%-owned newspaper subsidiary, Buffalo Evening News, Inc., in 1982 was higher than that of 1981, increasing marginally to $1,270,000 from $1,091,000 in the previousy ear Thus the surface indication from our newspaper figures for the full year 1982 would app. ear to be that we were correct last year when we stated with respect to the News: "We confidently predict a lack of improvement [in the News' 1982 operating figures]. We anticipate terrible market conditions for the News in 1982."

However, the underlying reality as we enter 1983 is quite different from the poor situation forecast in last year's letter to stockholders. What we failed to foresee last year was the business failure of the Courier Express, the News' most important competitor in Buffalo, which ceased publishing its newspaper on September 19, 1982, leaving the News as the only area-wide metropolitan daily newspaper in Greater Buffalo, New York.

Before the failure of the Courier Express the News and its employees were locked into an intense survival struggle in a recession-plagued market (albeit a fine city). The outcome of this struggle was always uncertain. Now the economic prospects for both the News and its employees are improved from the extremely hazardous state which formerly existed. Indeed, profits were earned in November and December of 1982 adequate to offset a major portion of extraordinary costs and losses incident to circulation-building, including start-up of the News' first weekday morning edition, after the Courier Express stopped publishing in September. We now expect the News to be profitable for the full year 1983. Our eventual target is a 10% margin on sales after taxes, and we hope to be well over halfway to this target in 1983. Our target return on sales is somewhere close to the norm for newspaper operations like the News.

We will not here repeat in detail our long account of the competition and litigation in Buffalo between the News and the Courier Express. That chapter has ended. Shareholders who wish to refresh their memories should read the section about the News in last year's letter. Highlights of an up-dated history from our acquisition of the News in 1977 through year-end 1982 are as follows:

1. We purchased the News for about $34 million in April, 1977.
2. The News lost about $12 million, before taxes, after our acquisition and through December 31, 1982.
3. The after-tax effect of these losses reduced the carrying value of our News subsidiary in our consolidated balance sheet to about $28 million at the end of 1982. (In addition, of course, we have realized no return at all for a great many years from employment of the $34 million originally expended in buying the newspaper, and we would have realized a substantial and compounded return if we had invested the money elsewhere.)

4. However, the newspaper which we owned at the end of 1982 is a much better business operation than the newspaper we purchased in April of 1977. The following comparisons indicate the rough dimensions of change at the News:

	In April, 1977	At 12/31/82
Weekday circulation	279,000	323,000
Saturday circulation	300,000	271,000
Sunday circulation	-0-	354,000
Estimated revenues for next 12 months	$43,000,000*	$85,000,000+

- Represents approximate actual revenues for twelve months beginning April 1977.

As this is written, the News ranks 21st among the nation's daily newspapers in weekday circulation, which was about 321,000 in February, 1983. At the same time Sunday circulation was about 367,000. Notwithstanding economic decline in Buffalo the present Sunday circulation of the News is 95,000 higher than the 272,000 Sunday circulation of the Courier Express in 1977 when it alone published a Sunday edition!

Plainly, considering the ambitions of other publishers to add to their newspaper holdings, the News could now be sold for considerably more than the amount at which it is carried in Blue Chip's consolidated balance sheet. However, we have no interest in selling. We are proud of the News and of our association with its people — including Henry Urban, Stan Lipsey, Murray Light, Clyde Pinson, Dave Perona, Dick Feather and many more — who have led the News to its present position. We are proud, too, that we have nourished as well as we have the journalistic tradition we inherited from the News' legendary Editor, Alfred H. Kirchhofer, predecessor to Murray Light. We hope to be better known as the years pass as good stewards of good traditions, as we believe we have been at both the News and See's.

Although the News is now a much stronger economic operation than it was last year, it nonetheless occupies no bower of roses, for the following reasons, among others:

1. Metropolitan newspapers as a group have lost advertising market share to electronic media in recent years. Newspaper publishing is inherently a very intense user of resources, energy and human time, compared to many other media, the influence of which is growing, assisted by rapidly improving technology. Newspaper costs have escalated more rapidly in some recent years than utility to advertisers, particularly at some large, old newspapers. One cause is newspaper inability, because of provisions in labor contracts, to realize anything like the full reduction in various costs possible with modern automation, while competitors not so restricted gain full benefits from technological change.

2. Competition from free publications and suburban newspapers has increased in vigor.

3. Retailing has increasingly been concentrated in chain-store operations which have learned how to deliver advertising circulars without using newspapers and often do so when dissatisfied with newspaper run-of-press or pre-print advertising rates.

