To Our Stockholders

Consolidated net income of Blue Chip Stamps and its subsidiaries for the calendar year 1977 amounted to $16,993,000 ($3.28 per share) compared to $11,703,000 ($2.26 per share) in the previous fiscal year.

Improvement in normal operating income was small and much less than indicated by these figures because this year's results included $.79 per share from securities gains of the parent company plus $.12 per share attributable to the parent company's share of net capital gains realized by Wesco Financial Corporation.

We have three major subsidiaries, See’s Candy Shops, Incorporated (99% 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 income (loss)[*3]	All other Blue Chip net income[*4,5]	Blue consolid net inco
December 31, 1977	$5,750,000	$5,715,000	$340,000	$5,188,000	$16,993
Per Blue Chip share	1.11	1.10	.07	1.00	
December 31, 1976	5,112,000	4,459,000	-	2,132,000	11,703
Per Blue Chip share	0.99	0.86	-	0.41	

- 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 Wesco book value at which the interest was acquired. The December 31, 1976 figure, due to our reaching 80% ownership of Wesco, includes reversal of income taxes provided in prior years.

- 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 1977 amounts include $4,100,000 or $.79 per Blue Chip share from securities gains, net of taxes. In 1976 securities losses reduced income by $77,000 or $.01 per Blue Chip share.

SEE'S CANDY SHOPS, INCORPORATED

First in importance again in our earnings picture last year was our equity in our 99%-owned subsidiary, See’s Candy Shops, Incorporated, See’s had another record year under the skilled leadership of Charles Huggins, with the percentage gain in earnings (11%) approximately equal to the percentage gain in sales (12%). 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 sto open at yeare
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

- 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, (ii) amortization of intangibles arising from purchase of See's stock at a large premium over book value and (iii) state income tax 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 business has been subject to extraordinary pressure from various factors in the last few years. Considering these business conditions, See’s 1977 operating results reflect a remarkable achievement attributable to excellent management, manufacturing and selling an outstanding product. See's is a very old-fashioned company, having been founded in 1921 by a redoubtable woman, then 71 years old, who established a tradition of extreme attention to quality control. From inception, See's has consistently followed the admonition published by Ben

Franklin in Poor Richard: “Keep thy shop and thy shop will keep thee." The result of its old-fashioned attention to quality control and cheerful retail service is the highest sales per store of any candy store chain in the world. We are privileged to own See's and to be stewards of its business tradition and example.

WESCO FINANCIAL CORPORATION

Almost equal to See’s in our earnings picture last year was our equity in net income of our subsidiary, Wesco Financial Corporation (80% owned). The substantial improvement in Wesco’s contribution to our consolidated net income was caused by a combination of capital gains and increased operating earnings in Wesco’s savings and loan business, coupled with an increase in our ownership. 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. Wesco's consolidated balance sheet is exceptionally strong, showing substantial assets outside its subsidiary savings and loan association and available for commitment elsewhere. For more complete information, we encourage Blue Chip shareholders to obtain a copy of Wesco’s 1977 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

THE BUFFALO EVENING NEWS

On April 15, 1977, we purchased, through a newly organized wholly-owned subsidiary, the newspaper assets of Buffalo Evening *News*, Inc., publisher of one of two competing area-wide daily newspapers in Buffalo, New York. This was a substantial transaction, and subsequent events in Buffalo have required qualification of our auditor's opinion for 1977. Accordingly, extended discussion is appropriate in this annual report to our shareholders.

The total price paid was $35,509,000, of which $34,076,000 was paid in cash, with the balance representing assumption of certain pension obligations. Although profitable in 1977, the *News* has thus far made an insignificant contribution to consolidated earnings, and, as discussed below, future operating results may well be less favorable than those of 1977. The pro forma effect of the acquisition, assuming ownership of the *News* throughout all of 1977 (including the normally unprofitable early months of the year), would have been to reduce consolidated earnings by $.10 per share.

