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