4. Buffalo has suffered and continues to suffer from far more than its share of the national recession. Unemployment has been as high as 15.3%, and many large and important retailers have gone out of business, shrinking the total amount of advertising available to newspapers by millions of lines per year. It was this extreme Buffalo-area business decline, plus general conditions making it difficult or impossible for two competing newspapers to survive, even in cities with above-average prosperity, which combined to cause Buffalo to become yet another American city with only one area-wide metropolitan newspaper. As things worked out, the News may well have realized some advantage as well as disadvantage as recent, above-average business misery in Greater Buffalo contri-buted to the disappearance of a major competitor. But any continuation of local business decline from this point will be a pure curse for the News. All managers know that it is easier to keep both owners and employees happy in a business in an expanding market, instead of a declining one. Shrinking-pie division is usually more troublesome and controversial than expanding-pie division.

These are not small problems, and in a few other cities (some more prosperous than Buffalo) without economic competition between two area-wide metropolitan newspapers, we surmise that little or no profit is now being earned by the metropolitan newspaper operation.

Finally, our shareholders should recognize that if our 1977 purchase of the News has now worked out acceptably from their viewpoint, which contrary to our prediction last year may now be true even after taking into account time delays, the conclusion does not follow that we made a sound managerial decision buying the News when we did for the price we paid. In retrospect, we were strongly influenced because we liked the newspaper, its people and the city, and we may simply have gambled shareholders' money against the odds and won. Our stewardship may have been, at best, dubious in this instance. We know that the financial outcome we now report could with slightly different breaks just as well have been either (1) a large loss on closure of the News or (2) the expectation of much more money-losing in continued operation, as part of the only defensive strategy with reasonable prospects.

PROMOTIONAL SERVICES BUSINESS AND MISCELLANEOUS SOURCES OF OPERATING INCOME

The final components of our consolidated net operating income last year were provided by (1) operating earnings from our promotional services (mainly trading stamp and motivation) business, after deduction of interest and other general parent company expense, plus (2) our share of operating earnings, after deduction of interest and other Wesco general corporate expense, from securities and real estate held by Wesco outside the savings and loan and steel service activities of its subsidiaries.

The promotional services business operated at a slightly increased profit, after parent company interest and other general expense and income taxes, last year, up to $4,212,000 from $3,659,000 after (properly) giving it credit for the entire income (dividends and interest, plus income tax benefits caused by dividends) from investment of the funds available through (1) "float" caused by trading stamps issued but not yet redeemed plus (2) a reasonable amount of shareholders' equity capital. Our shareholders should not be encouraged by the increase in after-tax profit, which was attributable in part to the fact that favorable revisions in our estimates of our liability to redeem outstanding trading stamps were made in 1982 but not in 1981 and in part to increased shareholders' equity capital. The revisions in redemption liability, which by their nature will not frequently recur, increased 1982 after-tax profit by $339,000.

Moreover, as we forecast in last year's letter, trading stamp service revenues declined drastically in 1982 to $9,203,000 from $15,619,000 in 1981. The Stater Bros. supermarket chain, which accounted for 51% of our trading stamp revenues in 1981 discontinued giving trading stamps on April 1, 1982, and we have not replaced the lost revenue. The main good news coming out of our trading stamp business last year was an increase in sales to service stations, attributable to very intense competition caused by the current gasoline glut, plus some heartening examples of customer success after adoption of our programs.

Our continued substantial profits in the trading stamp business, in the face of huge decreases in sales, are made possible only by the slow departure of "float" from trading stamps sold in earlier and better years. This "float" — resulting from past issuance of trading stamps when volume was many times greater than the current level — is very large in relation to current issuances. (Trading stamp revenues peaked at $124,180,000 in fiscal 1970, and our 1982 revenues of $9,203,000 therefore represented a decline of 93% from peak volume.) Eventually, unless stamp issuances improve, earnings from investing "float" will decline enormously. And, since the trading stamp business already operates at a loss before taking investment revenues into account, such future declines in "float" will aggravate what is already a poor situation. This happens because any significant decline in non-investment revenues is inevitably more rapid than the related decline in costs. Such is the normal result for any operator of a chain of retail stores (like our trading stamp redemption stores) whose "same store" sales decline in dollars from year to year.

Under such conditions it has been helpful to us that our decline in "float" in recent years has proceeded at so extremely slow a rate, leaving our reserved liability for trading stamp redemption at $60,240,000 at yearend 1982, down only 6.3% from yearend 1981.