Nonetheless, we are very pleased to have purchased the *News*. So far as we know, no newspaper acquisition in recent years looks sensible based on past earnings related to the purchase price. Recent buyers of newspapers have paid prices reflecting what they hope to achieve over a very long-term, inflationary future, and we, of necessity, conformed to this pattern in our acquisition.

Our investment decision was based on the belief that the existing journalistic merit of the *News*, encouraged and nourished, will eventually prosper in the marketplace and that inflation will eventually make a prosperous newspaper company a safer asset than any other company which we could then buy at the price paid for the *News*. Experience and reconsideration have made us more confident than ever that we were right in our original appraisal of the journalistic merit of the *News*. The *News* is a meritorious newspaper partly because it was dominated and molded for decades by a legendary editor, Alfred Kirchhofer, who, although retired, still comes to the *News* every day at age 83. Mr. Kirchhofer had and has a passion for accuracy, fairness and service. Present management had continued these standards before our purchase, and we have encouraged their perpetuation.

We have long wanted to buy a large daily newspaper, as demonstrated by our unsuccessful bid for the *Cincinnati Enquirer* in 1971. In order to get a large newspaper property, we have been quite willing, as attempted in Cincinnati and accomplished in Buffalo, to purchase a daily newspaper subject to the hazards of competition from another area-wide daily newspaper in the same city.

There are problems and uncertainties inherent in this sort of newspaper investment, as illustrated by the events subsequent to our subsidiary's purchase of the *News*.

For over 60 years the *News* had published only in the afternoons, six days a week, excluding Sundays and holidays. The Saturday afternoon edition was a large, special “Weekend” edition, with comics and other features of the sort traditional in Sunday newspapers, priced to subscribers at 30# per issue, twice the 150-per-issue price charged Monday through Friday. The competing daily newspaper in Buffalo published seven days a week, every morning, with a price to subscribers in recent years of 150 per issue daily except Sunday when it published without competition at a price of 500. The *News* had a large circulation lead Monday through Friday, selling approximately 270,000 papers against the competitor’s 125,000. On Saturday, the *News* sold approximately 295,000 copies of its large 30¢ weekend edition, compared to approximately 275,000 copies of the 50¢ Sunday morning edition published by its competitor.

After our purchase, the *News* reviewed this situation, as part of an overall effort to improve its newspaper and its long-term prospects. As a result, the *News* determined (1) that through its failure to publish on Sunday it was following a totally obsolete practice, comparable to the unthinkable practice of six-day broadcasting by a large television or radio news station, seriously limiting the quality of its overall service, and (2) that its continuing success over the long term depended on changing that obsolete practice.

The decision was facilitated by recognition that real trouble has been the invariable eventual outcome for every daily newspaper in the United States which has relied overlong, in an important city, exclusively on weekday publication while a significant daily competitor enjoyed a Sunday monopoly. A typical outcome may be indicated, for instance, by the history of daily newspaper competition in Hartford, Connecticut.

For many years Hartford had two daily newspapers, the evening *Times*, by far the most popular daily newspaper in Connecticut, and the morning *Courant*, with only the *Courant* publishing on Sunday. In this publication pattern in 1951, the evening *Times* was dominant weekdays, with circulation of 96,000 compared to the *Courant*'s 66,000, and the *Courant* enjoyed the only Sunday circulation of 111,000. The “no Sunday" evening *Times* in 1951 had on weekdays nearly three times the advertising lineage of its morning competitor (including well over 75% of daily retail display lineage), yet even this lead did not ensure continued prosperity. By 1960, the circulation lead of the *Times* on weekdays had narrowed to 122,000 vs. 109,000, and the *Courant* had 148,000 on Sunday. By 1965 the papers were even in weekday circulation, while the *Courant*'s Sunday circulation rose to 176,000 and the *Times* maintained a declining but still large weekday lead in advertising lineage of more than three to two.

