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