As discussed extensively in previous annual reports (particularly for fiscal 1976), which we urge shareholders to review, accounting for trading stamp redemption liability (which involves estimating the number of stamps that will ultimately be redeemed and the cost per stamp) is a difficult process under any circumstances, but particularly so in an inflationary economy and when stamp issuances decline by a large percentage. We periodically revise our estimated future redemption liability as conditions warrant. In 1982 we made revisions increasing operating income as above described, as explained in detail in Note 2 to our accompanying financial statements. Recent changes, including that in 1982, both decreased our estimates of stamps ultimately to be redeemed and increased our estimates of total redemption costs per stamp. Merchandise cost per stamp redeemed has remained relatively constant as volume has declined, and we hope this state of affairs will continue. Non-merchandise or redemption service cost per stamp redeemed is another story. Such cost per stamp is now virtually certain to go up sharply from last year's level as stamps redeemed in the future share store and warehouse operating expense which cannot be reduced at the same rate as redemptions. The 1982 changes take all the foregoing into account.

A higher proportion of non-merchandise costs in our redemption liability has an unfortunate income-tax effect, diminishing true "float" per dollar of book liability. The cash available to us for use from aggregate redemption liability as reported in our books is always considerably lower than the amount of liability shown. One cause is U. S. Treasury regulations (which we have conformed to despite doubting their legality) which do not allow us to deduct for income-tax purposes future redemption service cost (for instance, store operating expense) as distinguished from future merchandise cost. Both types of cost are unavoidable and require accrual of real liabilities in our audited financial statements. The cash-use consequences of the divergence (all of which is not caused by the U. S. Treasury regulation cited above) of IRS-specified income-tax accounting and our audited accounting are substantial. For instance, out of our total trading stamp redemption liability as we report it of $60,240,000 at yearend 1982, we must leave $17,175,000 in a non-interest-bearing deposit with the U. S. Treasury, designated "prepaid income taxes" in our balance sheet.

We remain convinced that trading stamps are an effective point-of-purchase sales promotion device for supermarkets, service stations, bowling alleys and the like. We intend to remain in the trading stamp business.

In our related motivation business revenues decreased slightly in 1982 to $1,351,000 from $1,446,000 in 1981. Revenues are expected to increase in 1983.

One final item augments our consolidated net operating income. Our share of operating earnings, after deduction of interest and other Wesco general corporate expense, from securities and real estate held by Wesco outside the savings and loan and steel service activities of its subsidiaries, amounted to $2,838,000 in 1982 compared with $2,167,000 in the previous year.

NET GAINS ON SALES OF CORPORATE SECURITIES, MORTGAGES AND IMPORTANT FIXED ASSETS

In our total assets, located among our five operating businesses, we hold considerably more corporate securities than might be expected in a consolidated enterprise of our size at the close of 1982 as we report consolidated revenues of $252 million and consolidated net worth of $218 million (see Note 3 to our accompanying consolidated financial statements).

Most of these holdings of corporate securities are held because of the very nature of the particular business in which they are owned. For instance, the trading stamp business owns liquid assets to provide for ultimate redemption of stamps, and the savings and loan business holds liquid assets to provide for repayment of savings account holders. The remaining security holdings exist temporarily, primarily in Wesco Financial Corporation, pending their disposition to provide funds for use in buying additional businesses.

Only Mutual Savings, which until January 1, 1983 was barred by law from owning most common stocks, has significant holdings of preferred stocks. Most holdings, therefore, are of common stocks. Our reported operating earnings include only the dividends from our stockholdings, after taxes. And, because the corporations whose common stock we own also have and reinvest earnings not paid out as dividends, a process which ultimately raises market value of the stock we own, we also realize irregularly net capital gains from sales of portions of our holdings.

In addition, our various businesses occasionally sell important buildings, machinery or other fixed assets, as such businesses adjust to changing conditions. No significant sale of fixed assets occurred in 1982.

Our aggregate share of all types of special net gains combined, after income taxes, was $23,101,000 in 1982 compared with $6,731,000 in 1981. All the 1981 net gain came from the sale of securities. The 1982 share of net gain consisted of $25,044,000 from sale of securities, offset by $1,943,000 in net loss from Mutual Savings' sale of mortgage-backed securities. The 1982 share of net gain from sale of securities included $23,901,000 from disposition of our entire holdings in Pinkerton's, Inc., discussed in the next section of this letter.

PINKERTON'S, INC.

Pursuant to a contract made in 1982 we received cash from American Brands early in 1983 for our entire Pinkerton's holding. The after-tax gain of $23,901,000 is included in our 1982 financial figures.