In the fall of 1968 the *Times* started a Sunday edition. But it was far too late. By 1972 the *Courant* had circulation of 170,000 on weekdays vs. 131,000 for the *Times*, and for Sunday the comparable figures were 202,000 vs. 130,000. The *Courant* had moved far ahead of the *Times* in weekday advertising lineage and utterly overwhelmed the *Times* on Sunday. A few years later the Hartford *Times* folded. This occurred despite the facts that (1) from 1928 until 1973 the *Times* had been owned by the Gannett newspaper chain, one of the largest and most experienced and successful newspaper operators in the world and (2) Gannett had tried to make its Sunday edition successful by pricing it at half the single-copy price of the Sunday *Courant*, with a 650 price for seven-day home delivery against 90¢ for comparable delivery of the *Courant*.

By the time our subsidiary purchased the *News* in 1977 most of the former big no-Sunday newspapers had disappeared. There remained in the major cities of the United States only three other area-wide daily newspaper publishing operations without Sunday editions: (1) the *Cincinnati Post* (owned by the prosperous Scripps-Howard chain); (2) the *New York Post* (controlled by the Murdoch chain); and (3) the Cleveland Press (also owned by Scripps-Howard). The *Cincinnati Post* and the *New York Post* have recently been losing heavily, and the Cleveland Press is losing market share at what to us appears an ominous rate. These losses and troubles have occurred at two of these papers (in Cincinnati and Cleveland) despite a past history of profitability once based, like that of the now-defunct Hartford *Times* and the present *News*, on a much superior weekday circulation position.

With all signs and surveys indicating Sunday newspaper readership was continuing to grow in importance relative to weekday newspaper readership, the *News* knew it should not continue to follow the no-Sunday policy which had created so universal a pattern of failure over the long term in other cities.

The obvious way to change the policy appeared to be to shift the *News*' 30¢ weekend edition to Sunday morning from Saturday afternoon and also to follow a national trend by having the *News* publish on Saturdays in the morning.

Succeeding in such a revision of publication practice is not easy. *News*paper habits are very hard to change, particularly in a city like Buffalo where almost all newspaper circulation is home-delivered.

Realizing the difficulty in changing such habits, Scripps-Howard, for instance, having once allowed its competitor to maintain a Sunday monopoly for a long time, simply gave up and never tried to establish a Sunday edition of its own in Cincinnati— even when its newspaper had a large lead in weekday circulation. Moreover, the history of creation of new Sunday editions elsewhere, in cities with only one area-wide daily newspaper, demonstrated that even without long-established competition of the type the *News* faced in Buffalo inauguration of a Sunday edition requires heavy promotion, free sample copies, etc. [Typical of the pattern, is the very recent plan used, about a year before inauguration of the Sunday *News* in Buffalo, by the Gannett newspaper chain in "going Sunday" with eight of the nine daily newspapers in its Westchester-Rockland Group. These eight no-Sunday papers competed with no similar daily newspapers in Westchester-Rockland, New York. The new Sunday papers were given a newsstand price of 25¢ and were delivered free to 162,000 daily subscribers for the first six weeks, then billed to subscribers only after subsequent deliveries. A nine-paper Sunday Circulation guarantee of 150,000 was given to advertisers, with the difference between 150,000 and the number of actual paid subscribers made up through heavy newsstand promotion and free samples.]

With Sunday editions generally so hard to establish, even in the absence of effective competition, a major factor which encouraged the *News*, under the competitive conditions in Buffalo, was the existence of a special large, premium-priced, Saturday afternoon weekend edition of the *News*. The *News* hoped that most of the hard-won patronage of its weekend edition could be retained when publication was transferred to Sunday.

In view of the prospective difficulties, the *News* decided to facilitate the shift of its weekend edition to Sunday morning and the creation of its new Saturday morning edition, scheduled at the onset of the Buffalo winter, by maintaining a 30# price for the weekend edition, charging 15* for the new Saturday morning paper, and allowing home subscribers, who had formerly paid $1.05 per week for six papers (five papers at 15¢ and one at 30¢), to continue to pay that price for five weeks, covering delivery of seven papers, after which the home-delivered price would rise by 15¢ to $1.20 (six papers at 15¢ and one at 30¢). This promotional arrangement would give home subscribers either five free papers on Saturdays or five half-price papers on Sundays, or a one-third discount for five weeks on a 45¢ Saturday-Sunday combination, depending on your point of view. Advertisers, during the introductory five weeks, were to be assured that such promotion would cause a large circulation on Sundays.

