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