The holding sold consisted of non-voting stock representing 37% of the equity in Pinkerton's, long the leading national security and investigation service company.

Our ownership of this non-voting interest demonstrates that, when all factors are considered, we often would rather buy stock we can't or won't vote than absolute control. We think the rationality of use-of-capital decisions is improved when the repertoire of a corporate manager includes purchases of business interests which do not augment the number of people to whom the manager can give orders. However, we have generally observed a low interest among corporate managers in passive investments, even when available at much better price/earnings and price/book value ratios than controlling positions. The strong preference for controlling positions is ordinarily justified by (1) expected improvements from a change in control based on a high appraisal of the business skills of the managers of the corporate investor compared to the managers of the corporate investee and (2) a low appraisal of the likelihood that the managers of the corporate investee, if free to act independently, will make decisions which best serve the interests of ultimate shareholders. Our view is different, and, although we have always expected to concentrate our activities primarily in operating businesses, we also have an uncommon interest in passive positions for the following reasons:

1. We know that our business skills are frequently inferior by a wide margin to those of others, as we can prove from comparative figures and our audited record reflecting gross errors;
2. We believe that many corporate managers can be trusted to serve the shareholders' interests even when the shareholders have no practical power to control or replace management;
3. We think the advantage of buying at a non-premium price, because control is absent, often counterbalances the disadvantage, if any, from lack of control;
4. Our consolidated enterprise includes operating businesses required by their nature to own significant passive investments.

We hope to become better known for an uncommon willingness to own "nonvoting-partnership" interests in businesses and to attract other offerings like that which produced our Pinkerton's holding. And we are sure, based on six years' observation from our non-voting position, that Pinkerton's wouldn't have been managed or merged one whit better or one whit more in its shareholders' interests if we had purchased voting control.

Only the dividends we have received from Pinkerton's are included in our reported operating income. These dividends were increased regularly in recent years, creating part of the income reported above under the heading: "Promotional Services Business and Miscellaneous Sources of Operating Income." The part created by Pinkerton's dividends was $2,011,000 in 1982 and $1,730,000 in 1981.

There will, of course, be no future operating income from Pinkerton's dividends, only income from reinvesting the $47,265,000 after-tax proceeds of disposition of the Pinker-ton's holding. Our average compounded, after-tax return from owning non-voting Pinker-ton's stock was 15% per year, merging the effects of both dividends over the years and the final large capital gain included in the portion of our 1982 income listed above under the heading "Net Gains on Sales of Corporate Securities, Mortgages and Important Fixed Assets."

CONSOLIDATED BALANCE SHEET AND OTHER DATA

Our consolidated balance sheet retains a strength befitting a company whose consolidated net worth supports large outstanding promises to others. As explained in Note 3 to the accompanying financial statements, the aggregate market value of our marketable securities was higher than their aggregate cost at December 25, 1982. In addition, an office building and related real estate owned by Wesco Financial Corporation has a market value substantially in excess of carrying value. We remain in a prudent position when total debt is compared to total net worth and total liquid assets.

Retaining the impeccable bank credit facilitated by a prudent balance sheet position has always been very important to us. When combined with our practice of doing a certain amount of long-term borrowing in advance of specific need, impeccable credit has given us maximum financial flexibility to face both hazards and opportunities.

Sections entitled "Principal Business Activities," "Selected Financial Data" and "Management's Discussion and Analysis" are presented immediately following this letter. We invite your careful attention to these items and to our audited financial statements.

A LOOK BACK AND A LOOK AHEAD

We began the 1970s with a single business, trading stamps, which was destined to decline to a small fraction of its former size, and a portfolio of securities, offsetting stamp redemption liability, which had been selected by previous owners and would have led to a disastrous result if held through to the present time. (The portfolio, for instance, contained a substantial amount of very-long-term, low-coupon municipal bonds of issuers with declining credit ratings.)

We began the 1980s with five constituent businesses instead of one. In order of acquisition they are: (1) trading stamps and other promotional services, (2) See's Candy Shops, Incorporated, (3) Mutual Savings, (4) Buffalo Evening News, and (5) Precision Steel.

Our five constituent businesses have more in common than might be noted by a casual observer:

1. They are all high-grade operations suffused to a considerable extent with the business ideas of Benjamin Franklin, manned by high-grade people operating within a long tradition emphasizing reliable and effective service, and
2. When functioning properly each business will usually generate substantial amounts of cash not claimed by compulsory reinvestment in the same business and therefore available for purchases of new businesses or debt repayment.