The *News*' plans seemed reasonable to the *News*' executives, calculated as such plans were to employ less aggressive promotion than they observed in general use elsewhere and also the minimum promotion which appeared likely to give the revised schedule a reasonable chance for success in a Sunday publishing venture of a type in which some strong newspaper chains (like Gannett in Hartford) had failed and still others (like Scripps-Howard in Cincinnati) had refused even to engage. However, the *News*' plans caused a strong reaction from its competitor which filed a lawsuit alleging that the *News* was trying to destroy the competitor through methods prohibited by federal antitrust laws. In its lawsuit, the competitor asked, among other things, that preliminary and permanent injunctions be issued against the *News*' introductory promotional programs and against the sale of the Sunday *News* at 30¢ per issue as proposed and also against the sale of advertising by the *News* at rates as proposed. The competitor claimed that its profits from its Sunday edition monopoly were required to assist it in maintaining publication on weekdays. In essence, in the *News*' view, the competitor asked the court to issue sweeping preliminary and permanent injunctions which would ensure failure for the Sunday *News*. The competitor also asked for an award of damages, trebled under the antitrust law, plus attorneys' fees and costs.

A preliminary injunction, under such circumstances, must be granted or denied based on incomplete evidence and does not bind or fix the rights of the parties as they will be determined after full trial. However, issuance of a preliminary injunction, despite its inconclusive and temporary nature, can have an important impact on the parties' businesses.

In our case the United States District Court in Buffalo denied part of the preliminary injunctions demanded but did issue some of them with some adverse practical consequences. Those issued, among other things, cut down the *News*' promotional pricing period for the new publishing schedule from five weeks to two weeks, eliminated guarantees of Sunday circulation to advertisers, and limited future circulation price reductions and free sampling. These injunctions, as the *News* conservatively construed them in an attempt to assure over-compliance while struggling mid-winter with a new publication schedule, caused serious interference with normal newspaper circulation methods.

In its opinion the court recognized that reasonable promotion of the new publication schedule was lawful but tentatively concluded, in essence, that more than two weeks of promotional pricing was unreasonable and that related guarantees of circulation to advertisers were unreasonable. Further proceedings are pending as to how the court's orders as heretofore made should be enforced or modified. The *News* is confident that at a full trial it can prove that it has not engaged in unlawful competition. Moreover, the *News* has made antitrust counterclaims in court against the competitor which the *News* believes are more justifiable than the competitor's claims.

Affected to some degree by the litigation (including coverage thereof in the competitor's newspaper in a manner one observer, quoted in a Buffalo news magazine, has suggested might more appropriately have been reserved for World War III), the results to date in the marketplace in Buffalo were roughly as follows in March, 1978, about four months after inauguration of the new publication schedule:

1. While no audited figures are available since those of the Audit Bureau of Circulation for the six months’ period ended September 30, 1977, we believe the *News* continues to enjoy its historical lead in paid circulation Monday through Friday, about 270,000 vs. 125,000.

2. On Sunday the tables are turned and the competitor is dominant. The paid circulation of the *News*' weekend edition has declined from about 295,000 to slightly over 160,000 after the shift to Sunday publication, whereas the paid Sunday circulation of the competitor has declined very much less and such competitor probably has in the area of a three to two Sunday lead.

3. On Saturday morning, the *News* leads its competitor in paid circulation by a large margin, but paid Saturday morning circulation of the *News* is about 45,000 lower than the paid regular weekday circulation.

4. Advertising relates to circulation. On Sundays the competitor holds about 75% of the two papers' combined advertising lineage, and an even greater share of combined advertising revenue because the *News* was required to reduce advertising rates on Sunday as its weekend edition circulation declined. On other days the advertising lineage and revenue tables are reversed in favor of the *News*.

Unless there is some new court injunction, or some unexpected construction of the existing preliminary injunction, it appears to us that from this point changes in competitive position are quite likely to be very slow. [Just how slow, at best, may be indicated by the history of daily newspaper competition in Philadelphia, where the evening *Bulletin*, long dominant on weekdays, belatedly commenced publication of a Sunday edition in 1947 against the long-established Sunday edition of the morning *Inquirer*. At the present time, 30 years later, the *Bulletin*, still the leader on weekdays, remains way behind on Sunday, selling 643,000 copies vs. its competitor’s 847,000.] Meanwhile, profitability of the *News* is adversely affected by litigation expenses, extraordinary circulation costs, etc., as well as the increased depreciation expense resulting from our subsidiary's purchase of physical assets at a price higher than their depreciated value on the books of the former owner.

Virtually every employee of the *News* has performed very well under the stress and additional workloads caused by the changes and challenges in Buffalo. In all areas— production, editorial, advertising and circulation— extraordinary efforts have been required of the people of the *News* and they have responded magnificently. The new and revised editions show it. We are committed to the principle of local management of news and editorial product, and we are proud of the quality that management is producing.

We hope this quality of news product and our regard for the essential integrity of the *News* augur well for our long-term expectations. Just as faithful stewardship of the customer-protection and employee-protection standards of Mary See has kept her candy business successful in our hands, so also may faithful stewardship of the journalistic and management standards of Alfred Kirchhofer protect us in Buffalo.

To sum up: (1) Faced with choosing between a no-Sunday publishing policy which has a 100% record throughout the United States of being devastatingly unsuccessful and a Sunday-inauguration policy which involved major uncertainties and difficulties, opting for the latter policy by the *News* was an obvious necessity; (2) Despite the difficulties experienced to date and the many more expected in the future, the *News*' commitment to future Sunday publication is total; (3) The *News* is proceeding in Buffalo on the theory that it will win its litigation by deserving to win and that adequate profits will eventually follow journalistic and managerial merits and good corporate citizenship; and (4) Because of the expense of litigation and other unexpected problems, the near-term profits of the *News* at times may be low or nil, and the ultimate security of the enterprise will almost surely remain in doubt for a very extended period.

TRADING STAMP AND MOTIVATION BUSINESSES

The final components of our consolidated net income last year were provided by our trading stamp business and motivation business. These businesses use the same headquarters and warehousing facilities. Combined, the businesses operated at an increased profit last year (up to $5,188,000 from $2,132,000) 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, profit before securities gains and losses declined, from $2,209,000to$1,088,000, as dividend income was reduced by net sales of securities. This decline was more than offset by net securities gains, after taxes, of $4,100,000 this year compared to net securities losses last year of $77,000.

Trading stamp service revenues continued to decline— to $15,723,000last year compared with $17,208,000 the previous year. However, the rate of decline has abated. Our motivation business continued to operate at a loss.

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 and is declining. Eventually, unless stamp issuances improve, earnings from investing "float” will decline greatly. The decline to date, however, has proceeded at a very slow rate.

As discussed extensively in previous annual reports, 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 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. We believe that we provide good and useful service to our present customers and that, given the opportunity, we can provide additional useful service to new customers.

PINKERTON'S, INC.

Early in 1976 we acquired non-voting stock representing 14% of the equity in Pinkerton's, Inc., the leading national security and investigation service company. We increased this equity to 25% by subsequent purchases of marketable non-voting stock during 1976. In 1977 we again increased our equity, to 27%, by additional purchases of marketable non-voting stock. Our total investment at cost at yearend was $22,616,000.

CONSOLIDATED BALANCE SHEET AND OTHER DATA

Our consolidated balance sheet remains strong; as befits 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, reducing the probability of our realization of future securities gains comparable to those of 1977.

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.

Cordially yours,

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

February 24, 1978