The second of these two common characteristics gets more important every year as inflation continues. Many businesses, once good investments when inflation was low, are now, under inflationary conditions, unable to produce much, if any, cash even when physical volume is constant. Any such business, always cash-starved at constant physical volume, even while reporting apparently satisfactory profits, is a very dubious candidate, absent some special factor, for acquisition by a rational acquirer.

Our balance sheet net worth at March 3, 1973 was about $53 million. By the end of 1982 our balance sheet net worth had increased to approximately $218 million, up 311% in ten years, after payment of regular dividends. At March 3, 1973 our equity in aggregate securities was worth about $4 million more than balance sheet cost. At the end of 1982 this equity was worth about $27 million more than balance sheet cost. Our average annual total percentage return earned on shareholders' investment over the ten years ending December 25, 1982 was approximately 16.7% per annum, without taking into account (1) the increase from $4 million to $27 million in unrealized appreciation in our equity in marketable securities or (2) unrealized net appreciation in such subsidiaries as See's and the Buffalo Evening News. The percentage return earned was acceptable in a moderate inflation environment, considering the headwinds in our initial trading stamp business.

In 1982, the year just ended, our total percentage return on the beginning investment of our shareholders was approximately 27%. This percentage return fluctuates from year to year depending upon various factors including changes in amounts of capital gains realized. The percentage return figure for any one year is not very significant, although the average figure over a period of years, and the trend in such average figure, are of vital importance.

In the future we hope to earn a higher average (though sharply fluctuating) annual total percentage return on shareholders' investment — at least for a while until we are dragged down by some law of regression toward mean results, an outcome sure to occur eventually at any corporation which retains a high proportion of its earnings. Some short-term prospects are favorable, for instance, the prospect that the Buffalo Evening News will have earnings in 1983, compared to a loss in 1982. Furthermore, we expect from time to time to acquire additional businesses which eventually will produce higher returns than the assets disposed of to fund their purchase.

However, even if above-average returns on shareholders' equity are earned for a long time in the future — far from a sure thing — the inflation problem for our shareholders will not automatically be solved. As we point out year after year, "A 16% return on equity obviously won't do much in real terms for shareholders if the inflation rate is 16%, or even 11% when we also allow for income taxes imposed on owners who must report taxable 'profits' while only maintaining their position on the purchasing-power treadmill."

Inflation is a very effective form of indirect taxation on capital represented by holdings of common stock. We know of no adequate countermeasure, generally available to corporate managers who wish to protect shareholders, to this form of indirect taxation. But, even so, we think a habit of always thinking about and trying to serve shareholders' interests in real terms, instead of rationalizing growth of managed assets regardless of real effects on shareholders, is quite useful and may fairly be expected of corporate managements. We make a very conscious effort, perhaps with occasional inadvertent lapses, to have and reinforce this habit.

For one example, low stock prices, caused by inflation, together with our preoccupation with real shareholder interests, have intensified our resistance to most proposals that we issue new common stock. We haven't issued a new share, for any reason, for a long time. With rare exceptions American corporations now cannot get as much intrinsic value as they give when new common stock is issued. Our corporation is no exception. And, quite clearly, a corporation can't further its own shareholders' long-term interests by diluting, through new stock issuances, the intrinsic value underlying each outstanding share. Our unwillingness to accept any such dilution explains our long-unchanged common stock capitalization.

Even in the presence of the moderation in inflation caused by the current severe recession, we think the likelihood of future inflation remains high in the United States, as well as in other modern democracies. In a sense the current recession has compounded the inflation problem by demonstrating that a conscientious corporate manager must take precautions not only against inflation but also against severe slump — no small order, considering the inherent contradictions involved.

Current conditions have only intensified our long-standing belief that a (1) heavy managerial emphasis on the cash-generating characteristics of businesses, (2) managerial reluctance to issue new stock and (3) strong balance sheet position are all likely to enjoy increased recognition in future years as qualities to be emphasized by selectors of common stocks for investment.

This may well be the last annual report our shareholders will ever receive from Blue Chip Stamps as a separate corporation, because work is in progress on a proposal that our corporation be merged with Berkshire Hathaway Inc., long a 59.6%-owner of Blue Chip Stamps. If such a merger occurs, our shareholders will become holders of common shares of Berkshire Hathaway Inc. We will not here further discuss merger possibilities, because such discussion will be contained in a formal merger proposal and proxy statement, which Blue Chip shareholders will receive in due course if such a proposal is approved by the board of directors of each corporation.

Cordially yours,

Charles T. Munger, Chairman of the Board
Donald A. Hoeppel, President

February 17, 1983

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